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Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: MB Docket No. 07-42

Dear Ms. Dortch:

After the close of the FCC's formal comment period in this proceeding, the Media Access Project ("MAP") submitted two separate analyses of commercial leased access rates. The first study, submitted as part of MAP's late-filed Reply Comments, proposes that the FCC adopt a flat leased access rate for digital tier carriage of \$0.15 per subscriber per month. The second study, filed on an ex parte basis a few weeks later, proposes that the FCC adopt flat leased access monthly per subscriber rates for analog and digital tier carriage of \$0.00591 and \$0.00825, respectively. Attached is a critique of Dr. Rose's studies prepared by Michael Baumann of Economists Incorporated. Dr. Baumann shows that both studies are seriously flawed and cannot form the basis of any rational decisionmaking.

As Dr. Baumann demonstrates, Rose's study's findings, insofar as they purport to determine cable operators' compliance with the existing rate rules, are "meaningless" and Rose's conclusions rest on a mistaken hypothesis. Moreover, Rose's attempts to justify a 15 cent per subscriber flat fee for digital tier leasing are based on per subscriber rates that "appear to have been calculated incorrectly and therefore setting any rate based on them is problematical." Under these circumstances, Rose's estimated per subscriber rates are "of no value in evaluating or setting leased access rates." Indeed, those NCTA member companies that have reviewed Rose's estimated per subscriber digital tier rates report to NCTA that they did not match up with the actual rates they charge, if determined on a per subscriber basis.

The second Rose report attempts to calculate the "transmission costs of leased access channels." But as Dr. Baumann also shows, this study too, "is flawed and is based on inaccurate data." Indeed, the vague nature of the data forming the basis of the second Rose report prompted the FCC to ask undisclosed questions about "[Rose's] methodology ... and the underlying data sources," at least according to a November 9 ex parte filed by Dr. Rose. But that ex parte, while reporting that the conversation took place, does not report what his answers or "data sources" were – even though the ex parte rules make clear that something more than merely "listing the

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subjects discussed” is necessary.¹ Obviously, it is impossible for interested parties to provide meaningful comments on information and arguments that have not been included in the public record, and the Commission cannot properly rely on them until they have been reported and tested through a public and transparent process.

In any event, even if these procedural and substantive infirmities were to be corrected, Rose’s analysis still “would provide no basis for setting the maximum leased access rates since his proposed rates ignore many of the obvious opportunity costs associated with carrying leased access programming,” according to Baumann, in particular the effect of leased access on subscribership and lost advertising revenues. Indeed, the Rose cost-based approach “suffers from the same infirmities that caused the Commission to abandon its attempt to set a cost-based rate a decade ago.”

In short, Dr. Baumann shows that neither MAP study justifies changing the leased access rate or adopting a flat fee approach. The record does not support revising the commercial leased access formula, and the FCC cannot and should not reduce the existing leased access rates.

Respectfully submitted,

/s/ Daniel L. Brenner

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Attachment

¹ 47 C.F.R. §1.1206 (b) (ex parte filing shall “contain a summary of the ex parte presentation and not merely a listing of the subjects discussed”). Moreover, if the FCC chooses to adopt a new methodology for determining leased access rates, it must provide an opportunity for public comment. That opportunity has been lacking in this proceeding, and the Commission cannot rely on late-filed ex parte comments or internal, undisclosed studies as a basis for departing from the existing rules. *See* Reply Comments of Comcast Corp. at 39-41.

**The Maximum Leased Commercial Access Rate:
A Critique of Dr. Rose's Analyses**

Michael G. Baumann

November 20, 2007

Executive Summary

- In his first submission, Dr. Rose attempts to study whether cable operators are following existing Commission regulations in setting leased access rates. He fails at this task and provides no insight into whether Commission regulations are being followed. The premise underlying his statistical analysis, that the maximum allowed per-subscriber monthly leased access rate is correlated with the number of system subscribers and operator revenues, is incorrect. The maximum per subscriber rate is independent of both of these measures. Therefore, his findings provide no evidence regarding the failure or success of the existing rate formula and his analysis provides no basis to support a claim that the existing rules should be modified. Indeed, the study's results are meaningless.
- Dr. Rose proposes that the Commission adopt a flat leased access rate for digital tier carriage of \$0.15 per subscriber per month. He provides no justification as to why a flat rate is appropriate and does not establish a basis upon which new maximum leased access rates could be computed. Moreover, the monthly commercial cable leased access rates per subscriber that Dr. Rose calculates and relies upon are inaccurate and, hence, are of no value in evaluating or setting leased access rates.
- In a second study, Dr. Rose attempts to calculate the transmission costs of leased access channels. He proposes leased access rates for analog and digital tier carriage of \$0.00591 and \$0.00825 per subscriber per month, respectively. This study is fundamentally flawed and is based on inaccurate data. Even if his calculations were correct, which they are not, they would not provide a basis for setting the maximum leased access rate since his proposed rates ignore many of the obvious opportunity costs associated with carrying leased access programming. In particular, he wholly ignores the effect of leased access on subscribership and the potential for lost advertising revenues.

