Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
	)	
Implementation of Sections of the	)	
Cable Television Consumer Protection	)	CS Docket No. 96-60
and Competition Act of 1992:	)	
	)	
	)	
Leased Commercial Access	)	

SECOND REPORT AND ORDER AND SECOND ORDER ON RECONSIDERATION OF THE FIRST REPORT AND ORDER

Adopted: January 31, 1997 **Released: February 4, 1997**

By the Commission:

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I. INTRODUCTION AND BACKGROUND

1. In this *Second Report and Order and Second Order on Reconsideration of the First Report and Order* ("*Order*"), we amend the Commission's rules pertaining to cable television commercial leased access, after considering the comments and reply comments[1] filed in response to our *Order on Reconsideration of the First Report and Order and Further Notice of Proposed Rulemaking*[2] ("*Reconsideration Order and Further Notice*")[3] and pursuant to the provisions of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act").[4] We

[1]A list of the parties that filed comments and reply comments, and the abbreviations used to refer to such parties, is attached as Appendix A.

[2]In MM Docket 92-266/CS Docket No. 96-60, FCC 96-122 (released March 29, 1996).

[3]Specific portions of the *Reconsideration Order and Further Notice* will be referred to below as either the "*Reconsideration Order*" or the "*Further Notice.*"

[4]Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992), 47 U.S.C. § 521 *et seq.* (1992). The 1992 Cable Act amends Title 6 of the Communications Act of 1934, as amended, 47 U.S.C. § 521 *et seq.*

also address petitions for reconsideration[5] of the leased access rules we adopted in the *Reconsideration Order.*

2. The statutory framework for commercial leased access, provided in Section 612 of the Communications Act of 1934 ("Communications Act"), was first established by the Cable Communications Policy Act of 1984 ("1984 Cable Act").[6] In promulgating Section 612, the House Committee stated that its "overriding goal in adopting this section is divorcing cable operator editorial control over a limited number of channels. . . . [I]t is not the cable operator's exercise of any economic power, but his exercise of editorial control, which is of concern to the Committee."[7] Leased access set-aside requirements were established in proportion to a system's total activated channel capacity to "assure that the widest possible diversity of information sources are made available to the public from cable systems in a manner consistent with the growth and development of cable systems."[8] Section 612 permits cable operators to use any unused leased access channel capacity for their own purposes until a written agreement for the use of such leased access capacity is obtained.[9] Each system operator subject to this requirement must establish, consistent with the rules prescribed by the Commission, "the price, terms, and conditions of such use which are at least sufficient to assure that such use will not adversely affect the operation, financial condition, or market development of the cable system."[10]

3. The 1992 Cable Act broadened Section 612's statutory purpose to include the promotion of "competition in the delivery of diverse sources of video programming," and required the Commission: (a) to determine the maximum reasonable rates that a cable operator may establish for leased access use, including the rate charged for the billing of subscribers and for the collection of revenue from subscribers by the cable operator for such use; (b) to establish reasonable terms and conditions for leased access, including those for billing and collection; and (c) to establish procedures for the expedited resolution of leased access disputes.[11] The legislative history of the 1992 amendments indicates a concern that some cable operators may have

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[5]A list of the parties that filed petitions for reconsideration and oppositions regarding the leased access rules adopted in the *Reconsideration Order*, and the abbreviations used to refer to such parties, is attached as Appendix B.

[6]Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779 (1984), 47 U.S.C. § 521 *et seq.* The leased access provisions are codified at Communications Act § 612, 47 U.S.C. § 532.

[7]House Committee on Energy and Commerce, H.R. Rep. No. 934, 98th Cong., 2d Sess. (1984) ("1984 House Report") at 50.

[8]Communications Act §§ 612(a), 612(b)(1), 47 U.S.C. §§ 532(a), 532(b)(1).

[9]Communications Act § 612(b)(4), 47 U.S.C. § 532(b)(4).

[10]Communications Act § 612(c)(1), 47 U.S.C. § 532(c)(1).

[11]Communications Act § 612(c)(4)(A)(i), (ii), (iii), 47 U.S.C. § 532(c)(4)(A)(i), (ii), (iii).

established unreasonable terms or may have had anti-competitive motives for refusing to lease channel capacity to potential leased access users, especially where the operator had a financial interest in the programming services it carried.[12]

4. In the *Report and Order and Further Notice of Proposed Rulemaking* in MM Docket No. 92-266 ("*Rate Order*"),[13] the Commission established initial regulations to implement the leased access provisions of the 1992 Cable Act.[14] The Commission adopted the "highest implicit fee" formula as the method for setting maximum reasonable rates, and adopted various standards governing access terms and conditions, tier placement, technical standards for use, technical support, security deposits, conditions based on program content, requirements for billing and collection services, and procedures for the expedited resolution of disputes.[15] In the *Rate Order*, the Commission also determined that leased access requirements were intended to apply to all systems regardless of the "effective competition" test that governs basic service tier ("BST") and cable programming services tier ("CPST") rate regulation.[16]

5. In the *Rate Order*, the Commission stated that given the small number of comments received relating to leased access, "the rules we adopt should be understood as a starting point that will need refinement both through the rulemaking process and as we address issues on a case-by-case basis."[17] The Commission stated that it was aware that leasing issues may need to be addressed in quite different ways depending upon the nature of the service involved -- whether the lease is for a pay channel, an advertiser-supported channel intended for wide distribution, a channel for a narrow commercial purpose not relevant to the wide body of cable subscribers, or for a single program or series of programs. Thus, the Commission stated that it was not attempting to resolve all the issues potentially involved, many of which could better be resolved in a more concrete factual setting.[18]

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[12]House Committee on Energy and Commerce, H.R. Rep. No. 628, 102d Cong., 2d Sess. (1992) ("1992 House Report") at 39. *See also* Senate Committee on Commerce, Science and Transportation, S. Rep No. 92, 102d Cong., 2d Sess. (1992) ("1992 Senate Report") at 32 ("the leased access provision is an important safety valve for anticompetitive practices").

[13]8 FCC Rcd 5631 (1993).

[14]The Commission's rules governing leased access are located at 47 C.F.R. §§ 76.701, 76.970, 76.971, 76.975 and 76.977.

[15]*Rate Order*, 8 FCC Rcd at 5937-5964.

[16]*Id.* at 5936-5937. The BST is defined as that tier of cable service which includes the local broadcast signals and public, educational, and governmental ("PEG") access channels, and may include any additional programming services the operator chooses to include. CPSTs include all video programming not included in the BST for which the operator does not charge the subscriber on a per-program or per-channel basis. *Id.* at 5637.

[17]*Id.* at 5936.

[18]*Id.*

6. In the *Reconsideration Order and Further Notice*, we addressed certain issues pertaining to the highest implicit fee formula, the provision of certain leased access rate and channel availability information to prospective leased access programmers, acceptable time increments and pricing for part-time leased access use, operator provision of billing and collection services for leased access programmers, security deposits, calculation of the leased access set-aside requirement and reporting requirements.[19] We also re-examined the highest implicit fee formula from an economic perspective, and tentatively concluded that the highest implicit fee formula is likely to overcompensate cable operators and does not sufficiently promote the goals underlying the leased access provisions. We proposed a cost/market rate approach to setting maximum reasonable rates and requested comment on the approach and its implementation. In addition, we sought comment on: (a) part-time rates and an operator's obligation to open additional leased access channels for part-time use, (b) the resale of leased access time, (c) tier and channel placement for leased access programming, (d) the placement of minority or educational programming when it is used as a substitute for leased access programming, (e) preferential treatment for certain types of leased access programmers, including not-for-profit programmers, (f) the selection of leased access programmers, and (g) streamlined leased access dispute resolution procedures.

