

ABC, Inc.

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Vice President  
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May 4, 1998

Hand Deliver

Ms. Magalie Roman Salas  
Secretary  
Federal Communications Commission  
1919 M Street, N.W., Room 222  
Washington, DC 20554

Dear Ms. Salas:

On behalf of ABC, Inc., transmitted herewith for filing with the Commission are an original and six copies of its Comments in MM Docket No. 97-247.

If there are any questions in connection with the foregoing, please contact the undersigned.

Sincerely,

Sam Antar

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Enclosures

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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

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 ABC, Inc.

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May 4, 1998

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## Summary

The Commission requests comment on which of the fee options for ancillary services would best promote the statutory objectives of encouraging the entry of new services while recovering for the public an appropriate portion of the value of the spectrum.

Establishing the appropriate fee structure for ancillary services involves a series of difficult trade-offs. While there appears to be little doubt that a “net revenue” approach would introduce the least economic distortion and hence maximize consumer welfare, this approach raises thorny questions about how to develop accounting rules that would fairly state a broadcaster’s true net revenue.

We believe that the Commission need not and should not now choose between the net revenue and gross revenue options, but rather should permit broadcasters initially to select either approach. This will lead to the greatest innovation and the introduction of greatest number of new services.

In lieu of detailed FCC-promulgated accounting rules, we propose that broadcasters who opt for the net revenue approach be required to (a) devise a methodology using the Commission’s net revenue definition which fairly states net revenues (by capturing gross revenues, costs unique to the business, and the costs shared with other businesses) and (b) file a report with the Commission detailing that methodology accompanied by an audit report by an independent accounting firm which confirms that net revenue has been calculated in accordance with that methodology. This approach would shift the burden of formulating the detailed rules for stating net revenue appropriate to the business from the Commission staff to the broadcaster who volunteers to undertake it.

If the Commission's experience in administering the program in the early years points to a need for change, change can be made. In the interim, given the start-up nature of the businesses involved, there is very little risk that any broadcaster would be unfairly advantaged by the flexibility we propose.

The Commission should set the initial fee at a very low percentage rate under either a gross revenue or net revenue formula. A low rate would most faithfully implement the statutory directive that the fee program approximate the fees that would have been recovered at auction. Appendix A, an econometric analysis of past auction results by Dr. Jerry Hausman, demonstrates that prices for spectrum auctions have been decreasing over time regardless of the use for which spectrum has been auctioned, and that this trend is likely to continue. Auction prices for WCS and LMDS spectrum, which share with ancillary services a high degree of technological and business uncertainty, are dramatically lower than prices for PCS spectrum. An additional and overarching factor that will drive down future auction prices is the supply of spectrum to be auctioned.

Dr. Hausman states that the goal of increased consumer welfare would be best served by a very low initial rate because successful new services can lead to billions of dollars in consumer value and because the risk of non-entry is significant given the fact that ancillary services are untested in the marketplace. The Commission can revisit the rates in the future and increase them if ancillary services turn out to be successful and the fee set too low. We would propose that the initial fee be set at no higher than 1% under a gross revenue formula or in the 2-3% range under a net revenue formula.

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In the Matter of )  
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Use of Digital Television Spectrum )  
Pursuant to Section 336(e)(1) )  
of the Telecommunications Act of 1996 )

To: The Commission

Comments of ABC, Inc.

I. Introduction

In its Notice of Proposed Rule Making in this proceeding (“Notice”), the Commission requests comment on various proposals for fee assessment programs for ancillary and supplementary services for which fees are required to be assessed pursuant to the Telecommunications Act of 1996 (“1996 Act”). The Commission is required by the terms of the 1996 Act to design a fee program “to avoid unjust enrichment” of broadcast licensees and recover for the public 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” in an auction.

The Commission properly recognizes that Congress intended that “broadcasters be allowed the flexibility to provide such services” and that a fee program that sets the fee too high would dissuade broadcasters from providing ancillary services.<sup>1</sup> The Notice discusses a variety of fee

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<sup>1</sup> Notice, at ¶9.

options and requests comment on which of the options would best promote the entry of new services while recovering for the public an appropriate portion of the value of the spectrum.