The Maximum Leased Commercial Access Rate: A Critique of Dr. Rose's Analyses

Michael G. Baumann*

Earlier this year the Commission initiated a proceeding to review its leased commercial access rules.¹ As part of their Reply Comments in that proceeding, NAMAC *et al.* submitted an analysis of leased access rates prepared by Dr. Gregory Rose.² The purpose of Dr. Rose's study was to determine if cable operators were following existing Commission regulations in setting leased access rates.³ Dr. Rose asserts that if the existing regulations were being followed he would expect to find a correlation between the monthly per-subscriber leased access rates quoted by cable operators and the number of subscribers to the cable system or the cable system's revenues. Dr. Rose finds no statistically significant correlation between the per-subscriber rate and either of these measures. Based on these results, NAMAC *et al.* argue that "[o]ne can only conclude that the rate formula adopted by the Commission has utterly failed in practice to achieve the goals of certainty and affordability intended by Congress, or that cable operators have circumvented the

* Senior Vice President, Economists Incorporated. I previously filed "An Analysis of the Federal Communications Commission's Maximum Reasonable Leased Commercial Access Rate," May 15, 1996, in CS Docket No. 96-60.

¹ *Notice of Proposed Rulemaking*, In the Matter of Leased Commercial Access, Development of Competition and Diversity in Video Programming Distribution and Carriage, MB Docket No. 07-42, FCC 07-18, released June 15, 2007 ("*Notice*").

² Gregory Rose, "Commercial Cable Leased Access Fees: Are FCC Regulations Being Followed?" ("Rose1") filed as an attachment to "Reply Comments of National Alliance for Media Arts and Culture, Center for Creative Voices in Media, Alliance for Community Media, United States Conference of Catholic Bishops, United Church of Christ, Office of Communication, Inc., National Hispanic Media Coalition, Communications Workers of America, Free Press, and U.S. PIRG," MB Docket No. 07-42, October 15, 2007 ("NAMAC").

³ The current leased commercial access rules were adopted by the Commission in 1997. See, *Second Report and Order and Second Order on Reconsideration of the First Report and Order*, In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Leased Commercial Access, CS Docket No. 96-60, released February 4, 1997 ("*Order*").

Commission's rules to reenforce [sic] the barriers to entry Congress explicitly intended to remove."⁴

There is, however, another, much simpler, explanation why Dr. Rose fails to find a correlation between per-subscriber rates for leased access and his various economic and demographic variables. Simply put, there is no mathematical reason that there should be any correlation. The per-subscriber maximum rate formula is independent of the number of subscribers to the system and the system's revenue. Since Dr. Rose's underlying belief that there should be some correlation is incorrect at the outset, his findings provide no evidence regarding the failure or success of the existing rate formula and his analysis provides no basis to support a claim that the existing rules should be modified. Indeed, the study's results are meaningless.

Dr. Rose and NAMAC *et al.* also suggest that the Commission establish a flat leased access rate and permit cable operators to contest the rate by providing the Commission with all necessary cost data. They propose a flat monthly rate of 15 cents per subscriber, if not lower. Dr. Rose's calculations and justification underlying the proposed 15 cents per subscriber are flawed and baseless.

Dr. Rose also submitted a separate ex parte filing that purports to estimate the cost of physical transmission for potential leased access channels.⁵ He argues that the cost of physical transmission provides a base from which to set a fixed national rate for commercial cable leased access. He concludes that the total fees for analog and digital commercial cable leased access should be fixed at less than 1 cent per subscriber per month. Specifically, Dr. Rose proposes that analog and digital commercial cable leased access rates be fixed at \$0.00591 and \$0.00825 per

⁴ NAMAC at ii. Dr. Rose also concludes that the finding "calls into question whether the method for calculation of such fees mandated by FCC regulation is being followed by cable operators." Rose1 at 3.

