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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of)
)
Fees for Ancillary or Supplementary Use of Digital)
Television Spectrum Pursuant to Section 336(e)(1))
of the Telecommunications Act of 1996)

MM Docket No. 97-247

To the Commission:

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

REPLY COMMENTS OF UCC *et al.*

Gigi B. Sohn
Andrew Jay Schwartzman
Cheryl A. Leanza

Law Student Intern:

Alyze Lowen
Harvard Law School

Media Access Project
1707 L Street, NW
Suite 400
Washington, DC 20036
202-232-4300

August 3, 1998

Counsel for UCC et al.

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The Office of Communication of the United Church of Christ, the Benton Foundation, the Center for Media Education, the Civil Rights Forum and the Media Access Project ("UCC *et al.*") respectfully submit these replies to comments filed by various broadcasters in the above docket.

INTRODUCTION AND SUMMARY

In fashioning fees for "ancillary and supplementary" services for digital TV broadcasters, Congress sought to ensure that public would benefit from the grant of free extra spectrum to broadcasters for revenue-enhancing uses other than advertiser supported free over-the-air TV. Indeed, Congress was explicit in defining the intended goals of the fee system, mandating that the Commission ensure that:

- the public receives a portion of the value of the spectrum given to broadcasters
- broadcasters are not unjustly enriched by the use of free spectrum for pay services
and
- the value recovered from the fees approximates that which would have been realized had the spectrum been auctioned.

47 USC §336(e)(2).

Even in the face of this clear statement of legislative intent, the broadcaster commenters urge the Commission to construe Section 336(e) in the narrowest possible manner, so as to avoid meaningful fees on ancillary and supplementary services. First, they seek to limit narrowly the types of these services that would be subject to fees. Specifically, they endeavor to shield retransmission consent revenues they will likely obtain from cable operators for carriage of their digital signals as well as other per-transaction compensation they might receive from advertisers. Second, they propose extremely low fees, and some ask for waivers of the fees for several years on top of that.

The Commission should reject the broadcasters' cramped interpretation of Section 336(e). Despite the NAB's selective interpretation of the legislative history, there is nothing indicating an intent to exempt retransmission consent revenues or other compensation, including in-kind compensation, received by broadcasters in exchange for their digital TV service. The Commission should apply fees to, *inter alia*, home shopping programming, infomercial programming, per-transaction direct marketing fees, retransmission consent fees, and all other kinds of in-kind compensation, however defined.

The Commission should also decline to adopt either the gross revenues fee proposed by the NAB and ALTV or ABC's proposed net revenue fee. Instead, it should set a fee which will better accomplish Congress' objectives. UCC *et al.* has commissioned an report by noted media economist and University of Maryland Professor Dr. Douglas Gomery (included as Attachment A), which demonstrates that the economic analyses upon which broadcasters rely for their proposals are rooted in fundamentally flawed premises. The studies incorrectly, *inter alia*:

- seek to derive the value of exclusively-granted broadcast spectrum by improperly

comparing it with the value of nonbroadcast spectrum distributed through competitive bidding;

- analyze ancillary and supplementary uses of the spectrum as if they were unrelated to broadcast services, even though the latter will be used in conjunction with the former;
- rely on a narrow microeconomic view that equates the public interest with economic efficiency, thereby ignoring non-market values such as the public's right to receive free over-the-air TV, Congressional intent in drafting Section 336(e), and the Commission's mandate to license broadcasting and ancillary and supplementary services in the "public interest, convenience, and necessity"; and
- assume that *all* ancillary and supplementary services will be risky ventures necessitating government largesse to jump start them, even though many are already winners in the marketplace.

The duty to license both analog and digital TV stations in the public interest requires the Commission to look beyond economic efficiencies in setting a fee structure. In addition, the Commission's actions must be consistent with Congressional mandates - reimbursing the public and avoiding unjust enrichment. Thus, the Commission should adopt a fee that more closely approximates what *UCC et al.* advocated in its initial comments - approximately 10 percent of gross revenues. This fee is similar to the amount other private entities pay for use of public property.

Congress' twin goals are also contrary to a blanket a waiver or deferral of fees. If broadcasters find that the services they employ are unprofitable, they can do what any other business would: terminate the service. To suggest, as does *Cox et al.*, that the Commission should defer fees because broadcasters have not yet developed a business plan for ancillary and supplementary services is outrageous given that acquiring spectrum for these uses was the broadcasters' highest legislative priority for well over five years.