7. In this *Order*, we: (a) revise the maximum rate formulas for use of full-time leased access channels; (b) decline to impose a transition period for the implementation of our revised rate formulas; (c) maintain the current rules for maximum part-time rates and adopt a rule that cable operators are not required to open additional leased access channels for part-time use until all existing part-time leased access channels are substantially filled or until a programmer requests a year-long eight-hour daily time slot that cannot otherwise be accommodated; (d) allow the resale of leased access time; (e) grant leased access programmers the right to demand access to a tier with a subscriber penetration of more than 50%; (f) stipulate that minority and educational programming does not qualify as a substitute for leased access programming unless it is carried on a tier with a subscriber penetration of more than 50%; (g) decline to mandate preferential treatment for certain types of leased access programmers; (h) require operators to accept leased access programmers on a non-discriminatory basis so long as available leased access capacity exceeds demand; (i) require that an independent accountant review an operator's rate calculations prior to the filing of a rate complaint with the Commission; (j) establish a standard of reasonableness for certain contractual requirements; (k) specify when leased access programmers must pay for technical support; and (l) define the term "affiliate" for purposes of leased access. We also address several issues on reconsideration, including the exclusion of programming revenues from the maximum rate calculation, the maximum rate calculation for a la carte channels, cable operators' obligations to provide certain information to potential leased access programmers and the need for operators to comply with those obligations, time increments, the calculation of the leased access set-aside requirement, and billing and collection services.

[19] *Reconsideration Order* at paras. 24-40, 43-47, 50-55 and 60. *Further Notice* at para. 102.

II. REPORT AND ORDER

A. Statutory and Policy Goals of Leased Access

8. As we explained in the *Reconsideration Order*, Section 612 expressly states that its purposes are twofold: to assure that the public has access to the widest possible diversity of information sources carried on cable systems, and to promote competition in the delivery of diverse sources of video programming.[20] The United States Court of Appeals for the District of Columbia Circuit recently affirmed that these purposes are "important governmental objectives unrelated to the suppression of speech."[21] The statute also states, however, that these goals must be accomplished in a manner consistent with the growth and development of cable systems.[22] Thus, in implementing the leased access provisions, including the establishment of maximum reasonable rates, the Commission must seek to promote the goals of competition and diversity of programming sources, while doing so in a manner consistent with the growth and development of cable systems.[23]

9. Many commenters contend that the goals of diversity and competition have been achieved in the marketplace,[24] and that the Commission therefore need do nothing further to fulfill the purposes of Section 612.[25] We note, in this regard, that the Commission has found that

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[20]Communications Act § 612(a), 47 U.S.C. § 532(a).

[21]*Time Warner Entertainment Co., L.P. v. FCC*, 93 F.3d 957, 969 (D.C. Cir. 1996).

[22]Communications Act § 612(a), 47 U.S.C. § 532(a).

[23]*See Reconsideration Order* at para. 25.

[24]According to Outdoor Life, et al., for example, nearly 100 new, mostly unaffiliated programming networks have emerged since the Commission adopted its original rate rules. Outdoor Life, et al. Comments at 2-3, 12-17 (leased access statutory goals have been accomplished through increased competition and the Commission's vertical integration restrictions; niche programming offers subscribers significant choice of programming). *See also, e.g.*, Lifetime Comments at 2, 10 (no current shortage of program services; approximately half of services now available are unaffiliated with cable operators); Viacom Comments at 8; C-SPAN Comments at 5 (diversity of sources achieved through vigorous competition within and with the cable industry); Prevue Networks Comments at 9 (traditional programming industry responds to consumer demand); Penn. Cable Network Comments at 6 (cable operators are in the best position to respond to subscriber needs and interests); USA Networks Comments at 4-5 (program supplier market is robustly competitive); MPAA Comments at 2; Encore Comments at 2 (number of programming services is expanding rapidly); PBS Horizons Comments at 2; Rainbow Comments at 4-8.

[25]*See, e.g.*, Viacom Comments at 2, 6 (no pricing reformulation is needed to meet the intent and purpose of Section 612 because nothing has changed since the Commission adopted its initial leased access rules, except that more programming services exist today than four years ago); C-SPAN Comments at 6 (new networks have effectively fulfilled Congress' goals for leased access); E!, et al. Comments at 3, 6 (same as C-SPAN); Penn. Cable Network Comments at 1-2 (the leased access provisions are themselves counterproductive to the objective of achieving diversity); Eternal Word Comments at 3 and n.2 (most operators already carry at least as many unaffiliated programmers as the number of leased access programmers they are subject to carry under their set-aside requirement).

the total number of non-vertically integrated programming services has increased in each of the past three years and represents over half of the national programming services in operation today.[26] Notwithstanding this growth in unaffiliated programming services, we believe that there is an important distinction between such programming and leased access programming under Section 612. The cable operator generally exercises editorial judgment in choosing which unaffiliated non-leased access programming services to carry. Section 612, by contrast, is designed to provide a limited amount of channel capacity over which the cable operator has no editorial control.[27] It is this divorce of editorial control that differentiates the leased access provision from other provisions of the Communications Act that seek to promote diversity of information sources, such as channel occupancy restrictions.[28] Congress was concerned not only with ensuring access for unaffiliated programmers, but also with ensuring that cable operators do not exercise editorial control in choosing which unaffiliated programmers obtain access to a limited percentage of channel capacity.[29]

10. Indeed, the legislative history of Section 612 indicates that Congress was concerned that while cable operators have an incentive to provide a diversity of program services, they do not necessarily have the incentive to provide a diversity of programming sources, "especially when a particular program supplier's offering provides programming which represents a social or political viewpoint that a cable operator does not wish to disseminate, or the offering competes with a program service already being provided by that cable system."[30] The legislative history also states that leased access is intended to promote "competition by independent programmers to the services selected by the cable operator" and "public access to a wide variety of voices and

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[26]*See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming* in CS Docket No. 95-61, Third Annual Report, FCC 96-496 (released January 2, 1997) at para. 142 (noting that during the past year, the number of non-vertically integrated national programming services in operation increased from 63 of 129 services to 81 of 145 services). *See also Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming* in CS Docket No. 95-61, Second Annual Report, 11 FCC Rcd 2060, 2132 (1996).

[27]*See* 1984 House Report at 47 ("Leased access is aimed at assuring that cable channels are available to enable program suppliers to furnish programming when the cable operator may elect not to provide that service as part of the program offerings he makes available to subscribers."). *See also* Telemiami Reply at 2-5; Denver Area Ed. Reply at 10-11; VIPNA Reply at 3.

[28]*See* Communications Act § 613(f)(1)(B), 47 U.S.C. § 533(f)(1)(B). *See also* 47 C.F.R. § 76.504. Cable systems with channel capacity up to 75 channels may not devote more than 40% of their activated channels to national video programming services owned by the cable operator or in which the cable operator has an attributable interest.

[29]1984 House Report at 47-48. Section 612 provides two exceptions to this general rule by providing that a cable operator may consider the content of leased access programming for the limited purposes of setting the appropriate price for leased access use and to determine whether the programming is indecent or obscene. *See* Communications Act § 612(c)(2), 47 U.S.C. § 532(c)(2).

[30]1984 House Report at 48.

viewpoints."[31] Thus, we believe that our statutory mandate to implement Section 612 is not obviated by an increase in diversity of programming services that are selected by cable operators; rather, our mandate is to promote a diversity of programming sources.[32] We are mindful, in this regard, that must-carry broadcast stations and public, educational, and governmental ("PEG") access channels have added to the diversity of programming services and sources, and that the current balance of diversity partly stems from cable operators' fulfillment of their obligations to carry these channels.

