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

MAY - 4 1998

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Fees for Ancillary or Supplementary	)	MM Docket No. 97-247
Use of Digital Television Spectrum	)	
Pursuant to Section 336(e)(1)	)	
of the Telecommunications Act of 1996	)	

**COMMENTS OF THE NATIONAL CABLE TELEVISION ASSOCIATION**

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Gregory L. Klein  
Senior Director, Economic and Policy Analysis  
Legal Department

Daniel L. Brenner  
Michael S. Schooler  
Loretta P. Polk  
1724 Massachusetts Avenue, N.W.  
Washington, D.C. 20036  
202-775-3664

Counsel for National Cable Television  
Association

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**COMMENTS OF THE NATIONAL CABLE TELEVISION ASSOCIATION**

The National Cable Television Association, Inc. (“NCTA”), by its attorneys, hereby submits its comments in the above-captioned proceeding. NCTA is the principal trade association of the cable television industry, representing owners and operators of cable systems serving over 90 percent of the nation’s cable television households. It also represents over 100 cable programming networks and others affiliated with the cable television industry.

**INTRODUCTION AND SUMMARY**

The Telecommunications Act of 1996, 47 U.S.C. §336, authorized the Commission to permit broadcast licensees to offer ancillary or supplementary services in the advanced television spectrum consistent with the public interest. In its Fifth Report and Order in the advanced television proceeding, the Commission decided to “allow broadcasters flexibility to respond to the demands of the audience by providing ancillary and supplementary services,” noting the benefit to broadcasters of developing “additional revenue streams from innovative digital services.”<sup>1</sup>

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<sup>1</sup> *Advanced Television Systems and Their Impact Upon the Existing Television Broadcast Service*, MM Docket No. 87-268, Fifth Report and Order, rel. April 21, 1997, ¶29.

Under the Act, broadcasters which offer ancillary or supplementary services and receive subscription fees or other compensation, except from commercial advertisements, are required to return a portion of that revenue to the public.<sup>2</sup> Congress directed the Commission to establish a program to assess and collect from broadcast licensees “an annual fee or other schedule or method of payment” that is designed to (1) recover for the public a portion of the value of the public spectrum resource made available for public use; (2) avoid unjust enrichment of broadcast licensees by their use of the spectrum for ancillary or supplementary services for which they collect fees or certain other compensation; and (3) recover for the public an amount that, to the extent feasible, equals but does not exceed the amount that would have been recovered had such services been licensed by the Commission through a competitive bidding process. 47 U.S.C. §336(e).

In the Notice, the Commission proposes several general approaches to assessing fees for ancillary and supplementary broadcast services. As the Commission recognizes, each of these approaches has its own pros and cons in seeking to meet the statutory objectives. Some approaches, however, do a better job than others in balancing those objectives. For a variety of reasons, an approach based on gross revenues is most likely to yield fees that accurately reflect the value of spectrum used to provide feeable services. Such an approach would rely on data that is readily available and would be easy to calculate and enforce.

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<sup>2</sup> The Act also provides that the use of ATV spectrum for ancillary and supplementary purposes be consistent with and not derogate ATV technology that may be adopted by the Commission. And it provides that such services may be subject to Commission regulations as are applicable to analogous services (except mandatory carriage rights). 47 U.S.C. §336(a); *see also* H.R. Conf. Rep. No. 458, 104th Cong., 2nd Sess. 160 (1996).

If the Commission adopts a gross revenues approach, however, it is critical that the Commission set the *percentage* of gross revenues at a level that is sufficient to prevent unjust enrichment and unfair subsidization of broadcasters. In particular, the Commission has a strong public policy interest in ensuring that its spectrum fee approach does not subsidize and artificially encourage the use of digital spectrum for ancillary and supplementary services.

First, subsidizing the provision of ancillary and supplementary digital broadband services by broadcasters will have the effect of *discouraging* the deployment of a digital broadband infrastructure by cable operators and others who have not been the beneficiaries of free or subsidized transmission facilities. Second, it would be unfair and contrary to the public interest to require consumers to incur the substantial costs of replacing or upgrading their television sets in order to receive digital television while at the same time encouraging broadcasters to use their spectrum to provide ancillary and supplementary services instead of high definition and advertiser-supported television service.