⁵ Gregory Rose, "Estimation of the Costs of Physical Transmission of the Lowest-Rated 15% of Channels on the Analog and Digital Tiers of CATV Providers," November 6, 2007 ("Rose2").

subscriber per month, respectively.⁶ The analysis in this second Rose paper is also fatally flawed and provides no basis for a cost-based leased access rate.

Even if it were calculated correctly, the proposed rate is designed to cover just the cost of physical transmission and allegedly the costs of technical and studio fees. This proposal ignores other costs imposed on the cable operator from leased access, including lost subscriber and advertising revenue. The proposed cost-based rate suffers from the same infirmities that caused to Commission to abandon its attempt to set a cost-based rate a decade ago. As the Commission previously determined, a cost based method of establishing a rate is unworkable because it does not adequately account for certain factors which, if excluded, would cause the resulting leased access rates to fall below the statutory mandate .⁷

If the assertion that the current maximum leased access rate overcompensates cable operators were accurate, cable operators would be actively pursuing leased access programmers and attempting to replace non-leased access program services with leased access program services. As I noted in my analysis in 1996, since all parties agree this is not occurring, and that there is a significant amount of potential leased access capacity that is not being used for leased access, there is a flaw in this assertion. The obvious flaw is that even the current maximum leased access rate fails to fully recognize the opportunity costs resulting from carriage of leased access programming.

Background

The 1984 Cable Act established a commercial leased access requirement for cable operators. The intention of this requirement was to provide access to the channel capacity of certain cable systems by parties unaffiliated with the cable operator so that programmers could distribute

⁶ Rose2 at 6. As clarified in a letter from Harold Feld, Media Access Project, to the FCC, “*Erratum* in Notice of Oral *Ex Parte* Presentation in MB Docket No. 07-42,” November 6, 2007, the proposed rates reported in Dr. Rose’s report are on an annual basis.

⁷ Order at ¶¶ 25-30.

video programming free of the editorial control of the cable operator.⁸ The Act also provided that each cable system operator was to establish “the price, terms, and conditions of such use which are at least sufficient to assure that such use will not adversely affect the operation, financial condition, or market development of the cable system.”⁹ Subsequently, the 1992 Cable Act provided the Commission with the authority to determine the maximum reasonable rate that a cable operator may establish for leased commercial access use.¹⁰

The Commission in 1997 adopted rules that base a cable system’s maximum reasonable leased commercial access rate for carriage on programming tiers on the “average implicit fee” paid by non-leased access program services that are carried on those tiers.¹¹ The Commission also adopted a maximum leased access rate for a la carte services based on the “highest implicit fee” that other a la carte services implicitly pay. These maximum fees were set in order to permit the operator to recover its direct and opportunity costs. The Commission concluded that Congress did not intend that cable operators subsidize leased access programmers, and that as long as the maximum leased access rate is reasonable, a lack of demand for leased access channels would not indicate that the rate should be lowered.¹² In March 2007 the Commission released a *Notice of Proposed Rulemaking* seeking comments on the Commission’s leased access rules.¹³

As defined by the Commission, the “implicit” fee for a channel is the price per channel each subscriber pays the operator minus the amount per subscriber the operator pays the programmer

⁸ Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779 (1984), 47 U.S.C. § 521 *et seq.*

⁹ Communications Act, § 612(c)(1), 47 U.S.C. § 532(c)(1).

¹⁰ Communications Act, § 612(c)(4)(A)(i), 47 U.S.C. § 532(c)(4)(A)(i).

¹¹ The Commission’s rules governing commercial leased access are located at 47 C.F.R. §§76.970, 76.791, 76.975 and 76.977. In 1997, the Commission moved from a highest implicit fee formula to an average implicit fee formula.

¹² *Order* at ¶ 23. The FCC’s leased access rate formula was upheld by the Court of Appeals for the District of Columbia Circuit in *Valuevision International, Inc. v. FCC*, 149 F.3d 1204 (D.C.Cir. 1998).

¹³ *Notice* at ¶ 8.

for the channel. Even though cable operators generally pay programmers a license fee for their programming services, there is an implicit fee paid by the programmer for carriage to the extent that the amount of subscriber revenue that the operator receives for the programming is greater than the fee that the operator pays to the programmer.

