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

In the Matter of	)	
	)	MB Docket No. 07-42
Leased Commercial Access	)	

COMMENTS OF THE

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NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

The National Cable & Telecommunications Association (NCTA) hereby submits its comments on the Further Notice of Proposed Rulemaking in the above-captioned proceeding.

INTRODUCTION

In its Report and Order in this proceeding,[1] the Commission adopted new rules governing the rates and procedures for the provision of commercial leased access channels pursuant to Section 612 of the Communications Act of 1934, as amended. Specifically with respect to rates, the Commission changed the formula for determining the maximum permissible rate that a system may charge for such channels.

Under the former rules, maximum rates were set at the "average implicit fee" that operators received from program networks carried on the tier on which commercial leased access channels are made available. In general, the average implicit fee represents the difference between the amount received by cable operators from their customers for the entire tier and the amount that operators pay for the programming on the tier, divided by the number of channels on

[1] *Report and Order and Further Notice of Proposed Rulemaking*, FCC 07-208 (released Feb. 1, 2008) ("Report and Order").

the tier. Under the new rules, rates will be capped at the "marginal implicit fee," which, according to the Commission, is supposed to represent the difference between the amount that an operator receives from customers for the least valuable channels on the tier – *i.e.*, the channels that the Report and Order assumes are likely to be removed to make room for leased access channels – and the amount the operator pays for those channels.

But the Commission decided, at least for the time being, not to apply this rule change to "programmers that predominantly transmit sales presentations or program length commercials" ("shopping channels"). The Commission recognized that, unlike most other program networks carried on cable systems, shopping channels typically pay cable operators for carriage. And it was concerned that setting leased access rates at a "marginal implicit fee" that will, in many cases, approach or be equal to zero – and which is, in any event, arbitrarily capped at 10 cents per channel – will simply cause existing shopping channels to "migrate to leased access because it is less expensive than their current commercial arrangements."[2]

To confirm that this is the case, the Commission is seeking comment, in a Further Notice of Proposed Rulemaking, on "whether leased access is affordable at current rates" to shopping channels, and "whether reduced rates would simply cause migration of existing services to leased access."[3] These are not hard questions. That leased access is readily affordable to shopping channels at current rates is obvious from the fact that shopping channels are ubiquitously *available* on leased access. And there is every reason to think that shopping channels that currently pay cable operators a percentage of their sales revenues for carriage would find it more attractive to pay operators *nothing* for such carriage.

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2 *Report and Order*, ¶ 37.

3 *Id.*

The Commission's new rate formula is seriously flawed in any event, even as applied to non-shopping programming. The concept of a "marginal implicit fee" is based on a notion that the Commission expressly rejected when it adopted the "average implicit fee" formula in 1997 – namely, that it is possible to calculate the implicit fee paid by particular program networks that are offered as part of a multichannel tier.[4] Now, the Commission has attempted to do just that, without even acknowledging its prior explanations of why it cannot be done. NCTA is seeking judicial review of the new rules and will show, in that appeal, why the new approach – which, according to Commissioner Adelstein, was "invented … out of whole cloth" – is arbitrary and capricious.[5]

But, for the very reasons identified by the Commission in *this* further proceeding, it would be *particularly* wrong and counterproductive to extend the marginal implicit fee approach to shopping channels. Given the unique economics of such channels compared to other program networks, the effect would be to enable existing shopping channels to migrate to leased access and stop paying cable operators for carriage. And it would encourage a flood of new shopping channels using virtually free access to cable channels to sell their wares.

I. LEASED ACCESS IS READILY AFFORDABLE TO SHOPPING NETWORKS AT CURRENT RATES

Whether or not leased access is "affordable" to particular program networks at a particular rate is, of course, not the test of whether that rate is reasonable under Section 612. To the contrary, Congress recognized that it was quite possible – even likely – that leased access

[4] *Second Report and Order and Second Order on Reconsideration of the First Report and Order*, 12 FCC Rcd 5267, 5284 (1997). Indeed, the United States Court of Appeals for the District of Columbia Circuit, in affirming the Commission's "average implicit fee" approach, specifically explained why it would be impossible to identify an implicit fee for the least valuable or marginal channels on a tier. *ValueVision Int'l, Inc. v. FCC*, 149 F.3d 1204, 1211 (D.C. Cir. 1998).