In our comments below, we explain in Section II why we agree with the Commission's conclusion to use a revenue proxy for auction value. In Section III, we review the various alternatives described in the Notice and develop the reasons we believe the net revenue approach is the preferable choice. In Section IV, we argue that during the early years when ancillary services will effectively be high risk, start-up businesses the Commission should permit broadcasters to elect to pay the fee on either a net revenue or a gross revenue basis. We offer our views as to why this approach will not impose undue administrative burdens on Commission staff and will enable the Commission to better fulfill its statutory obligations. In Section V, we offer our views on the appropriate percentage rate of fee the Commission should adopt. Appendix A to this pleading is a statement by Dr. Jerry A. Hausman, MacDonald Professor of Economics at the Massachusetts Institute of Technology ("Hausman"), which presents his econometric analysis of past auction results and his analysis of the economic implications of the various fee system alternatives.<sup>2</sup> Dr. Hausman's statement will be referred to as appropriate in these comments in support of the positions taken.

## II. The Commission Should Use a Revenue Proxy for Auction Value

We agree with the Commission that a fee tied to an auction model estimate "would involve innumerable unknown variables and would be difficult if not impossible to assess." As

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<sup>2</sup> The study by Dr. Hausman was commissioned jointly by ABC, Inc., the National Association of Broadcasters, CBS Inc. and National Broadcasting Company, Inc. for use in connection with this proceeding.

the Commission points out, the amount of capacity used for a feeable service may vary over time and the relative market demand for various services may be subject to similar fluctuations.<sup>3</sup> Even more to the point, no prior auction offers an appropriate model for the value of spectrum to be used for ancillary services.

The 1996 Act contemplated that the FCC would adopt rules designed to afford broadcasters flexibility to develop ancillary services. Pursuant to that mandate, the FCC has adopted a definition of ancillary services that encompasses a broad and diverse range of possible services.<sup>4</sup> As a very consequence of this statutory and regulatory framework, it is not possible to draw any useful analogy to other uses for which spectrum has previously been auctioned.

In earlier auctions, such as PCS, bidders had a great deal of information both about the costs of the business and consumer demand. The same cannot be said about ancillary services.<sup>5</sup> Ancillary services will be entirely new businesses subject to far greater uncertainty and risk. Broadcasters are currently preoccupied with the daunting difficulties and costs of meeting the Commission's ambitious digital build-out deadlines. Most have not begun to develop business models for ancillary services, much less to project their costs. Consumer demand for ancillary services is completely unpredictable at this time for a number of reasons. First, no one knows how quickly consumers will purchase the digital equipment necessary to receive such services.

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<sup>3</sup> Notice, at ¶15.

<sup>4</sup> "Ancillary and supplementary services could include, but are 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." Fifth Report and Order in MM Docket No. 87-268, 12 FCC Rcd. 12806 (1997), at ¶29.

<sup>5</sup> Hausman, at ¶16.

Second, there is no assurance that cable companies, through which broadcasters gain access to two-thirds of television households, will agree to retransmit broadcasters' ancillary services.<sup>6</sup> Finally, there is no reliable way to predict the appeal of such services to consumers who will be able to access them or how much those consumers would be willing to pay for which services.

For all the foregoing reasons, we agree with the Commission that there is no appropriate auction model and that a revenue proxy for auction value is the only viable approach. Moreover, to the extent that an auction model would call for upfront fees, Dr. Hausman points out that such an approach "has extremely poor risk sharing characteristics and would likely lead to diminished entry of new ancillary services and decreased consumer welfare."<sup>7</sup> A far better approach is one that measures consumer welfare by reference to revenue generated by the new businesses.<sup>8</sup>

### III. Net Revenue Is The Preferable Approach Because It Will Promote Entry Into New Ancillary Businesses and Thus Enhance Consumer Welfare

As pointed out by Dr. Hausman, "large amounts of consumer benefits ... originate with new telecommunications services."<sup>9</sup> Given that it has itself recognized the need to take consumer welfare into account in setting the fee and the desirability of encouraging the deployment of new services to stimulate consumer interest in digital television, the Commission "should be especially careful in creating a distortion that could limit the introduction of new ancillary services by DTV

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<sup>6</sup> The 1996 Act provides that the Commission's regulations may not provide for "must carry" of ancillary and supplementary services. 47 U.S.C. §336 (b)(3).