The average implicit fee standard that the Commission adopted measures the average amount that full-time programmers implicitly pay the cable operator for carriage. In other words, the average implicit fee represents the average amount of subscriber revenue that full-time programmers cede to the operator to permit the operator to cover its costs and earn a profit. From the operator's standpoint, the average implicit fee represents the average value of a channel after programming acquisition costs have been paid.¹⁴

Dr. Rose's Correlation Analysis ("Rose1")

Dr. Rose conducts a study that purportedly examines the per-subscriber rates for analog stand-alone and digital tiered commercial leased access to determine if those rates are in compliance with the fee calculation procedures specified in 47 CFR §76.970. The maximum leased access rate calculated under the Commission's rules is expressed in terms of a monthly per-channel rate for a channel on a specific tier or as a standalone service. Dr. Rose attempts to determine compliance by testing for correlation between per-subscriber fees (as estimated by Dr. Rose from the leased access rates quoted) and the number of subscribers to the system. His basis for assuming there should be a correlation is simply that the formulas for setting the maximum leased access rate are dependent on subscriber count and revenue. He states, "[i]t follows from the fact that these definitions involve calculation of rates based on specific relationships between number of subscribers in tier or system and the revenues derived from such subscribers (minus production costs) that one would expect there to be a mathematical correlation between number of subscribers and revenues from such subscribers, on the one hand, and the monthly per subscriber rates for commercial cable leased access calculated by these methods mandated by the

¹⁴ Order at ¶ 33.

FCC and the fees actually charged by the cable operators.”¹⁵ Since cable operator subscriber revenue data were unavailable, Dr. Rose used various proxies for subscriber revenue and tested for correlation between per-subscriber fees and these revenue proxies.

Dr. Rose finds no statistically significant correlation between per-subscriber fees and either the subscriber count per system or the proxies for system revenue. He claims that this finding “calls into question whether the method for calculation of such fees mandated by FCC regulation is being followed by cable operators.”¹⁶ But there is a simpler explanation.

The finding is not surprising, since there is no mathematical reason that per subscriber leased access rates (even if calculated correctly) should be correlated with either subscriber count per system or proxies for system revenue. The maximum per subscriber rate is independent of these measures. If Dr. Rose had found any correlation it would be merely coincidental. Dr. Rose’s findings are not unexpected and are of no value in reviewing leased access rates.

While it is true that the Commission’s formulas for setting maximum leased access rates depend in part on the number of subscribers and operator revenues, the mere fact that these measures are used in the formula does not mean that the resulting maximum rate will be correlated with either. Indeed, working through the formulas to develop the maximum per-subscriber leased access rate indicates that there is no mathematical reason to expect a correlation between this rate and either the number of subscribers or total revenue.

The maximum leased access rate per-subscriber is the average implicit fee per channel per subscriber, where each tier is weighted by the percentage of system subscribers that subscribe to the tier. To illustrate this point, consider a cable system having two tiers with more than 50 percent subscriber penetration. Then, the maximum leased access fee per subscriber is given by

¹⁵ Rose1 at 6.

¹⁶ Rose1 at 3.

$$\frac{IF_1 + (\delta \times IF_2)}{C_1 + (\delta \times C_2)}$$

where

IF_i = implicit fee for tier i = $(Fee_i - Cost_i)$, i = tier 1, tier 2

Fee_i = monthly subscriber fee for tier i

$Cost_i$ = monthly programming costs per subscriber for tier i

C_i = number of channels on tier i

S_i = number of subscribers to tier i

and δ = percentage of tier 1 subscribers that subscribe to tier 2 = (S_2 / S_1) .¹⁷

Thus, the per-subscriber average implicit fee formula boils down to (roughly) subscriber revenues less program license fees divided by the number of channels. Effectively, the formula yields the average net-of-license-fee revenue per channel.¹⁸ The formula is independent of the number of subscribers to the system and the system's revenue. Therefore, there is no reason that the maximum rate derived from the formula should be correlated with the number of cable system subscribers, total system revenue, or any of the proxies Dr. Rose used—cable penetration, mean and median income, number of telephones, proportion of minority population, and mean commercial network affiliate broadcast advertising rates.¹⁹

¹⁷ See Appendix for derivation of formula.

¹⁸ It is not exactly the average net-of-license-fee revenue per channel (unless $\delta = 1$) since net revenue and channels on tier 2 are weighted by the proportion of tier 1 subscribers that also subscribe to tier 2. If the number of tier 2 subscribers equals the number of tier 1 subscribers then $\delta = 1$ and the characterization is exact.