[5] *In the Matter of Leased Commercial Access*, Report and Order and Further Notice of Proposed Rulemaking, MB Docket No. 07-42, FCC 07-208, Statement of Commissioner Jonathan S. Adelstein, at 2 (Nov. 27, 2007).

would *not* be affordable to a substantial number of potential programmers at rates that are reasonable and do not "adversely affect the operation, financial condition, or market development of the cable system." As the D.C. Circuit recognized,

> Congress never intended to ensure financial success for leased access programmers. In fact, the Senate Report frankly acknowledged that leased access might not be economically viable. Outside of leased access, cable operators pay for the programs they select, offsetting the high costs of production borne by programmers. Yet under even the most generous formula, leased access programmers would be required to pay some fee to operators for access. Cable operators informed the Senate during oversight hearings that most programmers simply cannot afford to pay for access. The Senate Report conceded that the "cable industry has a sound argument that the economics of leased access are not conducive to its use."[6]

Nevertheless, it is apparent that leased access *is* affordable to shopping networks at current (*i.e.*, "average implicit fee") rates. Indeed, as a result of the unique economics of shopping channels – where such channels rely on sales of their products, rather than on subscriber fees and advertising, as their source of revenues – leased access is *more* affordable to them than to other program networks. Even supporters of the new rates acknowledge that this is the case. Thus, according to Andrew J. Schwartzman, president of Media Access Project, "Right now, the programmers that can most afford the lease rates . . . are shopping networks and religious groups."[7]

The surest proof of this is that shopping networks are currently leasing channels on systems across the nation and are, in fact, the predominant users of leased access channels. As Comcast stated in its comments on the initial Notice of Proposed Rulemaking in this proceeding, approximately half of the leased access time purchased on its systems is used for infomercials or

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6 *ValueVision*, 149 F.3d at 1209-10, *quoting* S. Rep. No. 102-92, 102d Cong., 2d Sess. at 31 (1991).

7 Bob Fernandez, *FCC Untangling Industry Norms*, Philadelphia Inquirer, Nov. 13, 2007, http://www.philly.com/philly/business/20071113_FCC_Untangling_Industry_Norms.html?referrer=delicious.

home shopping.[8] According to Time Warner, about a third of leased access usage on its systems falls into this category.[9]

Might there be even *more* shopping channels filling leased access channels if the price for such usage were reduced to zero, or even to 10 cents per subscriber per month? Of course. If access were free, anyone might line up to advertise his or her products to the cable system's subscribers – just as a newspaper would likely attract more advertisers if the price of display ads and want ads were reduced to zero. But the purpose of the commercial leased access provisions of the Cable Act was never to set aside cable channels for the posting of free video advertising at the expense of operators or, ultimately, subscribers.

Shopping channels are currently available on cable systems as the result of agreements, under which the shopping channels pay operators a negotiated fee – including, typically, a percentage of their sales revenues – for carriage. And additional shopping channels are obtaining access to cable systems via commercial leased access, under existing rules that provide an affordable alternative to such negotiated agreements. There is no basis for making leased access for such channels more "affordable" by setting the rates far below the negotiated fees that shopping channels typically pay for carriage.

II. REDUCED RATES WOULD CAUSE MIGRATION OF EXISTING SHOPPING NETWORKS TO COMMERCIAL LEASED ACCESS CHANNELS

Applying the "marginal implicit fee" formula to shopping channels would set the rates for such channels so far below the currently negotiated fees that it would result in the migration of existing shopping channels to leased access. It is intuitively obvious that this would be the case. Unlike most other cable program networks, shopping channels pay operators for carriage.

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8 Comcast Comments at 17.

9 Time Warner Cable Comments at 14.

If they can gain comparable carriage while paying less – or, as is likely to be the case under the new rules, while paying *nothing* – it is not hard to see why they would opt to switch to leased access.