<sup>7</sup> Hausman, at ¶6.

<sup>8</sup> Id.

<sup>9</sup> Hausman, at ¶15.

providers.”<sup>10</sup>

As we have pointed out above, the business of offering ancillary and supplementary services will be characterized by a high degree of risk, significant costs and uncertain rewards. That being the case, we believe that, at least during the initial phase of its fee program, the Commission should favor a fee system which would most likely avoid economic distortions and hence encourage entry. This will enable consumers to have the benefit of the greatest number and choice of new services.

A net revenue approach is best designed to promote entry when compared with the alternatives considered in the Notice.<sup>11</sup> Since it applies to profits, a net revenue approach “has favorable risk sharing properties”<sup>12</sup> and hence will cause the least amount of economic distortion. The Commission recognizes that the gross revenue approach is less desirable from this perspective because it ignores variations in the cost of providing different ancillary services and hence could deter entry. For starters, services which have relatively high unit costs would be less likely to be launched under a gross revenue system. Services which fit this category would likely include those which are high cost because they are high quality, such as services which contain a high percentage of original content. But the potential for deterrence to entry is far broader and will result in distorting not only the choice of ancillary services but also the quantity of such services that will be offered.<sup>13</sup> A fee payable from the first dollar of revenue would add to the

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<sup>10</sup> Id.

<sup>11</sup> Hausman, at ¶22.

<sup>12</sup> Hausman, at ¶21.

<sup>13</sup> Hausman, at ¶20.

losses a broadcaster would have to sustain before an ancillary service approached the break-even point. The additional cost of the fee is likely to swing some broadcaster decisions against entry even where the unit cost is not relatively high. We believe that a fee system that discourages the introduction of such services would defeat the objectives of stimulating the growth of DTV and maximizing consumer welfare.<sup>14</sup>

For this same reason, we would urge the Commission not to adopt a flat fee as a component of the fee system. The Commission recognizes in its discussion of this concept that because it adds to up-front costs a flat fee would serve as a disincentive to the offering of ancillary services.<sup>15</sup> Indeed as Dr. Hausman points out “the upfront fee only solution has poor risk sharing characteristics since all of the risk is borne by the licensee, which is likely to deter entry in a situation of high uncertainty and significant sunk costs as arises with ancillary services.”<sup>16</sup>

#### IV. Broadcasters Should Be Given the Option of Electing To Calculate the Fee on a Net Revenue or Gross Revenue Basis

Establishing the appropriate fee structure for ancillary services plainly involves a series of difficult trade-offs. On the one hand, there appears to be little doubt that a “net revenue” approach would introduce the least economic distortion and hence best accomplish the

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<sup>14</sup> A fee system based on “incremental profits,” which the Commission discusses as yet another alternative approach in paragraph 22 of the Notice, has similar shortcomings to the gross revenue approach because the failure to include joint and common costs in the cost basis for net revenues could lead to similar serious economic distortions. See Hausman, at ¶21.

<sup>15</sup> Notice, at ¶25.

<sup>16</sup> Hausman, at ¶18.

Commission's goal of implementing the statute in a way that maximizes consumer welfare. But the net revenue approach raises thorny questions about how to develop accounting rules that would fairly state a broadcaster's true net revenue and the Commission has expressed concern that the development and oversight of those rules would impose undue administrative burdens on the Commission staff. The gross revenue approach, on the other hand, avoids those administrative burdens, and while clearly preferable to any of the remaining alternatives, does create economic distortions that could deter entry, at least with respect to some businesses. Compounding the difficulty of selecting between these options is the fact that no one today can predict what ancillary services might evolve or what the underlying economics of those businesses might be.

For the reasons that follow, we believe that the Commission need not and should not now choose between the net revenue/gross revenue options, but rather should permit broadcasters to select either approach at least during the early years of the roll-out of the ancillary revenue businesses. By permitting a broadcaster to select the fee structure that most encourages entry, the Commission will have adopted the approach that will lead to the greatest innovation and the introduction of greatest number of new services and hence the greater consumer welfare. We believe that this approach can be adopted, at least on a provisional basis, without imposing any significant administrative burdens on the Commission or unfairly benefitting any broadcaster.

