COPYRIGHT ROYALTY TRIBUNAL

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| In the matter of:<br><br>COMPULSORY LICENSE FOR SECONDARY TRANSMISSIONS BY CABLE SYSTEMS;<br><br>ROYALTY ADJUSTMENT PROCEEDING | CRT Docket No. 80-3 |

2100 K Street, N.W.
Room 610
Washington, D.C.

Monday, September 29, 1980

The hearing in the above-entitled matter commenced at 10:00 a.m., pursuant to notice.

BEFORE:

MARY LOU BURG, Chairman

THOMAS C. BRENNAN, Commissioner

DOUGLAS L. COULTER, Commissioner

CLARENCE L. JAMES, JR., Commissioner

FRANCES GARCIA, Commissioner

APPEARANCES:

FRITZ ATTAWAY, Attorney-at-Law
Counsel for Copyright Owners

STUART F. FELDSTEIN, Attorney-at-Law
Counsel for NCTA

# C O N T E N T S


| WITNESS: | Direct | Cross | Redirect | Recross |
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P R O C E E D I N G S

CHAIRMAN BURG: Good morning ladies and gentlemen. Before we proceed with this cable adjustment proceeding, I want to make one or two announcements. The first announcement is that Mr. Attaway in cross examination, the joint copyright owners will have to specify one counsel to do the cross examination. In other words, you can't all have a go at the witness. Do you understand?

MR. ATTAWAY: What we had discussed if in the direct testimony presented by NCTA, there are issues of particular concern and interest to one of the associated organizations that their counsel would have had an opportunity to participate in cross.

CHAIRMAN BURG: We are not going to allow that. You will have to work that out among yourselves and decide which one will represent joint owners in the cross examination. Now, I would like to get something in the record at the outset.

On page 176 of the House Report 94-1476, it is stated that, "The Tribunal, at its discretion, may consider factors relating to the maintenance of the real constant dollar level of cable royalty fees per subscribers." It also states that, "The Tribunal need not increase the royal rates to the full extent if it can be demonstrated that the cable industry has been restrained by regulating authorities from increasing rates. In order to establish the necessary factual information with

respect to this matter, the Tribunal developed a cable operator questionnaire. The Tribunal accorded MPAA, NCTA and CATA the opportunity to review the questionnaire and to suggest additional questions.

On behalf of the Tribunal, I direct that there be inserted in the record a copy the questionnaire and the Tribunal's covering letter. The Tribunal utilized the records of the Copyright office for the preparation of the mailing list. I, therefore, direct that there be inserted in the record a copy of a letter dated July 10, 1980, to Commissioner Brennan from Walter D. Samson, Jr, Chief of the Licensing Division of the Copyright office describing the methodology of the survey.

The Tribunal has received 2251, 2251 replies. I direct that these replies be incorporated by reference as part of this record.

It has been decided ahead of time that the joint copyright owners will proceed with their case first. Are you prepared to proceed Mr. Attaway?

MR. ATTAWAY: Yes, ma'am.

CHAIRMAN BURG: Please do.

MR. ATTAWAY: For the record my name is Fritz Attaway. I'm acting as counsel for copyright owners in the proceeding. The copyright owners include the American Society of Composers, Authors and Publishers, Broadcast Music, Inc., Major League Baseball, Motion Picture Association of America, National

Association of Broadcasters, National Basketball Association, National Hockey League and North American Soccer League.

These groups have agreed to present a joint direct case in order to conserve the time of the Tribunal and conclude the proceeding as expeditiously as possible. Madam Chairman, I have a brief opening statement I would like to make before I call my first witness.

In sharp contrast to the situation which existed in the royalty distribution proceeding, the issues in this proceeding are rather narrowly defined, and the legislative guidance is quite specific. Section 801(b) (2A) provides that the Tribunal may adjust copyright royalty rates in Section 11, "To maintain the real constant dollar level of the royalty fee per subscriber which existed as of the date of enactment of this Act." Thus we are not talking about a real increase in compensation to be provided copyright owners. What we are concerned with in this proceeding is an adjustment to provide copyright owners with the same real constant dollar level compensation that was originally provided for by Congress.