¹⁹ Rose1 at 12. For an a la carte channel, the maximum implicit fee per subscriber is simply $(Fee_{j^*} - Cost_{j^*})$ where j^* is the existing a la carte service with the maximum implicit fee. There is no reason why the per subscriber net-of-license-fee revenue from an a la carte service should be correlated with any of the measures used by Dr. Rose.

Given that his statistical findings are not unexpected, Dr. Rose's hypothesis why he did not find any correlation must be taken as conjecture without support. The failure to find a correlation neither indicates a failure of the Commission's rate formula to produce reliable results nor provides evidence, as Rose asserts, that cable operators do not comply with the Commission's rate formula and set rates arbitrarily high to erect barriers to leased access carriage. His findings are meaningless.

Dr. Rose's Proposed Flat Rate of 15 Cents ("Rose1")

Based on his unfounded conclusion that monthly per-channel leased access fee quotes to potential lessees do not conform to the formulas mandated by the Commission, and on his equally unfounded conjecture that these fees impose barriers to entry to leased access carriage, Dr. Rose proposes that the Commission adopt a flat per-subscriber fee. Dr. Rose proposes a flat rate for digital tier carriage of \$0.15 per subscriber based on the mean rate of systems in the New York and Los Angeles DMAs. Why? This fee was chosen apparently because there is a correlation between alleged lower rates and the systems located in one of these DMAs. Dr. Rose claims that there is somehow more transparency or triopoly competition in New York and Los Angeles than in other markets and that this explains why rates are lower in these areas and hence are more likely to be set at the appropriate level. Even if this were true, which it is not, this would not justify setting a nationwide uniform rate at this level. However, Dr. Rose has a larger problem in that his per-subscriber rates appear to have been calculated incorrectly and therefore setting any rate based on them is problematical.

To calculate the per-subscriber leased access rates reported in Rose1 Table 1, Dr. Rose divided the monthly per-channel leased access rates he obtained from cable operators by subscriber numbers. While he had some data provided by a handful of systems, Dr. Rose primarily relied on system subscriber data obtained from Nielsen Media Research. Using these data introduced errors into his per-subscriber calculations. To correctly calculate the per-subscriber fee, what is required is not the number of system subscribers, but the number of subscribers to the tier or the a la carte service for which the rate is quoted. But the Nielsen subscriber data are not tier-specific and the data may not even be cable system-specific. Dividing the quoted rate by total system

subscribers or some larger number of subscribers is incorrect, and yields a per-subscriber rate that is too low, since generally there are fewer subscribers to a digital tier or to a standalone analog service than there are to the system. Hence, the monthly commercial cable leased access rates per subscriber reported in Rose’s Table 1 are undoubtedly all incorrect. Rose’s calculated rates are of no value in evaluating or setting the appropriate leased access rates.

NAMAC *et al.* attempt to provide another justification for a \$0.15 per subscriber flat rate. They argue, “[a]s useful benchmarks, the Commission should consider the rate cable operators pay for programming. Industry sources set the average rate cable operators pay (sic) for programming at 15 cents/sub.”²⁰ This attempted justification has no merit. It makes no sense to set the value of a product at the cost of one of its inputs. The fee a cable operator pays for programming provides no information about the value of the programming to the operator; except that the value must exceed the fee (if it did not, the operator would not purchase the programming). The value of the programming to the operator is the revenue that the programming generates. The net value is this revenue less the license fee paid. The leased access rate should be set to compensate for this lost net value. The license fee bears no relationship to this net value and cannot be used as a simple proxy for the value.

Dr. Rose’s Estimation of Costs and a Cost Based Rate Determination (“Rose2”)

In a second paper, Dr. Rose seeks to set the leased access rate based on his calculation of the transmission costs associated with a leased access channel. Even if this were the correct standard by which to set the maximum allowed rate, which it is not, Dr. Rose’s analysis is fatally flawed. Dr. Rose does not actually provide any factual data regarding those transmission costs. Rather, he simply tries to estimate those costs through backing out certain programming costs and profits from basic and digital tier revenues. Even if his calculations were not fatally flawed, there is no reason to assume – and Rose provides none—that his methodology would yield transmission costs for leased access channels or would cover costs associated with technical and studio

²⁰ NAMAC at 12.

support. Moreover, much of the underlying analysis is not adequately documented, making a proper independent review impossible.²¹

Most fundamentally, Dr. Rose's analysis entirely ignores other significant costs imposed on the cable operator that are associated with carrying leased access programming. As the Commission previously found, it is clear there are opportunity costs associated with the carriage of leased access programming. One of the key opportunity costs of carrying leased access programming is a reduction in current and potential subscriber revenues. A reduction in current subscriber revenues can occur either because subscribers discontinue their cable service or discontinue purchasing a particular service tier, or because the operator has to lower tier rates in order to retain subscribers by an amount that more than offsets the revenues from the leased access fee.