I. THE BROADCASTERS' DEFINITION OF "FEEABLE" DOES NOT REFLECT CONGRESSIONAL INTENT.

In their initial comments, UCC *et al.* urged the Commission to make Section 336(e) fees applicable, *inter alia*, to home shopping programming, infomercial programming, per-transaction direct marketing fees, retransmission consent fees and all other kinds of in-kind compensation, however defined. UCC *et al.* Comments at 12-13. Applying fees to these services is consistent with the plain language and the legislative history of Section 336(e), as well as the Commission's proposal to apply fees to "any ancillary or supplementary services that are not supported entirely by commercial advertisements." *NPRM* at ¶18.

The NAB seeks to shield these retransmission consent revenues and other direct and indirect revenue sources obtained through private agreements with advertisers and others. The NAB criticizes the Commission's proposal as being too broad and even contrary to Congress' intent in implementing Section 336(e). NAB Comments at 6-7. Focusing on the House Report language that fees are to be imposed "if subscription fees or any other compensation fees apart from commercial advertising *are required in order to receive such services*," the NAB concludes that "[t]he line dividing feeable and non-feeable services is not whether a service has some level of non-advertising support, but whether a subscription or other fee is required to receive the service." *Id.* (emphasis in original). Because a fee is not necessary "in order to receive [broadcast] services," the NAB posits that the Commission's fees should not attach. *Id.*

But the legislative history does not support the result the NAB seeks. Although analysis of legislative intent requires review of the House Report language upon which the NAB relies, the NAB bases its argument on a single sentence wrenched out of context. In discerning legislative

intent, it is also essential to review the language and design of the statute as a whole. *K Mart Corp.*

v. Cartier, Inc., 486 U.S. 281 (1988). The House Report, in its entirety, states that:

Subsection (D) requires the Commission to establish a fee program for any ancillary service if subscription fees or any other compensation fees apart from commercial advertisements are required to receive such services.

H. Rep. No. 204, 104th Cong., 1st Sess. 117 (1995).¹

Nothing in the report language indicates an intent to limit feeable services to those for which revenue comes from *viewers*. Thus, if a cable operator pays the broadcaster to carry its signal, then the cable operator has paid a fee "in order to receive such services." And if an advertiser pays a broadcaster for each viewer that downloads information about its product, it too is paying a fee "to receive" the broadcaster's services. Thus, the Commission could reasonably determine that retransmission consent fees and other fees broadcasters obtain to provide specific digital services are subject to fees under Section 336(e). See *Chevron USA v. NRDC*, 467 US 837 (1984).

Nor does this single sentence stand alone. Taken as a whole, Section 336(e) evidences Congress' desire that the public be compensated for broadcasters' use of free extra spectrum for revenue-enhancing purposes, and that broadcasters not be "unjustly enriched" by that use. 1996 Act, §336(e)(2). Were broadcasters to use the free spectrum for new revenue-enhancing services apart from commercial advertisements and *also* avoid payment of fees, this would surely result in the kind of "unjust enrichment" that Congress sought to avoid by requiring fees in the first place.

¹As the NAB notes, Section 336(e) was based on the House bill. NAB Comments at 6 n.7, *citing* H. Rep. No. 458, 104th Cong., 2nd Sess. 161 (1996).

II. ABC'S PROPOSAL TO BASE THE FEE ON NET REVENUES SHOULD BE REJECTED BECAUSE IT IS SUSCEPTIBLE TO MANIPULATION.

UCC *et al.*, NAB, and ALTV all urged the Commission to base the Section 336(e) fees on gross receipts. UCC *et al.* Comments at 7-8; NAB Comments at 7-13; ALTV Comments at 15-17. Such a fee would be simpler to calculate, would be less susceptible to manipulation, and would be the most likely of all the proposed fees to satisfy Congress' twin objectives of recovering a portion of the spectrum for the public and preventing the unjust enrichment of broadcasters.² UCC *et al.* Comments at 7-8.