The act instructs the Tribunal to adjust the rates to reflect two factors. First, national monetary inflation or deflation. And second, changes in the average rate charged cable subscribers for the basic service of providing secondary transmission. The purpose of this provision was clearly stated in the House Report which follows: "To assure that the value

of the royalty fees paid by cable systems is not eroded by changes in the value of the dollar or changes in average rate charged cable subscribers."

One specific concern noted in the House Report was the cable system may reduce the basic charge for the retransmission of broadcast signals as an inducement for individuals to become subscribers to additional service for instant pay cable. Such a shift in revenue sources, said the House report, would have the effect of understating basic subscriber revenues and would deny copyright owners the level of royalty fees for secondary transmission contemplated by this legislation. Accordingly, such shifts of revenue sources, if they do occur, should be taken into account by the commission in adjusting basic rates. And I emphasize the word "should" in that passage.

The statute permits the Tribunal to consider all factors relating to the maintenance of the constant dollar level of royalty payments, and specifically mentions one extenuating factor the Tribunal may consider whether the cable industry has been restrained by subscribers of rates regulating authorities from increasing the rates of basic service.

The House Report provides additional clarity with respect to the scope of this provision. It states that the Tribunal "need not increase the royalty rates to the full extent provided it can be demonstrated that the cable industry has been restrained by subscriber rate regulating authorities

from increasing rates for the basic service of providing secondary transmissions." I would like to emphasize two key passages in that statement, "need not increase" and "provided it can be demonstrated. Those passages are critical, I think, to this proceeding."

In light of the forgoing legislative background, our witnesses will present evidence demonstrating that on an industry wide basis, the 20 percent plus increase in the subscriber rates as of April 1980 would be required to accomplish Congressional purpose which is, again, to assure that the value of the royalty fees paid by cable systems is not eroded by changes in the value of the dollar or changes in the average rates charged cable subscribers.

In addition, our evidence will show that a one shot across the board adjustment will not accomplish the Congressional objectives nor will it extinguish the Tribunal's responsibility in this proceeding because basic cable charges vary dramatically from one cable to another as do marketing techniques such as tiering and probation of free services. In fairness and equity, both cable systems and the copyright owners require a more responsive decision from this Tribunal, a decision that recognizes that the cable marketplace has undergone considerable change since 1976 and will continue to change in the coming years.

Our witness will propose a simple mechanism by which

1 the royalties of each individual cable system can be adjusted
2 to maintain the constant dollar value of payment and to take
3 into account the particular marketing strategy employed by each
4 cable system. This adjustment will be revised semiannually to
5 prevent erosion of the royalty payment in the intervals between
6 formal Tribunal proceedings.

7 Finally, we will demonstrate the local rate regulation
8 as is not a relevant factor in this proceeding. The rate
9 increases are almost always granted when requested and the
10 cable systems can easily afford to maintain the level of royalty
11 payments that was prescribed by Congress in 1976. That
12 concludes my opening statement, Madam Chairman. I would like
13 to call my first witness Mr. Jack Valenti.

14 COMMISSIONER GARCIA: Before you do that, I have a
15 couple of questions. You mentioned something about a 20
16 percent--

17 MR. ATTAWAY: Yes, ma'am.

18 COMMISSIONER GARCIA: Would you repeat what you said
19 about this.

20 MR. ATTAWAY: Our evidence will show that a 20 percent
21 plus increase in the royalty rates would be needed as of April
22 1980 in order to maintain the real constant dollar value of
23 royalty payments.