Losing subscribers affects not only the operator's revenues from tier services but also the revenues from premium services, VOD, and other digital services. A smaller subscriber base will mean a diminished ability to market non-video services, such as high speed data and telephone services. Additionally, advertising revenues will be adversely impacted as viewership on a tier dwindles and as operators no longer can insert local advertising into channels that must be dropped to make room for leased access programmers. Revenues also will be reduced because it will be more difficult to attract new subscribers.

By focusing solely on transmission costs and ignoring the demand side, Dr. Rose misses the cost imposed on subscribers, and thereby on the cable operator, of carrying less desirable programming. As required by the statute, the leased access fee must cover this opportunity cost, lost subscriber revenues, and other opportunity costs in order to avoid adversely affecting the cable system.

²¹ According to a November 9, 2007 ex parte, the FCC asked Dr. Rose about his methodology and underlying data sources. Other than reporting that this conversation took place, Dr. Rose did not introduce any evidence into the record – in his November 9 ex parte or in the Rose2 report -- that addresses these fundamental questions about the soundness of his analysis.

Dr. Rose is not the first to suggest a “cost-based” approach to setting the leased access rate. In 1996, the Commission proposed an alternative approach using a “cost/market rate formula.” However, after reviewing the record in the proceeding and after carefully considering and analyzing all of the options presented, the Commission concluded that the cost/market rate formula did not adequately account for certain factors which, if excluded, would cause the resulting leased access rates to fall below the statutory mandate. One factor that the proposed formula did not account for was the negative effects that leased access programming might have on subscribership and subscriber revenues. The Commission came to the conclusion that this was a factor that could not be ignored as being too speculative or having no measurable effect.²²

Although providing no empirical evidence, Dr. Rose claims that the “selection of the lowest-rated fifteen percent of channels on each tier ... represent direct substitutables (sic) for commercial cable leased access carriage content.”²³ Dr. Rose’s study does not attempt to factor in the decline in subscribership that would be caused by the dropping of lower-rated cable channels that are highly valued by certain segments of the cable system’s subscribers. As has been well documented in the past, efforts to drop channels from a cable line-up are often met with great displeasure on the part of some cable customers. Moreover, the claim that operators will choose to take off the lowest rated services and put leased access on instead is not supported by Dr. Rose and is not necessarily correct. Operators may not have the ability to take off certain services, regardless of ratings, due to contractual obligations. Furthermore, cable operators choose to carry certain (low-rated) niche networks because they are valuable in attracting additional subscribers or retaining existing subscribers. Given that leased access rules do not apply to one of cable’s largest competitors (DBS), some customers who wish to get the cable channels that are displaced by leased access channels will switch to another MVPD. This decline in subscribership will have a direct impact on the financial condition of a cable system.

²² Order at ¶ 27.

²³ Rose2 at 2.

Dr. Rose's second study is flawed in numerous other ways, making his methodology and conclusions entirely inappropriate even if opportunity costs were not excluded from the mix.

First, Dr. Rose grossly understates basic analog service revenues which are a key driver in his results. He claims that "Total Basic Analog Service Revenue" equals \$8.819 billion and that there are 59.48 million analog subscribers. This implies that subscribers pay \$12.36 per month for basic analog service.²⁴ Clearly, this monthly rate can only apply to the broadcast basic service tier (BST). However, given that most cable programming networks are carried on a cable programming service tier (CPST), also referred to as an expanded basic tier, Dr. Rose should have used the total service revenues from all analog services (BST plus CPST). According to SNL Kagan data, basic cable revenue (*i.e.*, analog service revenue) will total \$33.686 billion in 2007. That is, actual analog revenues are 282 percent larger than reported by Dr. Rose. Understating revenues will understate Dr. Rose's estimate of transmission cost, since he calculates transmission cost as revenues less licensing fees and profit.