During the next several years, the Commission (and broadcasters) will gain valuable experience enabling more informed decisions about which of the fee structures best fulfills the statutory mandate and what adjustments to those structures, if any, need to be made. Rushing to judgment now on an appropriate fee structure will deprive the Commission and the broadcasting industry of the opportunity to gain from that experience. Because all ancillary

services will effectively be in start-up phases for some significant period of time, there is little risk that any broadcaster would be able to unfairly benefit from the flexibility we propose. Indeed by promoting entry the Commission would be best assured the maximization of consumer welfare. In any event, the Commission could revisit its decision at any point that it believed that the appropriate balance was no longer being struck.

Against the background of this perspective, we offer the following proposals:

1. Broadcasters should have the option of paying a fee based on net revenues, or, alternatively, to pay a fee based on gross revenues.
2. The Commission should impose a certification requirement with respect to “net revenue” calculations that would oblige the broadcaster, at its own expense, to develop and submit to the Commission a report reflecting the methodology used to state net revenues, accompanied by an audit report by an independent accounting firm that net revenue has been calculated in accordance with those rules. To guide the certification process, the Commission would issue general parameters for the net revenue concept.
3. The Commission should reevaluate the approach thus established after an initial start-up period and make any adjustments that may be called for based on real-world experience.

The heart of the problem with the use of a net revenue approach appears to be a concern that any such approach would embroil the staff in the promulgation and enforcement of complex cost accounting rules and that the imposition of that burden cannot be justified in these circumstances. We believe, however, that no such accounting rules need to be developed by the

Commission. Broadcasters are not in the posture of a public utility which must justify charges to consumers through rigid adherence to highly detailed accounting rules that must necessarily be prescribed by an independent governmental agency. The problem here is quite different: how to fairly capture the value of the use of spectrum for subscription start-up businesses without deterring the introduction of such businesses. Unlike the case of public utilities, there is, today, insufficient experience to craft detailed rules and any effort to do so could have the perverse effect of deterring entry and thus injuring rather than protecting the consumer. Moreover, given that we are dealing here with the start-up phase of a new category of businesses rather than the regulation of a mature industry, there is the opportunity, as well as the need, for greater flexibility.

In lieu of detailed FCC-promulgated accounting rules, we propose that broadcasters who opt for the net revenue approach be required to (a) devise a methodology, appropriate to the particular business involved, which, using the Commission's net revenue definition (discussed below), fairly states net revenues (by capturing gross revenues, costs unique to the business, and the costs shared with other businesses) and (b) file a report with the Commission detailing that methodology accompanied by an audit report by an independent accounting firm which confirms that net revenue has been calculated in accordance with that methodology. This approach would shift the burden of formulating the detailed rules for stating net revenue appropriate to the business from the Commission staff to the broadcaster who volunteers to undertake it. Broadcasters who wish to pay according to a gross revenue formula (and thereby avoid this burden) would be free to do so. While it may still be the case that the Commission will wish to undertake spot audits, the need for such audits, and the consequent burden on the staff, should

be small given the licensee's duty of candor to the Commission which is enforceable through forfeiture or license revocation.

As mentioned, the starting point for the broadcaster report and the independent accounting firm audit would be a Commission generated definition of "net revenue." We believe that the definition included in the Notice provides a good starting point subject to the further refinements proposed herein.<sup>17</sup> We would propose that net revenues be defined as revenues from the feeable service less service-specific incremental costs and that portion of joint and common costs fairly attributable to the feeable service. Service-specific incremental costs should be defined, as suggested in the Notice, as "the costs of all directly-attributable inputs of production, such as labor and equipment, and the economic depreciation and rate of return on any specific capital assets that are used exclusively in the production of a given feeable ancillary or supplementary service."<sup>18</sup> Given the wide range of possible ancillary businesses and the experimental nature of those businesses, we believe that a more precise definition is neither practical nor desirable.<sup>19</sup>

The final element of our proposal -- Commission review of the net option approach after an initial start-up -- addresses any possible concern that a net revenue formula may not recover

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<sup>17</sup> Notice, at ¶21.