24 COMMISSIONER GARCIA: Are we talking about 20 percent
25 of .675?

MR. ATTAWAY: Or .25 and so forth. What we would

1 recommend is surcharge on the existing rates that reflect the
2 royalty adjustment that is to be made. We will recommend that
3 cable systems compute their royalty payments just as they have
4 done for the past two or three years. After that computation is
5 made that a surcharge be imposed to reflect the decison in this
6 proceeding. This is as to what is required to maintain the
7 constant dollar value of that payment.
8 COMMISSIONER GARCIA: Would we arrive at the same
9 answer if you have a surcharge that would change the rate, say,
10 by 20 percent?
11 MR. ATTAWAY: Yes, ma'am. It would be the same thing.
12 There are a number ways you can do it. You can adjust the
13 royalty basis, the revenue basis, you can adjust the actual
14 percentages , the 3.675 or 4.25 and so forth; or you can impose
15 a surcharge. Either way, it would get you to the same place.
16 COMMISSIONER GARCIA: Thank you.
17 MR. ATTAWAY: Mr. Valenti?
18 Whereupon,
19 JACK VALENTI
20 was called as a witness and, having been first duly sworn, was
21 examined and testified, as follows:
22 DIRECT EXAMINATION
23 BY MR. ATTAWAY:
24 Q Would you state your name and occupation for the
25 record?
A My name is Jack Valenti. I am President of the Motion

1 Picture Association.

2 Q Mr. Valenti, is it correct that you were very closely
3 involved and are familiar with the events and circumstances that
4 lead to the passage of the Copyright Revision Act in 1976 and
5 particulary the provisions that relate to cable television?

6 A Yes, I think that is a fair statement.

7 Q Would you generally describe the events and concerns
8 that resulted in the passage of Section 111 and specifically
9 the rate adjustment provision that is the issue before us here
10 today.

11 A I dare say that Commissioner Brennan is far more
12 intimately familiar with this than anyone else I know since he
13 was at that time Chief Counsel of the Subcommittee Senate that
14 was dealing primarily with the construction of S22 which was
15 the genesis of the Copyright Act of 1976.

16 COMMISSIONER BRENNAN: I take no responsibility for
17 the current version.

18 THE WITNESS: I hasten to confirm what Commissioner
19 Brennan has said. In relating the historical procedure, the
20 process, the mark of that legislation, I think, it did collapse.
21 It was not the architecture that was first designed by Senator
22 McClellan. S22, I was merely trying to point out, Commissioner
23 Brennan, I do not consider myself an expert on it since I think
24 you know far more about this than I do. But to expatiate it
25 as briefly as I can, S22 was the architecture of Senator John
McClellan who was then Chairman of the Judiciary Subcommittee

with purview over copyright.

As the bill entered its design, I remembered that Senator McClellan told me that the rate schedule that was first contained in that bill did not bear any relationship at all to any economic analysis or data gathering or marketplace worth or negotiation,or bargain, or anything. He candidly said that it was an arbitrary number, and at that time, within the bill, the Copyright Royalty Tribunal was given broad powers to make such adjustments as it felt was necessary. Therefore, the Senator was quite honest in saying that while the figures were totally arbitrary and had no measuring relationship to the true market-place value, he thought that the Copyright Tribunal had enough power to make judgment after the experience in the marketplace to see whether or not these rates needed some substantial adjustment.

Now, when it left the Senate, when it first entered the Senate floor, it had up to five percent, up to five percent of gross revenues were to be the copyright fee. The cable interest began to marshal a massive lobbying program. And by the time that left the Senate, that five percent of gross revenues had been diminished to two and a half percent of gross revenues, although the broad powers of the CRT were still in tact.

When it entered the House, the lobbying efforts of the cable industry approached the movement of Ghenghis Kahn(PH)

across the corridors of the House, and it was a relentless lobbying campaign, and I must say, it was very effective. The broad review power of the Copyright Royalty Tribunal was gutted. The basic percentage fee schedule which began at two and a half percent began a downward movement under onslaught of successive amendments that carried in the committee until it reached about one percent. At which time, we in the program supply business attempted to apply a politcal torniquet to our severed arteries, and the bill passed.