Alone among commercial broadcasters, ABC advocates a fee system based on net revenues, and urges the Commission to permit broadcasters to choose between paying a fee based on either net revenues or gross revenues. ABC Comments at 4-6. Recognizing that "the net revenue approach raises thorny questions about how to develop accounting rules that would fairly state a broadcasters [sic] true net revenue," and also that "the Commission has expressed concern that the development and oversight of those rules would impose undue administrative burdens," ABC proposes to let broadcasters develop their own methodologies for determining net revenues, and submit to the Commission a certification and audit attesting that the revenues have been calculated using that methodology. ABC Comments at 7.

ABC further proposes to define net revenues as the Commission proposed in the *NPRM*: "revenues from the feeable service less service-specific incremental costs and that portion of joint

²Dr. Gomery agrees that "[t]he fee ought to be based on a percentage of the gross ancillary or supplementary revenues because the other alternatives considered by the FCC have economic, administrative and institutional disadvantages****The Commission would need little in additional allocated resources to tally and collect such fees based upon gross revenues." Gomery at 22.

and common costs fairly attributable to the feeable service." ABC Comments at 10. Similarly, "service specific incremental costs" would be defined 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." *Id.* A "more precise definition," ABC believes, is neither practical nor desirable." *Id.*

ABC is correct that a more precise definition is not desirable, but it is incorrect that the Commission could adopt a fee based on net income and avoid crafting exceedingly very complex regulations defining its parameters. As the Commission and other commenters, including UCC *et al.* have noted, the costs that constitute both "net revenues" and "service specific incremental costs" are subject to manipulation.³ *E.g.*, UCC *et al.* Comments at 5-7; Cox *et al.* Comments at 9. To wit, attempts to categorize and accurately assign costs has been the project of much common carrier regulation for the last 50 years, and has resulted in innumerable pages of accounting rules and regulations. *See, e.g.*, 47 CFR Part 64, Part 69; *Local Competition Order*, 11 FCC Rcd 15499, 15817-72, ¶¶ 630-740 (1998). If the Commission adopted ABC's plan, it would have to carefully scrutinize and approve each broadcaster's accounting plan to ensure that each broadcaster was accurately categorizing costs.⁴ Such a scheme would create an extraordinary

³For example, it would not be difficult to inflate those "joint and common costs *fairly* attributable to the feeable service." Similarly, the costs of "directly attributable" inputs of production are subject to inflation. A broadcaster could arguably have inputs of production that are directly attributable (as opposed to specifically attributable) to several services, including nonfeeable services. In that case, the broadcasters could choose to allocate most of the costs to the feeable services to avoid the maximum fees.

For example, the Commission currently requires the large incumbent local exchange carriers to file a Cost Allocation Manual which is approved by the Commission. *See* 47 CFR §64.903.

administrative burden for Commission staff and licensees.⁵ In addition, it would result in a different fee schedule for each broadcaster. The Commission should instead adopt a fee schedule based on gross receipts.

III. THE BROADCASTERS' FEE CALCULATIONS ARE DERIVED FROM ECONOMIC ANALYSES THAT ARE BASED ON FLAWED ASSUMPTIONS AND THAT DISREGARD IMPORTANT EXTERNALITIES THAT THE COMMISSION MAY NOT IGNORE.

Predictably, the broadcaster commenters propose very low fees for ancillary and supplementary services. For example, NAB proposes a two percent fee on gross revenues, ALTV proposes a one-half to one percent fee on gross revenues, and ABC proposes a one percent fee on net revenues or a two to three percent fee on gross revenues. See NAB Comments at 17; ALTV Comments at 17; ABC Comments at 14-15.

These fee calculations are largely derived from two economic studies prepared for the broadcast industry. NAB and ABC rely on economic analysis done by Professor Jerry Hausman, while ALTV bases its fees on similar analysis by John Haring of the Strategic Policy Research.

No less would be required here.

⁵Cox *et al.* described the effects of a net revenue fee similar to that ABC proposes:

[a fee based on net revenues] would require each company to develop cost-accounting systems...and to maintain financial records in such a way that the data could be turned over to Commission staff and evaluated. This would be highly burdensome for licensees. Likewise, the Commission would take on a significant additional burden, as it would have to hire and train personnel that could analyze every broadcast licensee's detailed cost data in order to verify (a) that they were in accordance with generally accepted accounting principles and otherwise sound and (b) that the proper fee had in fact been submitted. Further complicating matters, the Commission would need to "prescribe specific cost accounting rules to insure consistent and uniform calculations of incremental cost for purposes of calculating service-specific profit.