The attached declaration of Larry Gerbrandt,[10] a media analyst with particular expertise regarding home shopping channels, confirms that the differential between current negotiated fees and the new marginal implicit fee would lead to this result. According to Gerbrandt, home shopping channels typically pay cable operators approximately 5% of their gross revenues – in essence, commissions on sales – in return for carriage on cable systems.[11] They may also agree to purchase advertising on the cable system's channels, and in some instances may provide upfront guarantees and provide other consideration.[12]

As Gerbrandt points out, there are certain additional benefits and efficiencies that shopping channels may receive when they negotiate for carriage that they would not receive if they opted for leased access. For example, they may gain promotional benefits and co-op advertising, as well as guaranteed specific channel positioning.[13] But even taking these benefits into account, Gerbrandt concludes that allowing shopping channels to take advantage of the new "marginal implicit fee" formula – which, in his analysis, will yield rates that in many cases are approximately *zero* – will "driv[e] virtually *all* existing home shopping channels to the FCC's leased access model."[14]

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[10] Declaration of Larry Gerbrandt, Attachment A to these comments ("Gerbrandt Declaration").

[11] Gerbrandt Declaration, ¶ 9.

[12] *Id.*, ¶ 10.

[13] *Id.* "Since cable operators directly benefit from efforts to increase home shopping sales in their systems, it is in their interest to actively promote these services." *Id.*

[14] *Id.*, ¶ 13 (emphasis in original).

While, as noted in Part I, *infra*, shopping channels have proliferated as the predominant users of leased access under the existing "average implicit fee" rate formula, Gerbrandt points out that there have been very few instances of *existing* shopping channels migrating from negotiated carriage arrangements to leased access.[15] But he confirms that "[t]his undoubtedly would not be the case" under the marginal implicit fee formula. Today, according to Nielsen data, the average cable system today carries 2.09 home shopping channels.[16] And for these channels, "[v]irtually free carriage would make leased access a very attractive way to garner cable carriage."[17]

As the Commission has recognized, a maximum rate that resulted in such migration of existing channels to leased access would do nothing to promote the objectives of leased access and would be at odds with the statutory directive that the rules "not adversely affect the operation, financial condition, or market development of the cable system."[18] It "would not add to the diversity of voices and would potentially financially harm the cable system."[19]

As Gerbrandt shows, the magnitude of that harm would be enormous. While the new formula is likely in many instances to require rates that approach zero, "[e]ven using the FCC's leased access rate it derived in its example in Appendix D of the Further Notice (2.7 cents per subscriber), cable operators would lose *approximately $259 million* in revenues from the home shopping networks currently carried on their systems."[20] Moreover, the harm associated with this loss in revenues would be significantly compounded by the fact that the commercial leased

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15 *Id.* ¶ 17.

16 *Id.*, ¶ 11.

17 *Id.*, ¶ 17.

18 47 U.S.C. §532(c)(1).

19 *Report and Order*, ¶ 37.

20 Gerbrandt Declaration, ¶ 19 (emphasis added).

access rules apply only to cable and not to the DBS systems and other non-cable MVPDs, who will not be required to give up their shopping channel revenues. Thus, the rules will give an artificial competitive boost to those companies at the expense of cable operators.

Thus, the Commission was right to worry that applying the new formula to shopping channels would result in harmful and counterproductive migration of those channels to leased access. Because that is exactly what would happen, the Commission should adhere to its initial decision and continue to apply the existing "average implicit fee" formula to such channels.

III. APPLYING THE NEW FORMULA TO SHOPPING CHANNELS WOULD LEAD TO THE RISE OF MORE LEASED ACCESS SHOPPING CHANNELS

Applying the new "marginal implicit fee" formula to shopping channels would not only result in the migration of existing networks to leased access. It would also flood the leased access marketplace with a proliferation of *new* shopping channel applicants that would likely occupy the majority of leased access channels.