What was left, however, was the intent of the Congress that the copyright payment should not fall as a result of inflation that may or may not be raging. They insisted that the copyright payments be maintained at a constant dollar level. Now, I think that's important to understand because--and I think that pages 175 and 176 of the House Report confirmed this determination.

Now, there were two ways that the copyright payments could be reduced. One would be that subscription rates to subscribers did not keep pace with inflation. The second way would be for cable to shift its revenue base, i.e., to either or give away or diminish the amount of money that they were charging subscribers cable, say dropping it two one, two or three dollars or just give it away in order to load up on pay services. This is the philosophy expressed by one of the pioneers of cable Irvin Kohn(PH) who insisted and predicted that before long,

1 cable systems would be literally giving away their basic service
2 in order to entice customers on to their system so they could
3 load these customers with pay services arranging from $50 a
4 month or more.

5 I think I should point out that Congress insisted that
6 copyright owners ought not be penalized if either of these
7 factors intruded on the marketplace. They made that clear in
8 the House Reports. The single product that cable sells is
9 programming, and there is no way to dispute that fact. It is
10 the one ingredient without which they cannot be in business.
11 And even the NCTA, the National Association of Cable Television
12 Association. I'm not very good on acronyms, and I think that's
13 correct.

14 CHAIRMAN BURG: Is that a Freudian slip, Mr. Valenti?

15 THE WITNESS: I think it is. The NCTA, themselves,
16 commissioned the report, the Hart Report, which they submitted
17 to the FCC which concluded that courage of distant signals was
18 overwhelmingly important, crucially important, to cable opera-
19 tors. I think it is well stated that I am not happy with this
20 Copyright Act. I'm certainly joining Commissioner Brennan in
21 saying what started in the Senate sure as the devil didn't
22 end up the same way in the House as the final passage of the
23 bill. And the fact is that the rate schedule is barren on any
24 relationship to the real marketplace. We have said that over
25 and over gain. And we have said that with almost a dull litany

1 repetition because it is true. It is the one bone in the throat
2 of this procedure -- not this procedure but the whole enterprise
3 of cable is that the fee schedule is totally denuded of any
4 connection with reality.

5 The value of a program is the key. And I think having
6 read your decision, I think page 45 and 46 of the Copyright
7 Royalty Tribunal decision confirms this kind of judgment. You
8 said that there are risk to the copyright owner in the carriage
9 of distant signals, and you further said that this effectively
10 reduces the value of the program to the copyright owner.

11 This decision of your Tribunal went on to say in
12 pages 45 and 46, "That cable systems obtain the benefits of
13 programming at rates that have no relationship to the true worth
14 of that program." Now, that is the unhappy march of this
15 legislative in a brief nutshell.

16 BY MR. ATTAWAY:

17 Q Mr. Valenti, you mentioned that under S22 as passed
18 by the Senate the Tribunal had rather broad authority to review
19 the rates periodically and to revise the rates in light of
20 marketplace consideration. How does that compare with the
21 authority of the Tribunal as presently given in the Act passed
22 by the House?

23 A Are you talking about inflation?

24 Q Their general ability to revise the rates, is it
25 broad or narrow?

A I think the general ability to revise the rates on this particular issue is has to do with the inflationary trend making sure that the constant dollar value is maintained.

Q Well, other than revising the rates to maintain the constant dollar, is their any other way the Tribunal can adjust the rates for signals presently carried by cable systems on the basis of FCC rules that existed in 1976?

A Well, I think that their power is probably restricted in that area, but certainly not in adjusting for inflation.

Q This adjustment is really the only adjustment that can be made, then, of the rates?

A That's right.

Q There is no provision for adjusting the rates again for signals carried pursuant to FCC rules in effect in 1976?

A No.

Q Mr. Valenti, one of the primary issues in this proceeding is the selection the appropriate inflation index. We have argued that the proper index to use as a yardstick to measure inflation is the consumer price index. In the proceedings submitted by NCTA , they argued that the CPI has increased faster than the acutal rate of inflation to be measured here. Would you provide us with some information on the cost increases that have been experienced by program producers with specific relationship to the consumer price index?