## **DISCUSSION**

### **I. THE FEE PROGRAM SHOULD NOT DISADVANTAGE OTHER PROVIDERS OF COMPETITIVE DIGITAL SERVICES.**

The Commission sees a “wealth of possibilities” in terms of the kinds and numbers of enhanced services that could be provided to the public in the advanced television spectrum. It believes “that giving broadcasters flexibility to offer whatever ancillary and supplementary services they choose may help them attract consumers to the service, which will, in turn, hasten the transition” and “encourage entrepreneurship and innovation.”<sup>3</sup>

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<sup>3</sup> *Fifth Report and Order*, ¶33.

Under this policy, broadcast stations now will have the opportunity to use the public airwaves to generate revenues from video and non-video subscription services in competition with other industries. Indeed, the Commission envisions a broad array of ancillary and supplementary services including, but not limited to, subscription television programming, computer software distribution, data transmissions, teletext, interactive services, audio signals, and any other services that do not interfere with the required free service.<sup>4</sup> These emerging services, which will also be provided over the cable, telephone, and wireless platforms of the future, will only thrive under a government policy that promotes competitive market forces. A fee system that would enable broadcasters to compete on a subsidized basis with these alternative providers would defeat, rather than promote, market forces.

As the Commission recognizes, “DTV licensees could be placed at an unfair advantage if they paid no fee when using their DTV capacity to provide certain ancillary or supplementary service, given that nonbroadcast licensees providing analogous services may have acquired their spectrum through an auction process.”<sup>5</sup> The Commission is concerned that a fee set too high could be a disincentive to the provision of feeable ancillary services, but it also recognizes that a fee set too low could result in unjust enrichment of DTV licensees and the recovery of a lesser amount than would have been recovered at auction in derogation of the statute.

Congress imposed the fee requirement because it recognized that if broadcasters are to be permitted to offer subscription services in government-granted free spectrum, they should be

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<sup>4</sup> *Id.*, ¶30. The Commission generally defined ancillary and supplementary services as “any service provided on the digital channel other than free, over-the-air services,” whether or not broadcast-related. *Id.*

<sup>5</sup> Notice, ¶7.

treated like companies which pay fair market value in providing comparable services. Cable operators, for example, pay local governments up to five percent of their gross revenues in franchise fees for the use of public rights of way and incur fair market costs for the facilities needed to offer competitive video and non-video services. Cable companies are expending billions of dollars each year to upgrade their networks to offer new advanced services, including ancillary and supplementary data and Internet-related services. Given the rapidly evolving nature of these digital services, a thumb on the scale in favor of broadcast licensees in this proceeding would distort the market for these new services and would discourage innovation and investment in new broadband infrastructure. Nonbroadcast competitive providers (including not only cable operators but also telephone companies and wireless providers) would simply have little incentive to fully develop competing services because of the benefits conferred on their broadcast competitors by the government.

As we now show, the fee approach that is most likely to avoid artificially subsidizing broadcasters' provision of ancillary and supplementary services is also the approach that is most readily calculated and most easily enforceable. That approach, which is based on a variable that is directly linked to the value of spectrum used for feeable services, is a gross revenues fee.

## **II. A FEE BASED ON GROSS REVENUES BEST FULFILLS THE STATUTORY CRITERIA AND ACHIEVES THE COMMISSION'S GOALS**

As the Notice makes clear, there is no perfect methodology for calculating fees that accurately measure the fair market value of that portion of the spectrum that has been awarded to broadcasters and is used for the provision of ancillary and supplementary services. Each of the approaches described by the Commission is, to varying degrees, an inaccurate measure of the value of the spectrum, and each, to varying degrees, relies on data that would be difficult to

obtain or verify. Nevertheless, some strike a better balance of accuracy and practicality than others.

The Commission, in the Notice, indicates that an approach that bases fees on gross revenues is likely to strike the best balance -- and we agree.

The statute directs that fees should be designed to recover an amount that “to the extent feasible, equals but does not exceed (over the term of the license) the amount that would have been recovered had such services been licensed pursuant to the provisions of section 309(j)” -- *i.e.*, pursuant to *auctions*. But there are serious drawbacks to using the amounts that have been recovered in past spectrum auctions as a measure of the value of the DTV spectrum used by broadcasters for ancillary and supplementary services. As the Commission correctly notes, “spectrum auctions that have been held to date, such as those conducted for licenses to provide personal communications services, took place in circumstances so different from those in which a fee is to be assessed for the ancillary or supplementary use of DTV capacity that they are not necessarily applicable.”<sup>6</sup>

One problem is that the prices paid in previous spectrum auctions have varied widely based on differences in geographic markets, technical characteristics of the particular spectrum band, and differences in Commission-imposed conditions on the manner of payment and the use of the awarded spectrum. It is difficult to imagine the multivariate analysis that would enable the Commission to determine from these auctions the appropriate amounts that broadcasters should

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<sup>6</sup> Notice, ¶15.

pay when they use DTV spectrum for whatever ancillary and supplementary services they may choose to offer.