Cox *et al.* Comments at 9 (citations omitted).

Both economists have engaged in economic analyses on behalf of the broadcast industry for a number of years.

Whether or not these studies are sound from a purely microeconomic perspective, they are not appropriate bases upon which to calculate fees. First, they are based upon flawed assumptions, the most egregious of which is that the value of the spectrum given exclusively to broadcasters can be gauged by comparison to spectrum subject to competitive bidding for LMDS and PCS services. Second, they do not take into account critical non-economic policy, legal, and social values (what Dr. Gomery calls "externalities") that the Commission cannot ignore. See Gomery at 17-19. These include, but are not limited to, Congressional intent and the Commission's statutory duty to regulate both broadcast and ancillary and supplementary services in the "public interest, convenience, and necessity."

A. Broadcasters' Attempted Valuation of the Broadcast Spectrum is Erroneous.

The broadcasters correctly observe that fees should be based, in part, on the value of the spectrum that they are being given to convert to digital television. But their comparison to receipts derived from recent spectrum auctions for *non-broadcast* spectrum is deficient. Not surprisingly, the broadcasters' experts conclude that the value of the spectrum is declining, and will continue to decline. Hausman at 5-6; Haring at 14-15. This, they claim, is an important reason to propose very low fees.

Their comparisons are invalid for several reasons. First, broadcast spectrum is more valuable because it has superior physical properties than nonbroadcast spectrum, *e.g.*, it is located in a more favorable space on the electromagnetic band. Second, unlike new services such as PCS and LMDS, broadcasting has an installed base of several hundred million television sets ready to

receive digital signals with the addition of an inexpensive converter box or a cable hook-up and a customer base that is not going to forgo their access to free over-the-air television. Third, and perhaps most important, the broadcasters' valuation of the spectrum does not take into account the fact that broadcasters did not compete for the right to use the spectrum - Congress and the FCC gave it to them exclusively. An exclusive right has great value, and should be factored in to any calculation.⁶ Dr. Gomery states:

Broadcast television licenses are so valuable precisely because of the monopoly power embedded in their allocation.****Because electronic mass media continue to exert monopoly control of spectrum through exclusive licenses, many more people want to own a broadcast license than are able to do so, and therefore prices to obtain a license are high and climbing.

Gomery at 14. As a result, he concludes, the value of broadcast spectrum is increasing, and not declining. *Id.*

Moreover, it is also misleading, as the broadcasters and their economists do, to divorce the value of the spectrum that will be used for ancillary and supplementary services (particularly non-programming services) from that which will be used for broadcasting. *See* Gomery at 13. Hausman, for example, gives a "very large discount for services that face significant business and technological uncertainty." This ignores the fact that these broadcasters will use their ancillary and supplementary services in conjunction with their core broadcast service. Moreover, they will use their broadcast service to promote the availability of these supplementary services. These are advantages that LMDS and other nonbroadcast services simply do not have. Dr. Gomery notes

⁶Even ALTV's economist, John Haring, admits that there is a difference, saying that "[p]revious auctions have often dealt with substantially different spectrum resource rights than those currently at issue." Haring at 8.

these "synergies":

Building upon free, over-the-air advertising based broadcasting, the major companies owning television stations -- and converting from analog to digital -- can exploit and leverage other media production, and distribution units that make up their vast enterprises. They then can use this cross ownership to leverage the ancillary or supplementary services, built on their broadcast licenses. Sports broadcasts can offer up-to-the-minute scores; news shows can offer supplemental and individualized information; many other examples exist. Cross ownership gives the commercial broadcaster a unique place to build and exploit through the ancillary or supplementary channels.

Gomery at 11.

To the extent that the NAB and others assert that digital television is an "embryonic" industry in need of government largesse, *see* NAB Comments at 3, the Commission must dismiss these claims. *See* Information Technology Industry Council Comments at 4 (digital TV services, arguing that like the Internet, it is a "new medium," worthy of relief similar to the access charge exemption for enhanced service providers).