11. In addition, we believe that in order to promote competition and diversity in a manner consistent with the growth and development of cable systems, we must consider the broader effects of our rules on the video programming delivery marketplace, including the effect our rules might have on a cable system's ability to compete with other multichannel video distribution systems.[33] Section 612 itself provides that the "price, terms, and conditions" for leased access should "not adversely affect the operation, financial condition, or market development of the cable system."[34] Similarly, the legislative history states that "[w]hile the overall intent of [Section 612] is to diversify the sources of programming available to the public, this is to be accomplished in a manner consistent with the financial viability of individual cable systems."[35]

12. Guided by these statutory and policy goals, we hereby modify our leased access rules as set forth below.

B. Maximum Rate Formula for Leasing a Full Channel

1. Background

13. Section 612 directs the Commission to determine the maximum reasonable rates that cable operators may charge for commercial leased access.[36] In the *Rate Order*, the

[31] 1992 House Report at 40.

[32] *See Time Warner,* 93 F.3d at 968 (citing 1984 House Report at 48) ("'Diversity,' as the 1984 [Cable] Act used the term, referred not to the substantive content of the program on a leased access channel, but to the entities -- the 'sources' -- responsible for making it available.").

[33] *See* A&E, et al. Comments at 27; ESPN Comments at 3; MPAA Comments at 2 (all stating that the Commission should not promote leased access as an end to itself). *See also* A&E, et al. Comments at 19 (goals of leased access must be accomplished in a manner consistent with the growth and development of cable systems and without disruption to cable program services).

[34] Communications Act § 612(c)(1), 47 U.S.C. § 532(c)(1).

[35] 1984 House Report at 50.

[36] Communications Act §§ 612(c)(4)(A)(i), 612(c)(4)(B), 47 U.S.C. §§ 532(c)(4)(A)(i), 532(c)(4)(B).

Commission adopted rules that establish maximum rates based on the highest implicit fee paid by non-leased access programming services distributed on a system. In the non-leased access context, cable operators generally pay programmers (e.g., a contractual license fee or a copyright fee) for their programming services. Nevertheless, there is an implicit fee for carriage to the extent that the amount of subscriber revenue that the operator receives for the programming is greater than the fee that the operator pays to the programmer. In other words, the amount of subscriber revenue that the programmer forgoes to the operator represents an implicit payment for carriage. The Commission therefore determined that the implicit fee paid by a programmer is the average price per channel that a subscriber pays the operator minus the amount per subscriber that the operator pays the programmer. The highest of the implicit fees charged any unaffiliated non-leased access programmer is the maximum rate per subscriber that a cable operator may charge a leased access programmer.[37]

14. Under the current formula, PEG access channels and broadcast stations carried pursuant to the mandatory carriage provisions of Sections 614 and 615 are excluded when determining which channel results in the highest implicit fee.[38] In addition, cable operators are required to calculate the highest implicit fee for three programmer categories: (a) those charging subscribers directly on a per-event or per-channel basis, (b) those using a channel for more than 50% of the time to sell products directly to customers (e.g., home shopping networks, infomercials, etc.), and (c) all others.[39] These three categories were intended to account for the fact that leasing issues may need to be addressed in different ways depending on the nature of the service involved.[40] For leased access channels that are carried on a programming services tier, operators must calculate the highest implicit fee on a tier-by-tier basis; that is, if the leased access channel is carried on the BST, the calculation of the highest implicit fee should be based on the BST channels, and, if the leased access channel is carried on a CPST, the highest implicit fee should be determined for the channels on that CPST.[41]

15. The Commission's current rules also provide that for leased access channels carried on a programming services tier, the highest per subscriber implicit fee is multiplied by the number of subscribers that subscribe to the tier on which the leased access channel is carried. For a la carte channels, the highest per subscriber implicit fee is multiplied by the average

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[37] *Rate Order*, 8 FCC Rcd at 5950.

[38] 47 C.F.R. § 76.970(b).

[39] 47 C.F.R. § 76.970(f).

[40] *Rate Order*, 8 FCC Rcd at 5936.

[41] *Reconsideration Order* at para. 36.

number of subscribers that subscribe to the operator's a la carte services.[42] The implicit fee is intended to recover only the value of the channel capacity and not any fees, stated or implied, for services other than the provision of channel capacity (e.g., billing and collection, marketing, or studio services).[43] Accordingly, programming revenues (e.g., home shopping commissions) received by the operator from an unaffiliated programmer are not included in the highest implicit fee calculation.[44] Under our rules, cable operators are required to calculate the maximum rates for each programmer category annually based on the contracts with unaffiliated programmers in effect in the previous calendar year.[45]

16. In the *Reconsideration Order*, we identified certain problems with the highest implicit fee formula. First, we stated that the highest implicit fee formula may overcompensate cable operators because it appears to allow "double recovery" in that operators recover for the value of the channel capacity twice, once from the subscriber (included in the tier charge) and again from the programmer (included in the leased access programmer charge).[46]

17. Second, we expressed concern that the highest implicit fee allows an operator to charge a leased access programmer a rate based on the channel with the highest mark-up over programming costs (i.e., the highest of the relevant implicit fees). We stated that because the implicit fee for many, if not most, non-leased access channels is by definition less than the highest implicit fee, allowing the operator to charge leased access programmers the highest implicit fee is likely to overcompensate the operator in comparison to the amount the operator is willing to accept for most non-leased access channels.[47]

18. Third, we stated that the highest implicit fee formula is not based on the reasonable costs that leased access programming imposes on operators. We tentatively concluded that, when the set-aside requirement is not met, the rate should be no higher than is necessary to recover all reasonable costs of leasing and a reasonable profit. In this way, leased access is promoted

[42] As we stated in the *Reconsideration Order*, the average number of subscribers is used for a la carte channels because using the actual number of subscribers would unfairly penalize the operator if the leased access programming had low subscribership. *Id.* at para. 39.

[43] 47 C.F.R. § 76.970(c).

[44] *Reconsideration Order* at para. 37.

[45] 47 C.F.R. § 76.970(d). Section 76.970(d) of the Commission's rules also states that maximum rates for shorter periods of time can be calculated by prorating the monthly maximum rate uniformly, or by developing a schedule of and applying different rates for different times of day, provided that the total of the rates for a 24-hour period does not exceed the maximum rate for one day of a full-time leased access channel. See Section II.C. below for a discussion of part-time rates.

[46] *Reconsideration Order* at para. 29.

[47] *Id.* at para. 30.

without placing a financial burden on the operator. We asserted that a higher rate unnecessarily discourages leased access and rewards operators that do not meet the set-aside requirement.[48]

19. Given these limitations of the highest implicit fee formula, the Commission sought comment on a "cost/market rate formula," an alternative approach that we believed might better promote the goals of leased access.[49] Under this proposed approach, the maximum rate for leased access would depend on whether the cable operator is leasing its full statutory set-aside requirement. When the full set-aside capacity is not leased to unaffiliated programmers, the maximum rate would be based on the operator's reasonable and quantifiable costs (i.e., the costs of operating the cable system plus the additional costs related to leased access), including a reasonable profit.[50] The operator would be allowed to use the subscriber revenue received from a leased access channel to offset the operating costs associated with the channel.[51] In addition, the operator would be allowed to charge the leased access programmer the reasonable costs of bumping a programming service in order to accommodate the leased access programmer.[52] We believed that this approach would promote leased access without giving programmers a subsidy.[53] Our intent in proposing the cost/market rate formula was not to raise or lower leased access rates, but to ensure that they would be reasonable.[54]

20. We tentatively concluded that once the operator met its set-aside requirement, the cost-based maximum rate could be replaced by a market rate. The operator would be allowed to negotiate higher rates for leased access as long as its set-aside requirement continued to be met. We believed that market rates would most effectively determine which programmers should receive leased access on the system when the operator's set-aside is satisfied. We stated that the higher price that some leased access programmers may offer to pay for the channel capacity reflects the greater ability and willingness of consumers to pay for the programming to be carried on each of these channels. Thus, we tentatively concluded that relying on market prices to

[48] *Id.* at para. 31.

[49] *See Further Notice* at paras. 61-97.

[50] *Id.* at para. 66.

[51] *Id.* at para. 77.

[52] *Id.* at paras. 79-89. The operator would also be permitted to charge part-time leased access programmers any additional costs associated with negotiating and administering part-time leased access programming contracts. *Id.* at para. 95.