As discussed above and as Gerbrandt explains,

> [t]he home shopping channel economic model is unique in the television programming business. In contrast to virtually every other basic cable network they do not have to compete with other channels for national advertising. They do not have to license programming and the cost of producing home shopping shows is often less than many other forms of programming.[21]

Moreover, unlike most other forms of programming, shopping networks have a source of revenue other than advertising and subscriber fees. As a result, home shopping programmers are able and willing to pay for carriage (so that they can reach potential buyers of whatever they are selling), while other programmers typically rely on payments *from* cable systems and their subscribers.

[21] *Id.*, ¶ 18.

What this means is that establishing the same maximum leased access price for shopping channels and other program services will inevitably distort the marketplace in favor of shopping channels. At virtually any price point, leased access would be more attractive to shopping channels than to services that have additional licensing fees and production costs and none of the sales revenues of shopping channels. And at the price point established by the new marginal implicit fee formula – approximately zero – the disparity is likely to be overwhelming.

As Gerbrandt states, "Once other potential home shopping programming services ascertain that the commercial leased access rate is near zero, cable operators will be likely flooded with requests for leased access carriage by such services – especially if (as will often be the case) they are guaranteed carriage on an analog tier."[22] A zero rate will encourage the rise of leased access programmers with particularly low programming and production costs or other sources of revenue or subsidy, such as home shopping channels.

Even if the new marginal fee formula is not extended to shopping channels, that formula will impose unwarranted costs and disruptions on cable operators, cable program networks and cable customers – costs and disruptions that implicate and infringe First and Fifth Amendment interests. By setting a rate close to zero that effectively turns commercial leased access channels into the equivalent of public access channels, it is sure to attract an array of low-cost, low-quality or subsidized programming that displaces existing programming services that attract regular or occasional viewership on existing tiers. Extending this approach to shopping channels as well would result in a plethora of such channels.

[22] *Id.*, ¶ 16.

CONCLUSION

For the foregoing reasons, the Commission should not apply its new rate methodology to programmers that predominantly transmit sales presentations or program length commercials.

Respectfully submitted,

/s/ Daniel L. Brenner

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ATTACHMENT A

Declaration of Larry Gerbrandt in Support of Comments of the National Cable & Telecommunucations Association

I, Larry Gerbrandt, declare and state as follows: I am a principal with Media Valuation Partners. I founded this company in 2007. Prior to founding this company, I was SVP/general manager for Nielsen Analytics, a division of The Nielsen Company. From 1984 to 2004 I was a Senior Analyst at Paul Kagan Associates (now SNL Kagan) and was also COO of the company from 2001 to 2004.

1. SLN Kagan is a leading provider of research, data and analysis on the cable television, broadcast television, motion picture, home video and wireless communication industries.

2. I have testified or provided affidavits in over 20 legal proceedings as an expert witness on issues related to the custom, practice, economics and valuations of media and entertainment assets, including the Copyright Arbitration Royalty Proceedings, the Digital Performance Right In Sound Proceedings, the Satellite Arbitration Royalty Proceedings and in multiple cases involving the value of cable network assets.

3. In 1986 I launched the first monthly newsletter devoted to covering the home shopping industry, Kagan's *Home Shopping Investor* and also consulted with many entrants into the sector, including Cable Value Network and the JC Penney Shopping Channel.

4. In total, I have been an analyst in the cable television programming market for 24 years.

5. Basic cable programming networks have developed over the past 35 years based on an economic model that typically requires a dual revenue stream: advertiser sales and license fee revenues. Most basic cable networks could not rely solely on either source of revenue.

6. The economic model for basic cable networks has allowed for a diverse choice of programming to be made available to consumers. The cable programming industry has grown from a handful of channels in the mid-1970s to over 565 in 2006 according to the FCC's 13th Annual Report on the Status of Video Competition.

7. One category of cable programming networks works on a very different economic model. These channels, commonly referred to as home shopping channels, operate by selling

goods and services directly to viewers, as well as providing viewers with information about those goods and services.

8. Unlike cable networks that rely on license fee revenues (paid by cable operators to a programmer), home shopping channels typically <u>compensate</u> cable operators in return for carriage.

9. The amount of compensation is typically based on a percentage of sales in the cable operator's franchise area. Home shopping channels pay roughly 5% of gross revenues in the cable system franchise area for carriage. .