<sup>18</sup> Notice, at ¶22. This definition appears in the Commission's discussion of the incremental profits approach. While that approach would exclude joint and common costs, and the net revenue approach would take them into account, the definition of incremental costs should be transparent under either approach.

<sup>19</sup> Experience gained by reviewing the various methodologies devised by broadcasters may enable the Commission to offer more detailed guidance in the future should that become desirable.

for the public the appropriate portion of the value of the spectrum.<sup>20</sup> If the Commission's experience in administering the program in the early years points to a need for change -- either by discontinuing the net revenue option, providing more precise rules or by adjusting the rate -- change can be made. In the interim, given the start-up nature of the businesses involved, there is very little risk that any broadcaster would be unfairly advantaged by the flexibility we propose.

In sum, we believe that the net revenue option formula is best suited to encourage experimentation by broadcasters with ancillary services and to foster ease of entry and optimization of consumer choice. At a time when so little is known about the economics of ancillary services and the risks associated with offering such services are so high given the newness of the technology and the total lack of broadcaster experience in providing such services, we believe the Commission should err on the side of encouraging entry at the possible sacrifice of marginal increases in tax revenue.<sup>21</sup>

We believe that by seizing the opportunity for flexibility the Commission can avoid the administrative burdens that might otherwise foreclose the more desirable "net revenue" option. The approach we propose is admittedly "looser" than one based on the promulgation of detailed cost accounting rules, but we believe that there is little risk, and much to be gained, to the public in pursuing this approach.

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<sup>20</sup> An appropriate time to reevaluate the program would be at the four-year mark to enable the Commission to meet its requirement to render a report to Congress on the implementation of the program within five years pursuant to 47 U.S.C. 336(e)(4).

<sup>21</sup> Hausman at ¶17 discusses the tradeoff between distorting entry decisions and foregoing marginal increases in tax revenues.

V. The Commission Should Set the Initial Fee at a Very Low Percentage Rate

The Commission should set the initial fee at a very low percentage rate under either a gross revenue or net revenue formula. A low rate would most faithfully implement the statutory directive that the fee program approximate the fees that would have been recovered at auction and would lead to the greatest increase in consumer welfare by fostering the introduction of new services.

Dr. Hausman's econometric analysis demonstrates that prices for spectrum auctions have been decreasing over time and that this trend is likely to continue. This is true regardless of the use for which the spectrum has been auctioned.<sup>22</sup> Even if one considers only spectrum auctions for voice-grade mobile services (PCS), there is a marked downward trend in winning bids and the estimated time trend indicates further expected decline.<sup>23</sup>

But there is good reason to believe that even the declining value of PCS spectrum would significantly overstate the value of spectrum to be used for ancillary services. PCS was an established business with an existing market based on a proven technology at the time the auctions were held. Ancillary services, in contrast, are new and undefined businesses based on a new technology with great uncertainty as to consumer demand. As Dr. Hausman argues, that uncertainty should translate into significantly lower auction values.<sup>24</sup> For example, the prices paid for WCS and LMDS spectrum at auction are dramatically lower than the prices for voice-grade mobile spectrum. LMDS and WCS are a better predictor of auction values for ancillary services

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<sup>22</sup> Hausman, at ¶8.

<sup>23</sup> Hausman, at ¶10.

<sup>24</sup> Hausman, at ¶16.

than spectrum auctioned for PCS because of the greater technological and business uncertainty associated with LMDS and WCS.<sup>25</sup> And there is strong reason to believe that were an auction for spectrum to be used for such purpose to be held today values would be even lower.<sup>26</sup>

An additional and overarching factor that will drive down future auction prices is the supply of spectrum to be auctioned. In addition to 170 MHz of spectrum currently available for cellular and for PCS, another 100 MHz of spectrum below 3 GHz is required to be auctioned by the Balanced Budget Act of 1997.<sup>27</sup> The combination of these two factors -- business uncertainty and increasing supply of spectrum -- suggest that a low rate for ancillary services would best approximate the fees that would be recovered at auction.