[53] *Id.* at para. 68.

[54] *See id.* at paras. 63, 68.

allocate channel capacity provides consumers with an efficient mechanism to communicate their preferences about which leased access programming should be carried by the operator.[55]

21. We also tentatively concluded that this cost/market rate formula represented a pricing scheme that would establish a maximum reasonable rate without placing an unreasonable financial burden on operators. We stated that, with the possible exception of a preferential rate for not-for-profit programmers, any maximum reasonable rate formula that we adopt, including the proposed cost/market rate formula, would not provide a subsidy for leased access programmers.[56]

2. *Discussion*

a. Goals in Establishing Maximum Reasonable Rates

22. As described above, the purposes of Section 612 are "to promote competition in the delivery of diverse sources of video programming and to assure that the widest possible diversity of information sources are made available to the public from cable systems in a manner consistent with growth and development of cable systems."[57] Accordingly, we must focus on these statutory objectives in establishing maximum reasonable rates for leased access use. In addition, because Section 612 also requires that the price, terms and conditions for leased access be "at least sufficient to assure that such use will not adversely affect the operation, financial condition or market development of the cable system,"[58] the Commission is faced with balancing the interests of leased access programmers with those of cable operators.[59]

23. In the *Reconsideration Order*, we determined that as long as the maximum leased access rate is reasonable, a lack of demand for leased access channels would not indicate that the

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[55]*Id.* at paras. 70-73, 96-97.

[56]*Id.* at para. 68.

[57]Communications Act § 612(a), 47 U.S.C. § 532(a).

[58]Communications Act § 612(c)(1), 47 U.S.C. § 532(c)(1).

[59]*See Reconsideration Order* at para. 26. We agree with Outdoor Life, et al. that providing certainty with respect to rates was one reason Congress directed the Commission to establish maximum reasonable rates. *See* Outdoor Life, et al. Comments at 6, 8; 1992 House Report at 39-40; 1992 Senate Report at 31-32. We do not believe, however, that providing certainty was Congress' only purpose in requiring the Commission to set maximum reasonable rates. *See* 1992 House Report at 39-40; 1992 Senate Report at 31-32 (stating that one purpose is "[t]o make leased access a more desirable alternative for programmers").

rate should be lowered.[60] We continue to believe that Congress did not intend that cable operators subsidize leased access programmers.[61]

24. We emphasize that our role with regard to leased access rates is to establish maximum reasonable rates, not a mandatory rate that must be charged to all leased access programmers. Operators have the discretion to negotiate rates below the maximum rates established by the Commission. The legislative history of the 1992 amendments to Section 612 specifically states that "the operator and the programmer can bargain for a lower rate."[62] Furthermore, Section 612(c)(2) states that the operator may consider content to the minimum extent necessary to establish a reasonable price,[63] implying that the cable operator is not required to charge the Commission's maximum reasonable rate. We confirm that operators are permitted to differentiate with respect to price between one leased access programmer and another. This discretion only pertains to rates below the maximum rate. For clarification purposes, we will adopt a rule that specifically states that cable operators are permitted under our rules to negotiate rates below the maximum permissible rates.[64]

b. *Cost/Market Rate Formula*

25. We stated in the *Reconsideration Order and Further Notice* that we believed that our proposed cost/market rate formula would further the goals of leased access and would appropriately balance the needs of programmers and operators. After reviewing the record in this proceeding and after considering and analyzing all of the options presented, we now conclude that the cost/market rate formula does not adequately account for certain factors which, if excluded, would make the maximum leased access rates resulting from the formula unworkable in today's programming marketplace.

26. Although the proposed cost/market rate formula accounts for lost advertising revenue and lost commissions that would result from bumping existing programming, it does not account for negative effects that leased access programming might have on subscriber revenue (i.e., lost subscriber revenue caused by subscribers dropping the tier or by requiring a lower price due to a devaluation of the tier). In the *Further Notice*, we recognized this cost but tentatively concluded that the inability to quantify the specific effect on subscriber revenue caused by the replacement of current programming with leased access programming in the tiered programming

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[60] *Reconsideration Order* at para. 24. *See also* 130 Cong. Rec. H10441 (daily ed. Oct. 1, 1984) (colloquy in House proceedings); 130 Cong. Rec. S14288 (daily ed. Oct. 11, 1984) (reference to colloquy in House proceedings).

[61] *Reconsideration Order* at para. 27.

[62] 1992 Senate Report at 32. *See also Rate Order*, 8 FCC Rcd at 5951 ("lower rates could, of course, be negotiated").

[63] Communications Act § 612(c)(2), 47 U.S.C. § 532(c)(2).

[64] *See* TCI Reply at 11 n.26.

services context made it too speculative to include as an opportunity cost category in the cost/market rate formula.[65] We nevertheless sought comment on how our cost/market rate formula might measure changes in subscriber penetration due to the addition of leased access programming.[66]

27. Neither the Commission nor the commenters in this proceeding have been able to accurately quantify the effect that leased access programming carried on a programming services tier may have on subscribership or subscriber revenues to a degree specific enough to assign it a definite value in a formula. Nevertheless, we no longer believe that this effect is a factor that reasonably can be ignored. Under the cost/market rate formula, the value of a channel is measured by subtracting the programming or license fee the operator pays for the channel from the advertising revenues and commissions the operator receives for the channel. The formula does not include the subscriber revenue received for the channel because, as explained above, we assumed that leased access programming would have no measurable impact on subscriber revenue. By ignoring the effect of leased access programming on subscriber revenue, the cost/market rate formula assigns a negative value to a channel where the license fee is higher than the revenue collected from advertising and commissions.[67] For example, a programming service such as The Disney Channel, which carries no commercial advertising,[68] could have a negative value under the cost/market rate formula and thus would yield a negative leased access rate.[69] The proposed cost/market rate formula therefore must not accurately represent at least some important factor in assessing the value of a channel because a well-established channel like The Disney Channel is unlikely to have a negative value to the operator. The missing factor, we

[65]*Further Notice* at para. 86. We also noted that, for a la carte channels, this subscriber loss is included by allowing the operator to include as an opportunity cost an amount equal to the total subscriber revenue for the bumped programming service. Thus, in the a la carte context, the effect on subscribership appears to be measurable. See Section II.B.2.d. regarding the calculation of maximum rates for a la carte channels.

[66]*Id.* at para. 86.

[67]*See* Daniels, et al. Comments at 8-9 (license fees are often higher than advertising revenues and commissions).

[68]*See* Disney Channel Reply at 2.

[69]TCI, for example, applied the proposed cost/market rate formula to six of its cable systems and found that it would yield an overall negative leased access rate on all six systems. TCI Comments at 14-15 and Attachment E. Cox provided three examples of cable systems for which the cost/market rate formula would generate negative leased access rates. Cox Comments at 16. *See also* NCTA Comments at 11-12 (using advertising revenues as the measure of a channel's worth understates the value of numerous programming services, such as C-SPAN, Bravo, and Disney, that do not sell advertising); Daniels, et al. Comments at 8-9 (many programming services do not generate advertising revenues or commissions); SCBA Comments at 5-7 (rates would be zero or negative for many small systems because they rarely offer advertising insertion); Buckeye Comments at 5-6 (the system's minimal amount of advertising insertion would result in nominal or zero rates).

believe, is the subscriber revenue that an operator receives because it carries a particular channel.[70] In the case of a channel newly added to a tier, this subscriber revenue includes both the additional amount an operator can charge its existing subscribers when it adds a channel and also the full tier price paid by subscribers the channel attracts to the tier.