An equally vexing problem is that broadcasters, unlike bidders in previous auctions, are not acquiring a fixed amount of spectrum for “feeable” use. They have been awarded a fixed amount of spectrum, but the amounts used for feeable and non-feeable services may be in constant flux -- even, as the Commission points out, from “hour-to-hour.”<sup>7</sup> To attempt to measure the value of such varying use in terms of the amounts paid for spectrum in previous auctions would be futile. Yet to impose fees that are unrelated to the extent to which a broadcaster uses its spectrum for ancillary and supplementary services would be at odds with the Act, which requires that fees be paid only for the provision of such services.

Imposing fees on the basis of *revenues* attributable to feeable services is an imperfect but decidedly more sensible approach. Revenues are an indicator of the extent to which spectrum is *used* by broadcasters for ancillary and supplementary purposes. More importantly, the Commission explains that revenues can also be a measure of the *value* of the spectrum that is used for such purposes: “The relationship between the value of the DTV capacity used in the provision of feeable ancillary or supplementary services and the revenue produced from the provision of those services can be demonstrated using microeconomic theory.”<sup>8</sup>

Moreover, revenues -- at least, gross revenues -- are readily *measurable*. Other revenue measures based only in part on gross revenues, such as net revenues or incremental profits, would be more difficult to calculate. More to the point, as the Commission points out, they

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<sup>7</sup> *Id.*

<sup>8</sup> *Id.*, ¶17.

would be considerably more difficult to audit and enforce. This is because net revenues and incremental profits are based not only on gross revenues but also on *costs* attributable to particular services.

With respect to net revenues, calculating these costs would require the allocation of a portion of joint and common costs among feeable services and between feeable and non-feeable services. An incremental profits approach would avoid such cost allocation problems, because such profits are measured as the difference between the incremental gross revenues attributable to specific services and the incremental costs attributable to such services. Joint and common costs “would be omitted in the calculation of profit.”<sup>9</sup> But it would still be necessary for broadcasters to calculate and for the Commission to audit the calculation of service-specific incremental costs and service-specific profits -- tasks that the Commission suggests might even require the development of new cost accounting rules, since these calculations would not ordinarily be conducted and maintained by broadcasters.

Wholly apart from the practical problems of recordkeeping and enforcement, an approach based on gross revenues would more fairly link fees to usage of the spectrum for ancillary and supplementary services -- and to the *value* of the spectrum for such usage -- than an approach based on net revenues or profits. The Commission points out that a net revenue or incremental profit approach would have “the additional effect of allowing broadcasters to build their feeable ancillary or supplementary services to the break-even point without the assessment of a fee, fostering the development of these new services.”<sup>10</sup> But no other providers of competing

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<sup>9</sup> *Id.*, ¶22.

<sup>10</sup> *Id.*, ¶21.

services have the luxury of free use of spectrum or other inputs of production until they can make their services profitable. To make spectrum available on such a basis would effectively subsidize broadcasters in their provision of competitive services and would result in precisely the “unjust enrichment” that the statute directs the Commission to avoid.

Moreover, any approach that subsidized and artificially fostered the development of ancillary or supplementary services would have the corollary effect of discouraging the use of DTV spectrum for non-feeable, advertiser-supported services. In particular, it would discourage the use of the entire 6 MHz spectrum for the provision of high-definition television or for the provision of multiple channels of advertiser-supported television. It would be particularly inappropriate to impose on consumers the substantial costs of switching to digital television while establishing a fee approach that purposely favors the use of digital spectrum for supplementary and ancillary services rather than for enhanced advertiser-supported television service.

Finally, the federal government has years of experience with assessing fees based on gross revenues. It often imposes a percentage of gross revenue fee in authorizing use of public goods, such as scarce natural resources. The Bureau of Land Management’s Minerals Management Service, for example, collects billions of dollars annually from companies for gas and oil drilling. The government is paid one eighth (or 12.5 percent) of all revenues derived from on-shore drilling of gas and oil and this increases to as much as 16.67 percent of revenues for off-shore drilling.<sup>11</sup>

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<sup>11</sup> See 30 U.S.C. §226.

It is noteworthy, as well, that cable operators have paid franchise fees of five percent of their gross revenues from the very early days of cable television service. This fee only covers access to rights of way. In addition, of course, operators are required to incur the costs of their distribution plant and facilities -- costs that are comprise a significant additional percentage of gross revenues. The spectrum granted to broadcasters is, in large part, *their* distribution plant.