The goal of promoting entry would also be best served by a very low initial rate. As Dr. Hausman points out, successful new telecommunications services lead to hundreds of millions or billions of dollars of increased consumer welfare. In the case of ancillary services, the risk of non-entry is significant given the fact that such services are untested in the marketplace. If the fee is set too high, a broadcaster may find it uneconomic to provide one or more ancillary services that otherwise would have looked profitable and will simply not provide them. In balancing the risk of non-entry against the marginal increases in revenues for the Treasury if the Commission were to set higher rates, Dr. Hausman concludes, and we agree, that the Commission

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<sup>25</sup> Id.

<sup>26</sup> The Commission's recent decision to request that Congress delay the statutory deadline for auctioning the remaining wireless spectrum required to be auctioned by the Balanced Budget Act of 1997 based on lack of interest in the auction suggests that there has been an even further softening of auction values since Dr. Hausman prepared his study. Communications Daily, April 30, 1998, at page 1.

<sup>27</sup> Hausman, at ¶12.

should err on the side of low rates.<sup>28</sup> The Commission can revisit the rates in the future and increase them if ancillary services turn out to be successful and the fee set too low.

In evaluating the initial fee level which the Commission should adopt, Dr. Hausman suggests that under a gross revenue formula the Commission might consider beginning with a fee of 1% or less. As Dr. Hausman explains: “Given the potentially large gains in consumer welfare from new services and the likelihood that new services will have a high degree of risk, the Commission should initially set a very low rate to encourage entry.”<sup>29</sup> Dr. Hausman also points out that were the Commission to set a relatively high fee based on gross revenues, broadcasters could be expected to pass on the fee in higher prices to consumers for ancillary service offerings.<sup>30</sup> This would adversely impact consumers and could jeopardize the appeal and ultimate success of ancillary businesses. Given the high-risk nature of ancillary services, 1% is also consistent with the survey of private sector royalty rates undertaken by National Economic Research Associates (“NERA”).<sup>31</sup> While the analogy to private sector licensing is by no means precise, rates at the 1% end of the range are associated with higher risk services. In the case of ancillary services, where the businesses are undefined, where broadcasters have no experience in providing the services, and where there is as yet no way to predict the revenues they may be expected to generate (much less their expected profit margins), the risk is so great that too high

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<sup>28</sup> Hausman, at ¶26.

<sup>29</sup> Hausman, at ¶27.

<sup>30</sup> Hausman, at ¶25.

<sup>31</sup> “Fee Alternatives for Ancillary or Supplementary Services Offered by Digital Television Broadcasters,” by Kent P. Anderson, Ph.D., NERA, submitted with National Association of Broadcasters Comments in this proceeding.

a fee on gross revenues would likely kill many ancillary services in their incipiency. To avoid this undesired result and to promote consumer welfare, we would propose that the initial fee under a gross revenue formula be set at a rate no higher than 1%.

If a net revenue formula is used, Dr. Hausman would still set the initial fee at a low rate to allow for favorable entry properties. While a somewhat higher rate can be justified consistent with the desired gain in consumer welfare (because a net revenue approach takes account of the risk of new ancillary services by including the cost of capital in the calculation of net revenues) the same concerns should apply.<sup>32</sup> Here again, at least at the outset, care must be taken not to set the rate at a level that will discourage investment in new services and deter entry. As with the case of gross revenues, the Commission ought, at the outset, to err in the direction of setting a fee that would encourage entry. When considered against the background of all the additional levies against net revenue that businesses must assess in laying out business plans, we believe that the correct balance would be struck by a net revenue formula in the 2-3% range.

## VI. Conclusion

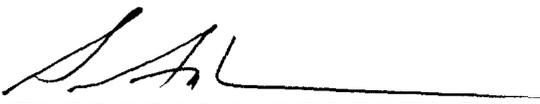
In these comments, we explain why we believe that a net revenue formula is the preferable choice among the various proposals for fee assessment programs for ancillary services discussed in the Notice. We further propose that the Commission give the broadcaster the option to pay a fee based on net revenues based on audited reports prepared by the broadcaster thereby avoiding an undue burden on the Commission staff. Finally, we propose that the Commission set the initial fee at a very low rate -- not to exceed 1% under a gross revenue formula or in the

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<sup>32</sup> Hausman, at ¶27.

2-3% range under a net revenue formula -- to foster ease of entry and thereby enhance consumer welfare.