28. ValueVision proposes using interim proxies for subscriber loss of 1% of tier revenue for the first three leased access programmers added, 2% for the next three programmers, and 3% for the next three programmers.[71] We decline to adopt this proposal because ValueVision's claim that this proxy would adequately compensate cable operators for any subscriber loss is based on only three anecdotal examples where one programming service was substituted for a very similar programming service.[72] We therefore find that ValueVision has not provided sufficient evidence allowing us to predict what the actual subscriber loss is likely to be for a typical system, especially when the leased access programming substantially differs from the displaced programming. In addition, as described below, TCI and Continental allege that the actual subscriber loss would be 25% and 30%, respectively.[73] Given that these cable operators and ValueVision provided such divergent estimates of subscriber loss, we do not believe that we can determine with any precision the actual amount that should be factored into the cost/market rate formula to account for subscriber loss.

29. Because the cost/market rate formula does not adequately account for a significant benefit that cable operators receive from programming, we believe it may result in an unduly low rate that does not adequately capture the value of a channel. Such a rate would not adequately compensate the cable operator and would force cable operators to subsidize leased access programmers, thereby impermissibly affecting the cable system's operation, financial condition or market development.[74] Similarly, such a rate could impair a cable operator's ability to compete in the multichannel video distribution marketplace by requiring the operator to bump

[70]A number of commenters contend that by omitting the subscriber revenue for a channel, the proposed cost/market rate formula would understate the channel's value. *See, e.g.*, NCTA Comments at 12-14; TCI Comments at 12-16; TCI Reply at 1-4; Time Warner Comments at 11-12; Discovery Comments at 5-10; Liberty Sports Comments at 3-4; Faith & Values Comments at 2-3; Adelphia, et al. Comments at 13-14; Buckeye Comments at 6-7; A&E, et al. Comments at 30-32; Comcast/Cox Reply at 7-8.

[71]ValueVision Ex Parte Letter, October 1, 1996, at 4.

[72]*Id.* at 3 (one home shopping network was substituted for another home shopping network).

[73]*See* Section II.B.2.c.

[74]*See* Communications Act § 612(c)(1), 47 U.S.C. § 532(c)(1). Numerous commenters claim that maximum rates under the cost/market rate formula would constitute a subsidy for leased access programmers. *See, e.g.*, Outdoor Life, at al. Comments at 10-11; NCTA Comments at 10-11; Daniels, et al. Comments at 12-13; Prevue Networks Comments at 4-5; Faith & Values Comments at 2-3; MPAA Comments at 2; A&E, et al. Comments at 28-29; Comcast Comments at 7; Cox Comments at 14; Comcast/Cox Reply at 7-8; Adelphia, et al. Reply at 3; Daniels, et al. Reply at 3-4; Disney Channel Reply 3-5; ESPN Comments at 2-3; ESPN Reply at 1. *But see, e.g.*, Telemiami Reply at 23-24 (cost/market rate formula would not provide a subsidy).

existing programming in exchange for less than its actual value, which would be inconsistent with the growth and development of cable systems.[75]

30. We therefore conclude that the proposed cost/market rate formula would not accurately establish reasonable maximum rates because, in its attempt to measure the opportunity costs of using a channel for leased access, it ignores a significant opportunity cost -- the effect on subscriber revenue. Because neither the Commission nor the commenters in this proceeding have been able to specifically quantify this effect, we are unable to revise our proposed formula in a way that would allow us to adopt it as an appropriate method for determining maximum leased access rates.[76]

c. *Maximum Rate for Full-Time Leased Access Programming Carried on a Programming Services Tier*

31. Based on our review of the comments, we no longer believe that the proposed cost/market rate formula is a reasonable formula for determining maximum leased access rates. Instead, we have decided to retain an implicit fee formula. We will, however, modify our current formula to address the concerns set forth in the *Further Notice* and in the comments. Specifically, as described below, we conclude that the maximum reasonable rate for leased access programming that is carried on a programming services tier should be the "average implicit fee."[77] We will, however, continue to monitor the availability of leased access channels and may revisit this issue if it appears that the average implicit fee formula no longer reflects a reasonable rate.

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[75]NCTA Comments at 14-15; U S West Reply at 2; Intermedia/Armstrong Comments at 7-8; Cox Comments at 14-15; TCI Comments at 11; Faith & Values Reply at 7. *See also* Viacom Comments at 5-6 (threat of being bumped for leased access will place the non-leased access programmer at a greater disadvantage in dealing with the cable operator).

[76]Because we are not adopting the cost/market rate formula, we do not need to address other concerns raised by commenters regarding our proposal. We note, however, that several potential leased access programmers argue that rate calculations under the cost/market rate formula would be complex, difficult to verify, and easily manipulated by cable operators. *See, e.g.*, CME, et al. Comments at 9-10; CBA Comments at 5-6; Viking Comments at 1; Telemiami Comments at 5-13; Telemiami Reply at 21-22; Denver Area Ed. Reply at 13. Other commenters claim that the Commission's proposal to require operators to identify which programming services would be bumped for leased access programming would make it difficult for those programmers to attract viewers, advertisers, investors, and third-party program suppliers. *See, e.g.*, A&E, et al. Comments at 13-15, 38; Continental Comments at 31; ESPN Comments at 8; ESPN Reply at 3. A number of commenters criticize the Commission's proposal to allow a cable operator to charge market rates once it fulfills its set-aside requirement. *See, e.g.*, Viacom Comments at 13; Time Warner Comments at 21; Continental Comments at 32; Blab TV Comments at 8-10; A&E, et al. Comments at 34 n.94; Visual Media Comments at 7; Denver Area Ed. Reply at 14.

[77]Many commenters support the adoption of a rate formula based on the average implicit fee if the Commission rejects the highest implicit fee formula. *See, e.g.*, NCTA Comments at 21-23; Lorilei Comments at 7; Discovery Comments at 10-12; Adelphia, et al. Comments at 17; TCI Reply at 9-10; Continental Reply at 4-5; Comcast/Cox Reply at 10-12; A&E, et al. Reply at 2; Daniels, et al. Reply at 8; Outdoor Life, et al. Reply at 6-7; ESPN Reply at 1-3.

32. To determine the average implicit fee for a full-time channel on a particular tier with a subscriber penetration over 50%, an operator must first calculate the total amount it receives in subscriber revenue per month for the programming on all such tier(s),[78] and then subtract the total amount it pays in programming costs per month for such tier(s) (the "total implicit fee calculation").[79] A weighting scheme that accounts for differences in the number of subscribers and channels on all such tier(s) must be used to determine how much of the total implicit fee calculation will be recovered from any particular tier. The weighting scheme is determined in two steps. First, the number of subscribers is multiplied by the number of channels (the result is the number of "subscriber-channels") on each tier with subscriber penetration over 50%. For instance, a tier with 10 channels and 1,000 subscribers would have 10,000 subscriber-channels. Second, the subscriber-channels on each of these tiers is divided by the total subscriber-channels on all such tiers.[80] Given the percent of subscriber-channels for the particular tier, the implicit fee for the tier is computed by multiplying the subscriber-channel percentage for the tier by the total implicit fee calculation. Finally, to calculate the average implicit fee per channel, the implicit fee for the tier must be divided by the corresponding number of channels on the tier.[81] The final result is the maximum rate per month that the operator may charge the leased access programmer for a full-time channel on that particular tier.[82] In the event of an agreement to lease capacity on a tier with less than 50% penetration, the average implicit fee should be determined on the basis of subscriber revenues and programming costs for that tier alone.

33. In essence, the average implicit fee measures the average amount that full-time programmers implicitly "pay" the cable operator for carriage. In other words, the average implicit fee represents the average amount of subscriber revenue that full-time programmers cede to the operator to permit the operator to cover its costs and earn a profit. For instance, if subscribers pay an average of $0.50 per channel for a particular tier, and the average

[78]*See* Section II.E., below, for a discussion of leased access programmers' right to demand access to a tier with a subscriber penetration of more than 50%.

[79]We reject the proposal of NCTA and TCI to allow multiple system operators to establish company-wide average programming costs for purposes of the average implicit fee calculation. NCTA Comments at 22-23; TCI Reply at 10. Maximum leased access rates should be calculated on a per-system basis because Congress established leased access as a system-by-system requirement.