Second, he claims that Basic Analog Service (BAS) revenue from the lowest-rated 15% of tier channels amounts to \$170.21 million. Dr. Rose never even identifies those channels he claims are the lowest-rated 15 percent, making his claims unverifiable. He compounds these infirmities by simply claiming that this estimate was "obtained from various sources" without documenting how this number was calculated. Dr. Rose thus provides no way to independently verify the number. Since total analog revenues are the starting point for his analysis, one can only wonder if this estimate is also off by several hundred percent. Perhaps even more importantly, the actual revenue derived from the carriage of any channel must also take into account the additional subscribers that that channel has either attracted or retained and the revenues attributable to those subscribers. None of the sources cited by Dr. Rose in Rose2 Table 1 account for this factor.

Third, as with the BAS revenue from the lowest-rated 15% channels, Dr. Rose provides no documentation for how he calculated the "Mean Licensing Fees for BAS lowest-rated 15% of

²⁴ This is derived as \$8.819 billion divided by 59.48 million subscribers divided by 12 months.

tier per subscriber.” However, Dr. Rose’s estimate that the average license fee for the lowest-rated 15% of analog channels is \$2.57 per subscriber per year implies a license fee of about 21.4 cents per subscriber per month.²⁵ This seems high for the lowest-rated channels. To spot check this number, I used the analog channel lineup for Comcast’s Washington D.C. cable system. Using data from SNL Kagan on cable network ratings and license fees, I determined the lowest rated 15% of analog channels on the system, ignoring broadcast and PEG channels, and computed that the average license fee per channel was about 13 cents per month or about \$1.56 per year.²⁶ Overstating licensing fees will understate Dr. Rose’s estimate of transmission costs.

Fourth, it is equally unclear how Dr. Rose arrived at his estimates for Basic Digital Service (BDS) revenue from the lowest-rated 15% of tier channels and “Mean Licensing Fees for BDS lowest-rated 15% of tier per subscriber.” Dr. Rose does not identify these services, either. I do note, however, that the license fees charged for digital channels are typically significantly less than those for channels carried on analog. In contrast, Dr. Rose’s analysis has a higher mean license fees for digital (\$2.66) than for analog (\$2.57). This does not seem correct, and suggests that one (or both) of these numbers is incorrect.

Fifth, Dr. Rose improperly uses Reuters “profit margins” for five cable companies to ascertain the amount of “Mean CATV profit per subscriber” for the lowest-rated 15% of channels. It is not clear what the reported profit margins measure and, moreover, an overall profit margin for a company is not an adequate estimate of the margin for video plant. Each of these companies has revenues and costs from a variety of activities, including basic and digital cable programming

²⁵ Alternatively, it is possible that the data in Rose2 Tables 3 and 4 are not on a per channel basis but are for all channels that comprise the lowest-rated 15% of the tier. In that case, since analog basic is typically comprised of about 75 channels, fifteen percent of 75 channels would equate to eleven channels. Based on an estimate that the lowest-rated 15% of channels have license fees totaling \$2.57 per subscriber per year, this amount would equate to a license fee of less than 2 cents per subscriber per month per channel for the lowest-rated 15% of channels. The 2 cent fee is far below what the typical cable network carried on an analog tier charges. Moreover, if Dr. Rose’s numbers are not per channel, but for all of the 15% lowest-rated channels, then Dr. Rose is advocating a monthly per channel leased access rate of \$0.000537 per subscriber for the analog tier and \$0.000750 per subscriber for the digital tier.

²⁶ This is based on the ratings data and license fees reported for the nationally distributed cable programming services listed under “Basic” on the channel line-up card.

service, premium and video-on-demand programming service, cable programming networks, internet service, telephony, and possibly other media interests. It is incorrect to assume that the overall profit rate from all of these activities applies to the video operations. Dr. Rose also does not explain why a measure of profit should be subtracted from revenues and why lessees should not have to contribute to the cable system's profit margin.

Finally, Dr. Rose improperly looks only at the lowest-rated 15% of cable channels to ascertain the transmission costs. He presents no evidence that the cost of physically transmitting a lower-rated cable channel is any different (cheaper) than physically transmitting the top-rated cable channel. For any given cable system, the cost of physically delivering any 6 MHz analog video cable channel to a customer's home is the same regardless of content. By ignoring this key and simple engineering fact, he wrongly leaves out the revenues and costs associated with the remaining video programming.

Conclusion

Dr. Rose's analysis provides no insight into whether FCC regulations are being followed, and provides no valid information that could be used to set a flat leased access fee. For reasons discussed above, his correlation findings are of no value. To base policy decisions this analysis would be irresponsible.