10. In addition to commission sales, home shopping stations typically pay other consideration in exchange for voluntary carriage on a cable system. For example, shopping channels may pay upfront guarantees and provide other consideration to cable operators in exchange for carriage. Both HSN and QVC negotiate for carriage with cable MSOs and satellite service providers under long term agreements. These agreements can typically contain multiple terms that may be beneficial to both parties, including specific channel position, tier carriage, number of hours (in the case of partial day carriage), promotional programs, and coop advertising on local avails in other cable program networks. Since cable operators directly benefit from efforts to increase home shopping sales in their systems it is in their interest to actively promote these services.

11. According to Nielsen data, the average cable system today carries 2.09 home shopping channels.

12. The FCC recently dramatically altered its approach to calculating the maximum permitted rate for commercial leased access channels. I have reviewed the FCC's new "marginal implicit fee" formula and estimate that the new formula will garner a fee that is likely, in many cases, to be approximately zero ($0.00). In any event, the rules provide that the rate may not exceed $0.10 per subscriber per month for leased access channels, even if the formula were to yield a higher rate.

13. The FCC did not, however, apply the revised formula to home shopping channels, which, for now, remain subject to the "average implicit fee" formula, which yields a significantly higher leased access fee. Allowing home shopping channels to use the rates

derived under the marginal implicit channel approach is tantamount to driving virtually *all* existing home shopping channels to the FCC's leased access model. This would significantly diminish operator revenues from such channels, which, in turn, would put upward pressure on retail pricing for those tiers of services with leased access channels.

14. Under the FCC's marginal implicit fee approach, it would be in the economic interest of a home shopping channel to migrate its service from the current contracts in which it pays cable operators five percent of its sales revenues in return for carriage to an approach which will generate a flat fee of no greater than $0.10 per subscribers (and likely closer to free carriage).

15. Moreover, such a move would foster the growth of even *more* home shopping channels, since it would reduce the leased access rates for such channels to approximately zero.

16. Once other potential home shopping programming services ascertain that the commercial leased access rate is near zero, cable operators will be likely flooded with requests for leased access carriage by such services – especially if (as will often be the case) they are guaranteed carriage on an analog tier. Established cable programming service may have to be dropped (or bumped to another tier) in order to accommodate leased access programmers.

17. There were very few instances of existing home shopping channels migrating to leased access carriage under the FCC's average implicit fee approach. This undoubtedly would not be the case under a marginal implicit fee approach. Virtually free carriage would make leased access a very attractive way to garner cable carriage. The home shopping channel economic model is unique in the television programming business. In contrast to virtually every other basic cable network they do not have to compete with other channels for national advertising. They do not have to license programming and the cost of producing home shopping shows is often less than many other forms of programming. Under the leased access rules being proposed, the cost of carriage (the commission on merchandise sold to subscribers) would be eliminated. Given these factors it is likely there would be a rapid proliferation of home shopping shows on leased access channels.

18. The home shopping channel economic model is unique in the television programming business. In contrast to virtually every other basic cable network they do not have to

compete with other channels for national advertising. They do not have to license programming and the cost of producing home shopping shows is often less than many other forms of programming. Under the leased access rules being proposed, the cost of carriage (the commission on merchandise sold to subscribers) would be eliminated. Given these factors it is likely there would be a rapid proliferation of home shopping shows on leased access channels, even if the leased access rates were 10 cents per subscriber.

19. The Commission, by allowing home shopping channels to use the leased access fee derived under their marginal implicit fee approach, would severely distort the cable program marketplace. Cable operators would not be adequately compensated for carriage of the home shopping channels. Even using the FCC's leased access rate it derived in its example in Appendix D of the Further Notice (2.7 cents per subscriber), cable operators would lose approximately $259 million in revenues from the home shopping networks currently carried on their systems.

I hereby declare, under penalty of perjury, that the factual information contained herein is true to the best of my knowledge, information and belief.

Larry Gerbrandt

Principal, Media Valuation Partners

March 31, 2008