Respectfully submitted,

By: 

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Counsel for ABC, Inc.

May 4, 1998

## Appendix A

### Statement of Professor Jerry A. Hausman

1. My name is Jerry A. Hausman. I am MacDonalld Professor of Economics at the Massachusetts Institute of Technology in Cambridge, Massachusetts, 02139.

2. I received an A.B. degree from Brown University and a B.Phil. and D. Phil. (Ph.D.) in Economics from Oxford University where I was a Marshall Scholar. My academic and research specialties are econometrics, the use of statistical models and techniques on economic data, and microeconomics, the study of consumer behavior and the behavior of firms. I teach a course in "Competition in Telecommunications" to graduate students in economics and business at MIT each year. Competition among broadcast TV, cable providers, and DBS are among the primary topics covered in the course. In December 1985, I received the John Bates Clark Award of the American Economic Association for the most "significant contributions to economics" by an economist under forty years of age. I have received numerous other academic and economic society awards. My curriculum vitae is included as Exhibit 1.

3. I have done a significant amount of research in the telecommunications industry. I have published numerous papers in academic journals and books about telecommunications. I have also edited two books on telecommunications, Future Competition

in Telecommunications (Harvard Business School Press, 1989) and Globalization, Technology and Competition in Telecommunications (Harvard Business School Press, 1993).

4. I have done research in the television industry over a long period of time. I first did research on DBS in the early 1980's when I served as a consultant to Sears and Comsat on the commercial viability of DBS. I have continued to follow the DBS industry since that time. I have previously submitted Declarations to the Commission on behalf of DirecTV regarding the competitive impacts of policies affecting DBS. I have also studied competition between broadcast and cable television. I have submitted statements to the Commission and to the Department of Justice on competition in the television industry. I have served as a consultant for the Tribune company for over six years. Tribune owns a number of broadcast stations and also participates in the recently formed UPN broadcast network. During 1996 I testified before both houses of Congress on matters relating to the adoption of advanced television in the United States. I have submitted two previous affidavits to the FCC regarding adoption of rules for economically efficient use of the spectrum from advanced television services.

## I. Summary and Conclusions

5. Prices for spectrum auctioned by the FCC have been decreasing over time on a per MHz per population basis. Shifts in demand conditions for spectrum (e.g. the success of CDMA) and supply conditions (more spectrum to be auctioned in the future) have both led to decreased expectations about the value of spectrum. The most recent auctions for WCS spectrum and LMDS spectrum have led to extremely small bids compared to prior expectations.

6. An upfront fee approach for ancillary services has extremely poor risk sharing characteristics and would likely lead to diminished entry of new ancillary services and decreased consumer welfare. Thus a "running royalty" type approach based as a percentage fee of revenues will be better than an upfront fee approach. While a fee based on net revenues leads to greater accounting complexity, a net revenue approach leads to less economic distortion with respect to both entry decisions and output decisions. The Commission should take this tradeoff into account in designing a fee structure.

7. If a fee based on gross revenues is used, the initial fee percentage should be very low so that entry is not discouraged too much. Indeed, a plan that began with very low fees that The FCC could adjust over time is likely to encourage entry of new ancillary services and increased consumer welfare.

If a fee on net revenues is used, higher initial fees on net revenue can be proposed since economic distortions from a net revenue approach are considerably smaller, so long as the correct risk-adjusted cost of capital is included in the net revenue calculations.

## II. FCC Goals and Econometric Results

8. The Notice correctly indicates that basing a fee structure on precise auction values to set fees for the spectrum used for ancillary services is impractical for a number of reasons. Thus, I have undertaken an econometric study of all auctions that have occurred to reach conclusions which should be generally predictive of future auction values and should guide the Commission in setting fee levels for ancillary services. My major finding is that auction results calculated on a per MHz per population (pop) have decreased significantly as additional auctions have occurred. Thus, the trend in auction results is down regardless of the use to which the spectrum will be put or the degree of uncertainty over the success of the technology.

9. My second major econometric result is that auction values are significantly lower for uncertain and unproven technologies.

Indeed, the most recent auction, the LMDS auction completed on March 28, raised significantly less money than expected. The amount raised in the auction, about \$579 million is only about