[I]t is disingenuous for the NAB to paint its members -- with their millions of dollars in amortized monopoly profits built into their licenses -- as some sort of 'infant industry' in need of special protection, unable to withstand the risk or uncertainty of innovating ancillary or supplementary media services****[I]f any industry is mature, it is broadcast television, with its long experience at assimilating technological and marketplace innovations, such as color TV, cable television redistribution, cable-originated programming and replacement of coaxial distribution by satellite."⁷

Gomery at 16-17.

Finally, the broadcasters cannot place a value on the spectrum based on the presumption

⁷Additionally, many of the ancillary and supplementary services that broadcasters can and will provide will not necessarily face "significant business and technological uncertainty." In fact, some of these services, (*e.g.*, subscription television) are already proven winners in the economic marketplace with no technological uncertainties. In addition, as discussed above, the fact that most Americans already have television sets and will willingly buy new digital TV receivers and converter boxes to continue receiving their free over-the-air service puts broadcasters in a far less "uncertain" position than their competitors.

that the return of the "repacked" spectrum in 2006 will greatly increase spectrum supply and thereby drive down spectrum prices even further. *See* Haring at 15. The Commission should base its fees on the current value of the spectrum, and not what it *might* be eight years from today. It is equally possible that the new services will become extremely profitable, thus driving up the value of the spectrum when it is returned. Moreover, it is unclear when, if ever, broadcasters will actually return the repacked spectrum. Administrative and technological difficulties with digital displays are already delaying the build-out, and more critically, the Balanced Budget Act of 1997 requires the Commission to grant waivers of the return date if fewer than 85% of the viewers in a market are receiving a digital signal. Thus, few, if any experts believe that the spectrum will be returned before a 15 or 20 year conversion period. *See* "DTV Industry At Hearing Passes Blame For Problems," *Communications Daily* at 3 (Jul. 9, 1998).

B. Microeconomic Analysis is an Insufficient Determinant of Appropriate Fees Because it Does Not Take Into Account "Externalities" Such as Congressional Intent and the Commission's Mandate To License Digital TV Broadcasters in the Public Interest.

Relying on their economists' analyses, the broadcasters claim that there is a greater public interest in setting low fees, because to do so would encourage the introduction of new ancillary and supplementary services. For example, ALTV states that "setting fees too high would lead to considerable losses in consumer welfare. On the other hand, fees set at too low a level would do no more than effectuate a wealth of transfer of marginal consequence." ALTV Comments at 12. *See* NAB Comments at 13 *quoting* Hausman at 10-11.

This argument rests on the narrow microeconomic perspective that equates what is good

for the public with what is good for broadcasters and the economy.⁸ "Pure micro-economic policy analysis treats and validates economic efficiency as a single policy goal." Gomery at 13. This overlooks the statutory determination that spectrum reserved for broadcasting will be treated differently from all other spectrum. Because microeconomics focuses on these claimed efficiencies to the exclusion of the relevant legal and policy framework, the broadcasters do not explain why: 1) the introduction of ancillary and supplementary services is any better for the public good than increased contributions to the Treasury and 2) the introduction of ancillary and supplementary services is any better for the public good than multiple free services or full high definition television.⁹

Thus, in disregarding the broader policy and equitable factors, microeconomics cannot answer those questions, or provide a reasoned basis for establishing a fee. These factors include, *inter alia*, the nature of commercial broadcasters as "large complex social, cultural and economic institutions," Gomery at 15, that "pervade and shape our social relations and cultural experiences." *Id.* at 19. Most important, microeconomics ignores variables such as Congressional intent and the Commission's mandates to license both broadcast and ancillary and supplementary services in the "public interest, convenience, and necessity," *see* 1996 Act §336(a)(1). "Thus, defining

⁸See Haring at 6 ("In setting fees, the Commission is, in essence, trading off greater output and enhanced consumer welfare against redistributive impacts (primarily equity concerns and considerations related to competitive parity and the efficiency of competitive discovery procedures....)")

⁹While the broadcasters promote efficiencies above all in setting a fee, they do not mention that the grant of free spectrum to one business segment is extremely inconsistent with microeconomic principles. In addition, "[t]he monopoly licensing system hardly fulfills the assumptions of an efficient marketplace requiring homogenous commodities, identical customers, numerous small transactions relative to the market, perfect information and free entry and exit." Gomery at 18.

the requirements for properly dealing with the externalities and thus serving the public interest lie at the center of any analysis of setting a proper fee for use of the spectrum for ancillary and supplementary services." Gomery at 18.