[80]This weighting scheme is also used in the FCC Form 393 to account for differences in the number of channels and subscribers. *See* FCC Form 393 at Line 106.

[81]This result can also be reached by adding together the implicit fees on all tiers exceeding 50% penetration, after adjusting the implicit fees for any lower penetration on CPST tier(s). This figure would then be divided by the total number of channels on the relevant tiers, again after adjusting for any lower penetration on CPST tier(s). Finally, to determine the maximum full-time rate for a channel on a particular tier, this result would be multiplied by the actual number of subscribers on the tier on which the leased access programmer will be placed.

[82]A detailed example of an average implicit fee calculation is attached as Appendix C.

programming or license fee on the tier is $0.10, then, on average, programmers on the tier are implicitly "paying" the operator $0.40 for carriage. We agree with Cox and Comcast that since full-time lessees resemble, and will be competing with, full-time cable networks, it is appropriate that the maximum full-time leased access rate reflect the average marketplace terms and conditions under which cable networks are able to gain access to the cable system.[83] From the operator's standpoint, the average implicit fee represents the average value of a channel after programming acquisition costs are paid. As Encore argues, a formula based on the average value of a channel may reflect the value of channel capacity more accurately than a formula based on the value of the programming bumped for leased access, such as the proposed cost/market rate formula, because programming that is bumped for leased access may not have had sufficient opportunity to reach its full revenue-generating potential.[84]

34. In addition, we are adopting an average implicit fee formula because it is possible to determine the average value of a channel accurately, even when channels are sold as part of a package (i.e., a tier). A precise calculation of the average channel value is possible because the necessary components are known: in particular, what a subscriber pays for the tier and what the operator pays in total programming costs for all channels on the tier. By contrast, the proposed cost/market rate formula and the highest implicit fee formula cannot provide such accuracy because they attempt to measure the value of an individual channel on a tier. However, the value of an individual channel on a tier cannot be ascertained accurately because it is not possible to determine the subscriber revenue attributable to a particular channel that is sold collectively with other channels as a single package.[85] The same problem would be presented by an attempt to determine the lowest implicit fee.

35. We also believe that developments in the multichannel video programming marketplace are relevant to our decision to adopt the average implicit fee formula. As noted above, the number of non-vertically integrated national programming services has grown in each of the past three years.[86] We believe that a shift from a highest implicit fee formula to an average implicit fee formula may provide additional opportunities for diverse, unaffiliated

[83] *See* Cox Comments at 22-23; Comcast Comments at 16.

[84] *See* Encore Reply at 7. *See also* Liberty Sports Comments at 4 (programming services deleted for leased access may not have achieved their full revenue-generating potential); Faith & Values Comments at 3 (same as Liberty Sports); Continental Comments at 17-18 (new programming typically takes several years to build a loyal audience). *But see* CME, et al. Reply at 24-25 (using the average rate, instead of a channel-specific rate, overcompensates cable operators because they will bump their least valuable programming services).

[85] *See* Comcast/Cox Reply at 10 (it is impossible to quantify the amount that subscribers pay for each channel on a tier).

[86] *See* Section II.A.

programmers to enter the marketplace, without creating a maximum rate that is artificially low and putting the cable operator's operation, financial development or market development at risk.[87]

36. Moreover, we believe that the average implicit fee formula addresses the concerns with the highest implicit fee formula that we expressed in the *Reconsideration Order*. Most importantly, we do not believe that the average implicit fee formula permits the operator a "double recovery."[88] In the *Reconsideration Order*, we noted that the highest implicit fee formula overcompensates the operator because it appears to allow the value of the channel to be recovered twice -- once from the leased access programmer (the highest implicit fee), and once from subscribers (the average per channel subscriber charge).[89] For example, if the subscriber revenue for a tier is an average of $0.50 per channel and the lowest license fee for unaffiliated programming on that tier is $0.05, the highest implicit fee for that tier would be $0.45. Because we assumed that the leased access programmer would pay up to $0.45 (the highest implicit fee) and the subscriber would still pay $0.50 (the average per channel subscriber charge), we believed that the operator was permitted to recover the value of the channel twice.[90]

37. Our "double recovery" hypothesis was based on the assumption that operators would be able to charge subscribers the same amount for leased access programming that they charge on average for other programming on the same tier. Several commenters supported this assumption. For instance, the Game Show Network states that its programming had tested very favorably with consumers and that it tied The Discovery Channel and MTV in one ratings survey.[91] In addition, Blab TV and Telemiami cite themselves as examples of full-time local leased access programming that has proven to be commercially successful over a lengthy time span.[92] More generally, ValueVision argues that operators are not likely to lose subscriber

[87]*See id.* (in implementing Section 612, including the establishment of maximum reasonable rates, the Commission must seek to promote the goals of competition and diversity of programming sources, while doing so in a manner consistent with the growth and development of cable systems).

[88]*But see* Telemiami Reply at 11-12 (average implicit fee formula does not eliminate double recovery problem, does not improve the viability of leased access, and bears no greater relationship to reality than the highest implicit fee formula).

[89]*See Reconsideration Order* at para. 29.

[90]In addition, we assumed that the operator was further overcompensated by also recovering from the subscriber the amount of the lowest license fee (the average per channel subscriber charge equals the highest implicit fee plus the lowest license fee).

[91]Game Show Network Comments at 3-4. *See also* CBA Reply at 5 (leased access is sought by many low power television stations that produce "large amounts of high quality local and regional television programming").

[92]Blab TV Comments at 1-3 (Blab TV has been in business since 1984); Letter from Congressman Lincoln Diaz-Balart filed in conjunction with Telemiami Comments (Telemiami has been in business since 1988). Blab TV contends that its programming increases subscribership and has occasionally scored in terms of audience share at least as high as CNN, MTV, ESPN, The Discovery Channel, and Showtime. Blab TV Reply at 5-6 and Exhibit 1 (1986

revenue because they will substitute leased access programming with their least profitable networks, which recent data show have virtually no audience.[93]

38. Many commenters, however, assert that subscribers will not be willing to pay the same amount for leased access programming because subscribers value it less than programming selected by the operator.[94] Cox and Comcast contend that the amount of subscriber revenue that operators will be able to collect for most leased access channels will be close to or equal to zero.[95] Several commenters claim that leased access programming will in fact diminish the value of a tier because subscribers will find it so unappealing that viewership of the other programming on the tier will be adversely impacted.[96] They argue that this "neighborhood effect" will force operators either to lose subscribers or to reduce the price of the tier.[97] Many commenters assert that due to the increasing threat of losing subscribers to other services that are not subject to leased access requirements, such as direct broadcast satellite services and wireless services, cable operators cannot afford to use scarce channel capacity for programming that subscribers value negatively.[98]

letter from Group W Cable attributing the addition of 311 new subscribers to Blab TV) and Exhibits 2-3 (Neilsen data for several days in January 1986 and for a one-week period in September 1987). Telemiami states that its Neilsen ratings are far higher than ratings for another Spanish-language cable channel owned by a cable operator that refuses to carry Telemiami except at "exorbitant" rates. Telemiami Reply at 18.

[93]ValueVision Comments at 6-7 (citing Richard Katz, *Cable Ratings Continued to Soar in 1Q*, Multichannel News, April 1, 1996, at 16). *See also* ValueVision Reply at 18-19. *But see* International Channel Reply at 2-3 (programming services that target relatively small "niche" markets play an important role in increasing subscriber penetration).

[94]*See, e.g.*, NCTA Comments at 14; Cox Comments at 6-7; Comcast Comments at 11-12; TCI Comments at 17-19; Continental Comments at 8-12; Daniels, et al. Comments at 9-12; Time Warner Comments at 32-33; Prevue Networks Comments at 6-7; NCTA Reply at 7-9; U S West Reply at 9-10; TCI Reply at 1-7; Outdoor Life, et al. Reply at 6.