For all these reasons, a fee based on gross revenues appears to be the best approach. It relies on a variable that can be demonstrably linked to the value of DTV capacity used for feeable services. That variable will be readily available from broadcasters' accounts; it will require little if any additional computation and will not be difficult to audit. Finally, an approach based on gross revenues, unlike a net revenues or incremental profits approach, will not artificially subsidize or encourage the development of ancillary and supplementary services instead of high-definition or additional advertiser-supported television services -- provided, of course, that the percentage of revenues that is assessed is reasonably related to the value of the spectrum.

**III. THE PERCENTAGE RATE OF THE GROSS REVENUES FEE SHOULD ENSURE THAT A MINIMUM PAYBACK IS OBTAINED BY TAXPAYERS AND THAT BROADCASTERS ARE NOT GIVEN AN UNFAIR COMPETITIVE ADVANTAGE.**

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As the Commission recognizes "the percentage rate of the fee must reflect the statutory requirements that the fee recover a portion of the value of the spectrum used for these services, avoid unjust enrichment, and approximate the revenue that would have been achieved had these services been licensed through an auction."<sup>12</sup> The Commission suggests, in this regard, that a fee

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<sup>12</sup> Notice, ¶27.

that is based on gross revenues should “be set at a lower percentage rate than a fee based upon net revenues or incremental profits.” It is not obvious, however, that the percentage rate for a gross revenues fee should be *substantially* lower than the rate for a net revenues or incremental profits fee. Indeed, there are several reasons why it is fair and reasonable to expect broadcasters who use their spectrum to provide ancillary and supplementary services to pay a fee that represents a significant portion of their gross revenues.

First, because broadcasters are already required to use portion of their spectrum (subject to no fee) for the provision of at least one channel of advertiser-supported television, the incremental or marginal cost of providing any ancillary and supplementary revenue-generating services will be negligible. The most substantial costs incurred by broadcasters, such as transmitters and towers, will be "sunk" or fixed costs that are already incurred in connection with the provision of non-feeable services, and little more will be required to provide feeable services.<sup>13</sup> The truly largest cost, the value of the spectrum, is being borne by the public and, in any event, is unaffected by its particular use.

Therefore, almost all the revenue generated by ancillary and supplementary services would correctly be viewed as "profit" in both the economic and accounting sense. In other words, in these unique circumstances, gross revenues are not significantly greater than net revenues or incremental profits. And just as it would be reasonable to ask broadcasters to apply a significant portion of their profits from feeable services to the reimbursement of taxpayers for

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<sup>13</sup> Apart from the fact that the broadcasters will be able to use free spectrum to offer ancillary and supplementary feeable services in competition with other video and non-video providers, they enjoy a major advantage over their competitors as they venture into this area: lower risk. Under the digital television scheme, the broadcast licensee always has the flexibility to go back to using the spectrum for proven advertiser-supported non-feeable services.

the use of valuable spectrum to provide such services, it is reasonable in these circumstances to require payment of a comparably significant portion of their gross revenues.

Second, because the spectrum is currently "free" to the broadcasters and will remain free to the extent that it is used for advertiser-supported services, broadcasters may have the ability and incentive to subsidize their feeable services with revenues from non-feeable services and to price ancillary and supplementary services well below the true, full cost (even including spectrum fees) of providing them. Such pricing behavior would thwart and discourage the competitive provision of comparable services by others who receive no facilities or subsidies from the government. A significant fee on gross revenues -- up to a certain cap or threshold, as suggested below -- would result in more appropriate pricing behavior. Such an approach would encourage the "right" price for the first units of output, in anticipation of crossing the threshold into a competitive environment.

Finally, we believe that the percentage of gross revenues assessed for feeable uses of the spectrum should be significant because the value of that spectrum is substantial. As discussed previously, prior spectrum auctions may not provide a precise measure of the amount that would be paid at auction for the spectrum that has been given to the broadcasters -- and, indeed, are likely to understate the value of that spectrum. Nevertheless, they indicate the order of magnitude of that value.

Thus, in Los Angeles, where spectrum for mobile applications is very valuable, the two cellular licenses sold for an average of \$26 per pop for 30 MHz, or roughly \$5.20 per pop for 6

MHz.<sup>14</sup> KNBC, Channel 4 in Los Angeles, has been allocated channel 16 for HDTV with the ability to reach some 13.8 million people. Therefore, by this measure, the new channel is worth approximately \$71 million (\$5.20 per pop, multiplied by 13.8 million people). Even at the government's current cost of funds, let alone the higher rates a commercial enterprise would have to pay, an asset worth \$71 million would produce approximately \$4.6 million a year in interest alone.