As discussed at length in *UCC et al.*'s comments, Congress did not ignore these externalities, and specifically required the Commission to develop a fee structure that both reimburses the public for the value of the spectrum and avoids unjust enrichment of broadcasters. *See generally*, *UCC et al.* Comments. It did not, however, require the Commission to develop a fee structure that would encourage ancillary and supplementary services. This evidences Congress' belief that reimbursement better promotes the public good. Congress also specifically tasked the Commission with adopting regulations "that allow holders of such licenses to offer such ancillary or supplementary services on designated frequencies *as may be consistent with the public interest, convenience and necessity*" and required it to "limit the broadcasting of ancillary or supplementary services on designated frequencies so as to avoid derogation of any advanced television services, including high definition television broadcasts...." 1996 Act, §336(b)(2). Certainly the debates over the past 10 months with respect to whether broadcasters will provide multiple programming and nonprogramming services (as opposed to high definition television) demonstrate that many influential members of Congress believe that the public good is better served by the provision of HDTV than by ancillary and supplementary services, regardless of what microeconomic analysis, standing alone, might dictate. *See, e.g.*, Paige Albiniak, "Congress wants its HDTV," *Broadcasting & Cable* at 16 (Sept. 8, 1997); Paige Albiniak, "Tauzin warns against abandoning HDTV," *Broadcasting & Cable* at 11 (Aug. 25, 1997). Microeconomics does not concern itself with whether all citizens will receive free over-the-air TV. Rather, it lets the market ration access to

what is seen as the most efficient level. But Congress wants *all* Americans to have free TV, not just the optimal number in terms of economic efficiency.

The disregard for the public and its rights *vis a vis* broadcasters is also reflected in the ALTV's view that only competitive providers of ancillary and supplementary services stand to be harmed by the institution of lower fees, which they claim is not necessarily bad for society. ALTV Comments at 12. Haring states, for example, that "[i]t's easy to say that more [ancillary and supplementary services] is better; it is harder to say that a dollar less for one person and a dollar more for another person represents a *net* loss/gain in economic welfare considered in the aggregate." Haring at 7 n. 8, cited in ALTV Comments at 14 (emphasis in original). By focusing only on "economic welfare," and the effect of fees on broadcasters and their competitors, Haring completely overlooks the fact that the "dollar more" is for broadcasters, and the "dollar less" is diminished access to free programming and/or diminished revenues for the public.

C. Licensing Rates for Technology Do Not Serve As a Proper Basis Upon Which To Set Fees For Ancillary and Supplementary Services.

The NAB attempts to justify its proposed fee by comparing it to the rates at which different kinds of technology have been licensed in private negotiations. NAB Comments at 16 *citing* Kent Anderson, "Fee Alternatives for Ancillary or Supplementary Services offered by Digital TV Broadcasters." The NAB reasons that this is an apt analogy because, like the licensed technologies, there is uncertainty about technology and market demand for ancillary and supplementary services. NAB Comments at 17. And, it says "were the spectrum for such services to be sold at auction or licensed in private negotiations, the expected price would be quite low." *Id.*; *accord* ABC Comments at 12-13 .

This comparison again fails. First, one cannot compare technology licensed in the private sector with technology that is based upon a public grant of spectrum. Gomery at 25. Second, as discussed above, the value of the ancillary and supplementary services cannot be separated from the value of the broadcast service, especially because these services may well be used in conjunction with the broadcast service, and the broadcast service may be used to help promote the ancillary and supplementary service.

If there is any appropriate comparison to make under Anderson's analysis, it is with "those technologies with unusually favorable economies [which] receive [licensing] rates of more than 10 percent." Anderson at 1. This is because, as Dr. Gomery notes:

The broadcast TV industry has been highly profitable.... This is precisely why TV licenses sell for so much on the open market. The economies are unusually favorable, and investors know this, and are willing to pay millions to gain the advantage of an exclusive license. Adding ancillary or supplementary services to the value of a broadcast TV license simply makes the unusually favorable economics that more advantageous and profitable.

Gomery at 25.