[95]Cox Comments at 6-7; Comcast Comments at 11-12. *See also* Time Warner Comments at 32 (over half of the subscribers responding to a Time Warner survey stated that they would not pay anything for leased access programming).

[96]TCI Comments at 17-19; Continental Comments at 8-12; Comcast Comments at 6; Daniels, et al. Comments at 9-12; NCTA Reply at 7-9. *See also* Time Warner Comments at 32-33 (consumers often place a negative value on leased access programming); Turner, et al. Comments at 11-12 (leased access programming will create a negative spillover effect on the tier because fewer consumers will want to subscribe to a less attractive tier).

[97]TCI Comments at 17-19; Continental Comments at 8-12; Comcast Comments at 6; Daniels, et al. Comments at 9-12; NCTA Reply at 7-9; Outdoor Life, et al. Reply at 6. *See also, e.g.*, Turner, et al. Comments at 11-12 (the "neighborhood effect" will also impact the non-leased access programmers on the tier because their license fee revenues and advertising revenues will decrease).

[98]*See* NCTA Comments at 14; Continental Comments at 8; TCI Comments at 18; Daniels, et al. Comments at 9-12; Lifetime Comments at 8; U S West Comments at 9; Turner, et al. Comments at 12-13.

39. Continental attempts to quantify this "neighborhood effect," claiming that 60% of subscribers surveyed stated that replacing existing cable networks with leased access programming would lead to decreased satisfaction with the channels offered on the system and that 30% of those surveyed threatened to discontinue service.[99] Continental asserts that the impact of a lost subscriber extends far beyond the loss in value of a single channel, since subscribers must drop the entire tier.[100] For example, Continental alleges that a 1% drop in subscribership would amount to a loss of $0.21 per subscriber per month for its typical system.[101] Similarly, TCI cites survey results showing that 80% of the responding subscribers stated that leased access programming would lower the value of their cable service and that 25% claimed that they would definitely cancel their service.[102] By contrast, as described above, ValueVision proposes using interim proxies for subscriber loss of 1% of tier revenue for the first three leased access programmers added, 2% for the next three programmers, and 3% for the next three programmers.[103]

40. Based on the record before us, we cannot conclude that operators, in general, will be able to charge the same amount for a tier once leased access programming is added, especially since most leased access programming will be new and will not have an established audience.[104] We cannot, however, predict with any certainty what the relative value of the leased access programming will be.[105] It is possible that some leased access programming will be as profitable, if not more so, than some of the operator's selected programming and that the effect on the tier

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[99]Continental Comments at 8-9.

[100]*Id.* at 10-11. *See also* TCI Reply at 4 ("even a minor reduction in existing or potential subscribership would have major financial ramifications for cable operators").

[101]Continental Comments at 11. *See also* Economic Analysis at 19-20 attached to Time Warner Comments (for Time Warner's Tampa Bay system that has an average per subscriber revenue of $32 per month -- the national average -- a 2.5% subscribership loss would result in a loss of $0.57 per month per remaining subscriber).

[102]TCI Comments at 17-18. We share the concerns of several commenters that dispute the methodology used in surveys by TCI and Continental to demonstrate the negative effects that leased access programming will have on subscribership. *See, e.g.,* Game Show Network Reply at 13-15; ValueVision Reply at 21-22; Telemiami Reply at 15-17. For example, it does not appear that the surveys were based on random samples, that the questions were phrased objectively, or that the surveys were targeted to the relevant decision-maker in each household.

[103]*See* Section II.B.2.b. Again, we decline to adopt this proposal because ValueVision's claim that this proxy would adequately compensate cable operators for any subscriber loss is based on only three anecdotal examples where one programming service was substituted for a very similar programming service.

[104]*See* Continental Comments at 14 (new programmers typically have no audience base).

[105]*See* Game Show Network Reply at 6-8 (prospective calculation of losses in subscriber revenue would be inherently speculative and retrospective calculation would be unreliable because the effect of leased access programming on subscriber revenue could not be isolated from other causes for a loss).

charge will be neutral or positive.[106] On the other hand, it is also possible that some leased access programming will be less valuable than the operator's current programming, leading either to a loss of subscribers or to a loss of subscriber revenue if the operator lowers the tier price. For instance, subscribers whose subscriptions are due in large part to the non-leased access programming service that is bumped could drop the programming tier or the entire cable service.

41. We therefore find that the assumption underlying our "double recovery" hypothesis -- that leased access programming will always be equally valuable to the operator as its non-leased access programming -- is not supported by the record. Neither the Commission nor the commenters, however, have been able to develop a reliable method for predicting what value, if any, subscribers will place on leased access programming. In cases where subscribers are willing to pay some amount above zero for leased access programming, the operator will recover an excess amount because the leased access programmer is already reasonably compensating the operator for the value of the channel. In cases where leased access programming causes a loss of subscriber revenue that exceeds the amount paid by the leased access programmer, the operator will be under compensated. Since the current record does not permit us to accurately assess the impact of leased access programming on the value of the tier, we cannot find that leased access programming will necessarily result in an excess recovery (let alone a "double" recovery) for the operator.

42. Moreover, we believe that any potential excess recovery generally will be minimal. Based on what cable operators in a competitive environment are able to charge subscribers for the addition of a new channel, our "going forward" order allows operators to charge a subscriber $0.20 a month for an additional channel.[107] We expect, however, that operators will recover less

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[106]Cox claims that operators choose not to carry leased access programming for "marketing reasons" because it is of less value to subscribers. Cox Comments at 6-7. We will not automatically assume that the programming that Congress sought to promote through leased access is necessarily of lesser value. In establishing the leased access provisions in 1984 and amending them in 1992, Congress was concerned that unaffiliated programmers would be denied access to cable systems, not for "marketing reasons," but because of the cable operator's ability to restrict the editorial content of the unaffiliated entity's programming and to thwart competition to the operator's chosen programming. Therefore, operators may be unwilling to carry quality programming for anti-competitive reasons or because of personal editorial preferences. *See* ValueVision Reply at 7-8 (despite endorsements of ValueVision's programming by local cable system general managers, ValueVision lost access to 900,000 subscribers served by cable systems affiliated with competing home shopping services); Denver Area Ed. Reply at 5-6 (even though a survey commissioned by the operator showed that subscribers preferred the leased access channel over several other channels on the system, the operator raised the leased access rate to the point where the programmer was forced off the system); Game Show Network Reply at 10-11 (due to scarce channel capacity, operators are reluctant to carry programming that has not been tested in the market even if it is of high quality).

[107]In addition, operators are also permitted to charge subscribers an average of $0.05 a month for programming costs. Because operators do not pay programming costs for leased access programming, we have no evidence demonstrating that the value of leased access programming to subscribers will reflect this additional $0.05 value. *Sixth Order on Reconsideration, Fifth Report and Order, and Seventh Notice of Proposed Rulemaking* in MM Docket Nos. 92-266, 93-215, 10 FCC Rcd 1226, 1251-1255 (1995). ESPN and Adelphia, et al. argue that leased access channels should not count against an operator's "going forward" cap. *See* ESPN Comments at 8-9; Adelphia, et al.

than $0.20 for a new leased access channel because we believe that, on average, subscribers will not be willing to pay as much for new leased access programming as they do for new programming selected by the cable operator. In selecting its own programming, a cable operator is able to take into account the particular mix of programming already on its system and the particular interests and demands of its subscribership. Thus, unlike with leased access, the operator can select programming that will maximize net subscriber revenue.