The cellular licenses in New York went for a more modest \$17 per pop, but reach more people. WNBC, Channel 4 in New York, has been assigned HDTV channel 28 reaching an estimated 18.1 million people. Using the same calculus, 6 MHz is worth somewhere in the neighborhood of \$61.5 million, which would generate approximately \$4 million per year in interest. Chicago's Channel 5 (HDTV channel 29) has been granted spectrum worth \$50 million, which would generate \$3.25 million per year in interest.

It would be wholly reasonable to assess a percentage fee on gross revenues (which, in this case, consist largely of profits) that is sufficient to reimburse taxpayers for the substantial value of the spectrum, to the extent that the spectrum is used for feeable purposes. The fee could be capped so that broadcasters who derive substantial revenues from feeable services do not pay more than the annual value of using the spectrum. But it should not be set so low as to result in across-the-board subsidization of the provision of ancillary and supplementary services. Such a

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<sup>14</sup> These calculations are quite conservative and meant to be illustrative rather than determinative. The auction for cellular licenses, the so-called A- and B-blocks, was conducted several years ago. Since then, the C-block auctions for PCS licenses produced valuations much larger; e.g., Los Angeles \$45.00 per pop and New York \$55.00. While there is some evidence the C-block bids may have been inflated due to government-supplied financing, the current true values are undoubtedly more than the A and B auction results].

result would impair competition, and it would give broadcasters inappropriate incentives to provide ancillary and supplementary services instead of high definition and advertiser-supported television.

**IV. THE FEE PROGRAM SHOULD ENSURE THAT BROADCAST LICENSEES CAN NOT AVOID PAYING FEES THROUGH THE SIMULTANEOUS TRANSMISSION OF FEEABLE AND NON-FEEABLE SERVICES.**

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The Commission concludes that, consistent with the Act and its legislative history, “a fee must be assessed on any ancillary or supplementary services that are not supported entirely by commercial advertisements.”<sup>15</sup> Thus, any ancillary or supplementary service which is supported by some combination of subscription fees and advertisements is not exempt from the fee requirement. The Commission seeks comment, however, on the fact that feeable ancillary or supplementary services may be offered simultaneously with other services, including HDTV, SDTV, or other video programming supported entirely by commercial advertisements, or other non-feeable ancillary or supplementary services. It asserts that “the mere fact that a feeable ancillary or supplementary service is being transmitted does not mean that all simultaneously transmitted ancillary or supplementary services are feeable.”<sup>16</sup>

Given the emerging data applications of digital technology and the capacity to manipulate data bit streams into a broad array of real-time, simultaneously-delivered services, there is a need for specific rules which clearly delineate the portions of the spectrum attributable to feeable

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<sup>15</sup> Notice at ¶8. See H.R. Conf. Rep. No. 458, 104th Cong., 2nd Sess. 160 (1996) (“the Commission must establish a fee program for any ancillary or supplementary services if subscription fees or any other compensation apart from commercial advertisements are required in order to receive such services.”)

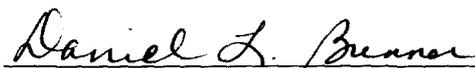
<sup>16</sup> Notice at ¶8.

services. The Commission's rules should set forth, therefore, that broadcast licensees may not circumvent the fee requirement, or otherwise obscure feeable services in the data stream of non-feeable services, through the simultaneous transmission of feeable and non-feeable services in the digital spectrum. Such rules are important to the overall fee program because no fees are to be assessed for spectrum used to offer advertiser-supported services.

### CONCLUSION

The Commission should, for the foregoing reasons, seek to ensure that its spectrum fee approach does not subsidize the provision by broadcasters of ancillary and supplementary services in a manner that allows them to compete unfairly with other providers of such services. The Commission should also avoid any approach that artificially encourages broadcasters to use their spectrum to provide ancillary and supplementary services instead of high definition and advertiser-supported television services. A fee that is based on a percentage of gross revenues -- where the percentage is sufficient to reflect the substantial value of the spectrum -- may be the best approach for achieving these objectives.

Respectfully submitted,



Daniel L. Brenner  
Michael S. Schooler  
Loretta P. Polk

1724 Massachusetts Avenue, N.W.  
Washington, D.C. 20036  
202-775-3664

Counsel for National Cable Television  
Association

Gregory L. Klein  
Senior Director, Economic and Policy Analysis  
Legal Department

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