IV. THE COMMISSION SHOULD NOT GRANT BLANKET WAIVERS OR DEFER ITS FEES FOR ANCILLARY AND SUPPLEMENTARY SERVICES.

ALTV asks the Commission to waive fees for ancillary and supplementary services "where a station derives no profit from ancillary or supplementary services." ALTV Comments at 19-20. Such a waiver, ALTV argues "would afford DTV licensees the breathing room '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.'" ALTV Comments at 20 *citing* NPRM at ¶21. Cox *et al.* is even more bold, asking the Commission to not set a fee structure at all at this time, because

[b]roadcast licensees do not yet know exactly which ancillary services they will provide, which types of services...will prove most in demand, which technology is going to prove to be most effective or most cost-effective, or whether other spectrum or other preferable means exist to provide a particular service.

Cox *et al.* Comments at 2. In the alternative, Cox requests a five year "interim period" in which fees be waived for the first two years and a one percent of gross revenues fees would be charged for the following three years. Cox, *et al.* Comments at 6.

It is truly remarkable, after receiving valuable extra spectrum for free and after receiving permission to use that spectrum to engage in new money-making services, that some broadcasters now seek to avoid the one firm obligation they have to compensate the public. But it is nothing less than *outrageous* to suggest, as does Cox *et al.*, that broadcasters' consistent refusal to develop a business plan for ancillary and supplementary services should be the basis of a waiver. The broadcast industry has been pushing for "spectrum flexibility" to provide ancillary and supplementary services for nearly 5 years,¹⁰ and has known for about three years that it would likely receive the right to engage in these services.¹¹ To grant any relief on broadcasters' lack of a plan would be to reward years of broadcast industry efforts to keep the extra spectrum out of competitors hands while at the same time not spending the necessary funds to convert to digital

¹⁰The first manifestation of this effort was an amendment offered by Rep. Tauzin on March 1, 1994, to H.R. 3636, the "National Communications Competition and Information Infrastructure Act of 1994," which was passed by the House. The amendment required the Commission to promulgate regulations "to permit broadcasters to make use of the broadcast spectrum that they are licensed to use for services that are ancillary or supplementary to the programming services which they are authorized to provide." The amendment also provided for broadcasters to pay fees for these services.

¹¹When the Commission issued its *Fourth Further Notice of Proposed Rulemaking* in the DTV docket in August, 1995, it proposed that broadcasters be permitted to engage in ancillary and supplementary services using their digital capacity. *Fourth Further Notice* 10 FCC Rod 10540, 10544 (1995).

transmission. *See generally*, Joel Brinkley, "Defining Vision: The Battle for the Future of Television" (Harcourt Brace 1997).

While the Commission can always waive its rules for good cause, there is no justification for a *blanket* waiver. If a service does not generate much revenue, broadcasters will not pay high fees, and if a service is very unprofitable, the broadcaster always has the option of terminating it, and engaging in another service or increasing free over-the-air service. As Dr. Gomery notes, many businesses take the risk of losing money for a service for the first few years in the hope that it will catch on and eventually be profitable. Gomery at 17. Moreover, those companies have not been granted free use of a valuable public resource to commence such services.

Moreover, a blanket waiver would be contrary to Congress' desire that the fee structure "promote the objectives" of Section 336(e)(2), discussed *supra*. As long as a broadcaster can show that it is not making a profit on a service, the public will not be able to recover a portion of the value of the spectrum.¹² The objectives in Section 336(e)(2) reflect Congress' desire to recompense the public for the simple *opportunity* that broadcasters will have to increase revenues using their excess digital capacity. Thus, it is irrelevant whether or not those services actually turn a profit initially.

CONCLUSION

Broadcasters convinced Congress that political values should trump economic values and therefore Congress awarded broadcasters additional spectrum at no charge. Now that

¹²The ability to manipulate revenue and cost numbers to demonstrate profitability raises many of the same concerns discussed in Section II with regard to basing fees on a "net revenue" calculation.

microeconomic analysis serves their goals, however, broadcasters believe that such analysis should prevail above all other values. Congress concluded otherwise when it directed the Commission to impose fees on ancillary and supplementary services. The Commission should reject the broadcasters' proposals and their economic analyses that ignore the fact that broadcasters did not pay for their digital spectrum allocation. The Commission should adopt a fee of 10 percent of gross revenue and define ancillary and supplementary services broadly to meet Congressional objectives.