43. Additional factors are likely to further reduce any potential excess recovery. For one, the "going forward" rate is based on what operators can charge subscribers when new channels are added without displacing existing programming. Therefore, if leased access programming displaces existing programming, any amount of subscriber revenue that an operator gains from a leased access channel may be offset by subscriber revenue lost from the displaced channel. In addition, we believe that subscriber revenue from a leased access channel will be further offset by lost advertising revenues since leased access programmers, unlike other programmers, generally will not provide advertising slots to the cable operator. Subscriber revenue will also be offset by additional administrative costs imposed by leasing,[108] which are not recovered through the average implicit fee formula.[109] For all of the above reasons, we believe that any excess recovery for a leased access channel will be significantly less than the $0.20 that an operator is allowed to charge subscribers for a new channel.

44. Although we no longer believe that our "double recovery" concern was a valid reason for rejecting the highest implicit fee formula, we nonetheless believe that the average implicit fee formula is a more appropriate method for determining the maximum leased access rate. First, as discussed above, the average implicit fee is based on a more logical calculation than the highest implicit fee, because it is derived from values that can be measured -- subscriber revenue for the tier(s) and programming costs for the tier(s) -- to arrive at an average amount of subscriber revenue that programmers cede to the operator in exchange for carriage. The highest

Comments at 25 n.14. We disagree. A newly-added channel is not exempt from an operator's "going forward" quota simply because it is a leased access channel.

[108]A number of commenters argue that part-time leased access contracts impose additional administrative costs because operators must negotiate with numerous programmers, which increases transaction costs. *See* SCBA Comments at 10-11; Daniels, et al. Comments at 21; Comcast Comments at 14-15; Cox Comments at 21-22; TCI Comments at 30; Time Warner Reply at 19.

[109]In light of these offsets, we will not adopt the proposal advanced by NCTA and others to permit operators to further "mark-up" the leased access rate as compensation for lost advertising revenues and administrative costs that are not reflected in the average implicit fee. NCTA Comments at 23. *See, also* TCI Reply at 8-10; Continental Reply at 4-5; Comcast/Cox Reply at 11 (all supporting NCTA's 11.25% mark-up proposal). We find that the examples NCTA cites where the Commission has allowed mark-ups in other rate regulation contexts are distinguishable in that they relate to marking up a cost-based rate which does not already include profit for the operator. For example, NCTA cites the fact that operators are permitted to charge subscribers equipment costs plus an 11.25% mark-up. The average implicit fee formula, however, is not a strictly cost-based formula. Because it represents the average "value" of channel capacity to the operator, the average implicit fee formula inherently includes the operator's profit and a further mark-up is not justified.

implicit fee formula, by contrast, attempts to measure the implicit fee of a particular channel by using one verifiable figure (the actual programming cost) and one proxy (the average per channel subscriber revenue), since the actual amount that subscribers pay for any particular channel on a tier cannot be determined. Second, the average implicit fee mitigates our previous concern that the highest implicit fee may overcompensate operators by permitting them to charge the highest mark-up over programming costs (i.e., the highest of the implicit fees).[110] While the average implicit fee formula does not allow the operator to recover its highest mark-up over programming costs, it also does not restrict the operator to charging the lowest mark-up over programming costs. Although we stated in the *Rate Order* that using the highest market value of channel capacity is fair,[111] we believe that basing the maximum rate on the average mark-up over programming costs more appropriately balances the interests of cable operators and leased access programmers.

45. Third, we also expressed concern in the *Reconsideration Order* that an implicit fee formula is not based on the operator's reasonable costs.[112] We now believe, however, that an implicit fee formula may better reflect the value of the channel capacity, since a formula based strictly on quantifiable costs cannot account for lost subscriber revenue and therefore may not adequately compensate the operator.[113] Given that the maximum rate should not adversely affect the operation, financial condition or market development of the cable system, it is entirely appropriate to consider these non-quantifiable costs, such as any negative effects leased access programming may have on the value of the tier, in establishing the market value of a channel.

46. We will also make a few other changes to the manner in which the maximum leased access rate is calculated for tiered channels.[114] First, we will depart from the current rule requiring rate calculations to be made on a tier-by-tier basis.[115] As described below in Section II.E., we have determined that leased access programmers have the right to demand access to a tier with more than 50% subscriber penetration. We believe that subscribers generally perceive these highly penetrated tiers as a single programming package, not as separate products.

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[110] *Reconsideration Order* at para. 30.

[111] *Rate Order*, 8 FCC Rcd at 5951.

[112] *Reconsideration Order* at para. 31.

[113] *See* Section II.B.2.b. *See also* Comcast Comments at 2 (an implicit fee approach is superior to a cost-based approach because it more accurately reflects the market value of a channel); Cox Comments at 3-4 (same).

[114] In light of pending petitions for reconsideration in this proceeding, the Commission retains jurisdiction to reconsider its rules on its own motion. *See* Communications Act § 405, 47 U.S.C. § 405; 47 C.F.R. § 1.108; *Central Florida Enterprises v. FCC*, 598 F.2d 37, 48 n.51 (D.C. Cir. 1978), *cert. dismissed*, 441 U.S. 957 (1979).

[115] *Reconsideration Order* at para. 36. *See* NCTA Comments at 22 (arguing that the average implicit fee should be calculated by averaging across all channels carried on basic and expanded tiers). *But see* A&E, et al. Reply at 9-10 (averaging across tiers fails to take into account the value of tier placement).

Consistent with this view, we believe that operators should calculate the average implicit fee using all channels carried on any tier with more than 50% subscriber penetration. In addition, we note that our rate regulation rules generally are based on the principle of tier neutrality, which requires cable operators to charge the same per channel rate regardless of the programming costs incurred on a particular tier.[116] Prior to rate regulation, we believe that tier prices did not necessarily follow this tier neutrality principle. Similarly, because the Communications Act requires cable operators to transmit must-carry and PEG access channels on the basic service tier, the average programming cost on that tier will tend to be lower than it would be absent such a carriage requirement.[117] Since, as a result of regulation, individual tier prices may not be directly correlated with their underlying programming costs, we believe that it is appropriate to permit cable operators to assess these costs more accurately by averaging across highly penetrated tiers.

47. Second, we believe that the maximum rate calculation should no longer exclude channels devoted to must-carry broadcast signals or PEG access programming. In the *Reconsideration Order*, we stated that must-carry and PEG access channels should be excluded from consideration because the lack of program license fees for those channels does not represent a marketplace decision, but is the result of statutory mandates.[118] Under the highest implicit fee approach, the inclusion of channels with zero license fees, such as must- carry and PEG access channels, would virtually ensure that every cable system had a commensurately high leased access rate. Now, with the average implicit fee formula, because all of the programming costs are averaged together, it is appropriate to include must-carry and PEG access channels in calculating the maximum leased access rate.[119] Although the lack of programming costs for these channels makes it inappropriate to use them as the sole determinant of maximum rates, these channels are relevant to a calculation that is based on the value of the relevant tier(s). Since the average implicit fee is derived from the total value of the tier(s) being considered, it is appropriate to account for the effect of all of the channels on the tier(s). Moreover, as with all individual channels on a tier, it would not be possible to ascertain how much the total subscriber revenue for the tier should be reduced if must-carry and PEG access channels were excluded.

48. For the same reason we also conclude that the maximum rate calculation should no longer exclude channels devoted to affiliated programming. In the *Rate Order*, we determined that affiliated programming should not be considered in determining the highest implicit fee because to do so could affect the operator's right to charge affiliated and unaffiliated

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[116]*See Rate Order*, 8 FCC Rcd at 5746. Although the Commission is now exploring giving operators additional flexibility in pricing their tiers, all of the proposals under consideration are grounded in the principle of revenue neutrality. *See Memorandum Opinion and Order and Notice of Proposed Rulemaking* in MM Docket No. 92-266 and CS Docket No. 96-157, FCC 96-316 (released August 15, 1996).

[117]*See* Communications Act § 623(b)(7), 47 U.S.C. § 543(b)(7).

[118]*Reconsideration Order* at para. 35.

[119]*See* NCTA Comments at 21-22 (proposing that average programming costs be based on all channels carried on basic and expanded tiers); Comcast/Cox Reply at 11 (supporting NCTA's proposal).