Dr. Rose states, without support, that a flat commercial leased access rate of 15 cents per subscriber for digital tiers should be a reasonable rate for cable operators. This rate appears to be based upon the low per-subscriber leased access rates in the New York and Los Angeles DMAs he inaccurately computed in Rose1 Table 1. He provides no justification for why a flat rate is appropriate and does not establish a basis upon which new maximum leased access rates could be computed. Dr. Rose provides no basis for a flat rate or any other alternative to the existing maximum rate calculation.

Dr. Rose's attempt to calculate the costs of physical transmission of leased access channels is fraught with errors. His proposed analog and digital leased access rates of \$0.00591 and \$0.00825 per subscriber per month, respectively, are illogical and unrealistically low. Even if his calculations were correct, which they are not, they would not provide a basis for setting the maximum leased access rate since they ignore many of the obvious opportunity costs associated with carrying leased access programming.

APPENDIX

Average Implicit Fee Calculation for Programming Tiers with More Than 50% Subscriber Penetration

The maximum commercial leased access rate that a cable operator may charge for full-time channel placement on a tier exceeding subscriber penetration of 50 percent is the average implicit fee for full-time channel placement on all such tier(s).

Assume that there are only two tiers with more than 50% subscriber penetration. The analysis is similar if there are more than two tiers but the additional tiers complicate the expression. Let

S_i = number of subscribers to tier i , $i=1, 2$

C_i = number of channels on tier i

Fee_i = monthly subscriber fee for tier i

$Cost_i$ = monthly programming costs per subscriber for tier i

Following the Commission's average implicit fee (AIF) calculation:

$$\text{Combined Subscriber Revenue} = S_1 \times Fee_1 + S_2 \times Fee_2$$

$$\text{Combined Programming Costs} = S_1 \times Cost_1 + S_2 \times Cost_2$$

$$\text{Total Implicit Fee} = S_1 \times (Fee_1 - Cost_1) + S_2 \times (Fee_2 - Cost_2)$$

$$\text{Total Subscriber Channels} = S_1 \times C_1 + S_2 \times C_2$$

$$\text{Implicit Fee for Tier } i = \frac{S_i \times C_i}{S_1 \times C_1 + S_2 \times C_2} (S_1 \times (Fee_1 - Cost_1) + S_2 \times (Fee_2 - Cost_2))$$

$$\text{AIF for Tier } i = \frac{S_i}{S_1 \times C_1 + S_2 \times C_2} (S_1 \times (Fee_1 - Cost_1) + S_2 \times (Fee_2 - Cost_2))$$

Dr. Rose expresses the maximum fee on a per subscriber basis. Assuming that he divides the AIF by the correct number of subscribers, this yields

$$\text{AIF per Subscriber for Tier } i = \frac{S_1 \times (\text{Fee}_1 - \text{Cost}_1) + S_2 \times (\text{Fee}_2 - \text{Cost}_2)}{S_1 \times C_1 + S_2 \times C_2}$$

Note that the AIF per Subscriber does not depend on the tier. AIF per subscriber can be rewritten as

$$\text{AIF per Subscriber} = \frac{IF_1 + \delta \times IF_2}{C_1 + \delta \times C_2}$$

where

IF_i = implicit fee on tier $i = (\text{Fee}_i - \text{Cost}_i)$ and

δ = percentage of tier 1 subscribers that subscribe to tier 2 = (S_2 / S_1) .

Maximum Implicit Fee Calculation for A la Carte Channels

The maximum commercial leased access rate that a cable operator may charge for full-time channel placement as an a la carte service is the highest implicit fee on an aggregate basis for full-time channel placement as an a la carte service.

For commercial leased access as an a la carte service, assume there are J a la carte channels on the cable system. Let

Fee_j = monthly subscriber fee for channel $j, j = 1, \dots, J$

Cost_j = monthly programming cost per subscriber for channel j

S_j = number of subscribers to channel j

Then the maximum leased access rate for an a la carte service is

$$\text{Max} \{S_1 \times (\text{Fee}_1 - \text{Cost}_1), S_2 \times (\text{Fee}_2 - \text{Cost}_2), \dots, S_J \times (\text{Fee}_J - \text{Cost}_J)\}$$

Assume the highest implicit fee on an aggregate basis occurs for channel j^* . Then the maximum leased access rate would be $S_{j^*} \times (Fee_{j^*} - Cost_{j^*})$. If this were divided by the number of subscribers, then the maximum fee per subscriber would be $(Fee_{j^*} - Cost_{j^*})$.

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