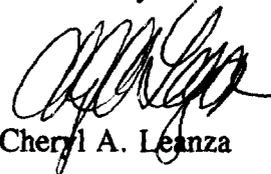
Respectfully submitted,



Gigi B. Sohn



Andrew Jay Schwartzman



Cheryl A. Leanza

Alyze Lowen
Law Student Intern
Harvard Law School

MEDIA ACCESS PROJECT
1707 L St., NW
Suite 400
Washington, DC 20036
(202) 232-4300

August 3, 1998

ATTACHMENT A

Statement of Professor Douglas Gomery

1. My name is Douglas Gomery. I am a full professor in the College of Journalism at the University of Maryland in College Park, Maryland, 20742.

2. I received my B.S. in economics from Lehigh University (graduating first in my class), an MA in economics from the University of Wisconsin-Madison, and a Ph.D. In Communications from the University of Wisconsin-Madison, with a minor in economics. My academic and research specialties are media economics and media history. I teach courses surveying the current state of the media industries in the United States, the changing media industry landscape, and policy analysis of regulation and legislation. The analysis of the ownership, and competition in the broadcast television, cable television, DBS, and home video industries -- as well as technological innovation -- are the major foci of these courses. My curriculum vita is included as Exhibit 1.

3. I am the author or co-author of ten books on the economics and history of the mass media in the United States, including a forthcoming book, Who Owns the Media. I have written articles for leading economic and media publications about the status of that important communications industry in contemporary times as well as analyzed how and why the media industries are shaped the way they are and operate in such fashion. My column, "The Economics of Television," is a regular feature in the American Journalism Review. This deals with changes in the television business. As a founding member of the editorial board of the Journal of Media Economics, I support this leading academic publication to analyze longer term trends.

4. I have received numerous academic awards and fellowships. My books and articles have been translated into more than a dozen languages. I am listed in Who's Who in America. My publications number into the thousands, but an updated curriculum vitae is attached.

5. I have done research in the television industry for the past two decades. I first researched how Hollywood functioned as the new television technologies began to challenge Hollywood's domination in the marketplace. Thereafter, I became interested in the interaction of Hollywood and television as the networks and the studios merged and joined in collaborative ventures. I am now helping analyze the state of mass media ownership in the United States for the Government Accounting Office. I have not served as a consultant for private industry because I wished to keep an independent point of view. I have assisted consumer organizations in petitioning the FCC, often without compensation.

I. Summary and Conclusions

6. This statement has been prepared for submission in Federal Communications Commission Docket 97-247, a proceeding convened to establish regulations and policies implementing those provisions of the Telecommunications Act of 1996 which provide that television broadcast licensees may be required to pay fees for the right to provide "ancillary and supplementary services." In this statement, I address the premises and reasoning employed by economists in preparing statements submitted on behalf of television broadcasters in Docket 97-

247. It is my position that they vastly understate the value of spectrum reserved for television broadcasting, and that the methodologies they propose for such valuation are flawed.

7. The best way to reflect the value of the spectrum, and to provide the most accurate and least burdensome mechanism is to base fees for ancillary and supplementary services upon a percentage of the gross revenues. It is the most practical approach. Other alternatives offered in this docket by the Commission and commercial broadcasters have substantial administrative disadvantages. An ideal fee ought to reflect in some manner the excess monopoly profits that digital broadcasters expect from their exclusive control of television spectrum set aside for their future use. Fees for ancillary or supplementary services ought to be based upon real world comparisons, with particular focus on potential profits that can be earned because spectrum reserved for exclusive use of over-the-air television commercial broadcasters in the United States is highly valuable. This value is increasing, not falling. Comparison with what is paid for licenses to use other spectrum is invalid and not useful, in part because TV broadcasters receive much greater protection from competition; PCS, LMDS and other services are subject to competition from other spectrum bands, but there is not real competition for local, over-the-air TV. Other alternatives have not proven substitutes chosen in large measure by consumers. Spectrum reserved exclusively for broadcast licensees is by far the most valuable, and will remain so as a result of the provisions of the Telecommunications Act of 1996 and prior statutes. In particular, the broadcast lobby's hard-won fight to obtain a new option to provide ancillary or supplementary services significantly adds to its value.