A The cost increases suffered by program suppliers over

past several years have been almost malignant in nature. Indeed we are just finishing up a 72-day strike that is still going on which is going to add an enormous amount of cost to our business, both in television residuals, both in the basic cost of making movies and television material, and that cost is going to go up even higher.

I can cite you though some figures which are specific and are not in the future. In '76, the average negative cost, that is the cost to complete a film, to make the master negative from which prints would be struck, either television material or film. But in the film business, the average film in '76 cost about four million dollars.

In 1979, that average cost had risen to 8.9 million dollars, a 122 percent increase. By 1980, in the next three months, we expect the average cost of the film made in 1980 to cost $10 million which is an increase of about 150 percent. We do know that daily Variety which tabulates the television cost figures estimates that between 1976 and 1979 prime time programming costs rose 77 percent. The professional sports people say that their expenses, 1976 through 1979, have gone up 63 percent.

We do know that everything that cable buys, the automobiles that cable system uses, the power, the electricity that they consume, the salaries they pay their secretaries and their clerks, the technical equipment they must buy, has

all gone up in exponential terms. It is mockingly ironic that in the time 1976 to this very hour, the one element of cost within the cable business that has not risen one decimal, one iota, is the cost of their programming. The irony becomes even more sardonic when you recognize that you might get along with only three secretaries instead of four or you might hold off the purchase of some technical equipment, or you might not have two cars to drive in your cable system but the one product without which, the one cost that you must have, the one element without which your business would completely collapse is programming. And that remains the one alien element in their cost sheet because that is the one part of their expense that has not gone up.

Q As you are aware and I stated in my opening statement, the Act requires the Tribunal, or allows the Tribunal, to consider the effect of rate regulating authorities as an extenuating circumstance to be considered in this proceeding. On the basis of your understanding, what is the purpose of this provision, and how should it be considered in this proceeding?

A In my conversation, literally hundreds of conversations, with Senators and Congressmen in the march of this legislation through the House and the Senate makes me understand with great clarity that what the Congress was worried about was the ability of cable systems to pay for programming. That's what they were worried about at that time if you recall, and things have gone

1 by with such startling swiftness, we are unable to leap back
2 into our memories to remember 74, 75 as this legislation was
3 being designed. Cable was in swaddling clothes. There was
4 some concern on the part of a lot of people in the business and
5 the Congress as to whether or not cable had the ability to pay.
6 That, I think, was the rostrum on which that provision rested.
7 However, in the interim a lot of things have happened
8 to shatter some of the illusions that a lot of us had. Day
9 cable is fabulously wealthy. I don't think there is anybody
10 in this room that won't agree it is an extraordinarily profitable
11 buisness. The New York Times had a story on the front
12 page of this paper some weeks ago in which it was categorizing
13 the franchising. "The reach for cable franchising is the last
14 great goldrush" is what they said. They recognize that there
15 is money in them there hills and cable costs are going after it.
16 The Lewis Report of the Warburg Paribas Becker people is coming
17 out now.
18 The '78 fiscal performance of cable with its 77 fiscal
19 performance comparison showed revenues were up 26 percent.
20 Cable increased 70 percent. The basic widely increased 76
21 percent. The new report: This profitability, 1979 over '78
22 profitability has gone up 80 percent on top of 70 percent of
23 the previous years. The profitability figures are advancing
24 in geometric progression.
25 Anthony Hoffman who is probably the number one expert
on cable with Bache, Halsey, Stuart, Shields had this to say:

1 I want to quote it because I think it is very pertinent which
2 is the ability of cable cost to pay additonal fees. "We have
3 watched the earnings of these smaller cable companies just go
4 skyrocketing with very low tax rates. Cable is an extremely
5 popular investment right now. It has been that way for about a
6 year in terms of the retail investors, and now it is becoming
7 that way with the industrial investors.
8 There is almost no industry in the United States that
9 you can point to and call it recession proof, except cable."
10 Let me point out this. The only new aroma of scandals
11 with the cable industry is naked evidence of the high profit
12 and growing profitability of cable franchise. When cable goes
13 into a community and gives away 20 percent or more of the stock
14 of the franchises of local citizens in order to enlist their
15 political power or influences.
16 You, again, understand how much profit there is in this.
17 Warren wrote in the Washington Post two weak ago how he was
18 approached by a cable operator and was given stock. He was given
19 stock and refused it. He wrote a piece for Washington Post and
20 said the profits had become outrageously high and said cable
21 is willing to give away 20 times more than they are paying for
22 their programming right now.
23 I think the fact that you can give away 20 percent of
24 your base equity is about the most visible evidence. I know
25 that you are in a pretty fat business. Let me cite an intent
to what we are talking about to give you clarity of the

1 immensity of the pot of gold. New York Times decided to go
2 into the cable business. They brought Gary Kohn(PH) a 60
3 subscriber plus, only 60,000 subscribers. They paid $120 mil-
4 lion for this link of cable systems. These are very wise
5 experts. They would not do this whimsically. The fact is even
6 if cable companies were not immensely profitable there are no
7 circumstances to just less than keeping copyright payments to
8 this full constant dollar level. That is all we are asking for.
9 As I said, if a cable company is paying one percent for its
10 copyright fees now and it is giving away 20 times that from
11 positive investors, I think you could increase the fees 100
12 percent, and they would still only pay two percent
13 revenues.

14 Now, I want to place before this Tribunal something
15 else which I think is meaningful. It is yesterday in the
16 Washington Post, a story broadcasting hookups for big money.
17 It is a very clarifying article, and I commend it as excellent
18 nighttime reading. I want to quote you what the Chief
19 Executive officer of Storer Broadcasting has said which, to me,
20 goes directly to the heart of the questions you asked Mr.
21 Attaway. That is what Congress had in mind, and my answer,
22 ability to pay. It has to do with the rent, a citizen contro-
23 versy.

24 The troublesome aspect of giving away a large part
25 ouf your business in exchange for political power. I quote
from John F. Barrets article of September 28, the Washington

1 Post , Section L, page 9: "But Peter Storer, Chief Executive
2 Officer of the company, views the passing out of stock and other
3 favors as simply one of the cost of doing business."
4 I think one of the costs of doing business is purchasing
5 programming. I think that the least is that this programming
6 cost not be subtracted, diminished, or otherwise wither buried
7 inflation. We are going to fight in the Congress with all the
8 skill we can on the Tribunal to rectify the Copyright Bill.
9 There are a growing number of Senators and Congressmen
10 who have a sense of the gross unfairness of the Copyright Act
11 to program suppliers. That is to correct that legislative
12 deformity which is not the purpose of this hearing. I would
13 pray that this Tribunal would accomplish what the Congress
14 intended. The cable systems have the ability to pay and the
15 copyright payments at least, be maintained so that inflation
16 does not cut away what already is a grossly inequitable share we
17 are receiving for the use of our programming.
18 MR. ATTAWAY: Thank you. That is all I have.
19 CHAIRMAN BURG: I take it you agree with the proposal
20 of your counsel to apply a 20 percent surcharge to the basic
21 rates?
22 THE WITNESS: Yes, ma'am.
23 CHAIRMAN BURG: What is magical about that figure?
24 THE WITNESS: I would like to pass answering your
25 questions because Mr. Korn and Mr. Cooper are going into

1 vivid detail on that and are prepared today to explain this
2 with specific, and I hope, exquisite detail so you will under-
3 stand precisely what we have in mind and how we came to that
4 conclusion and the documents we have to fortify those conclu-
5 sions.

6 CHAIRMAN BURG: I will yield on that basis.

7 COMMISSIONER GARCIA: Mr. Valenti, one day this week
8 I was reading in the paper about the home earth stations and the
9 people who are able to put them in there backyards and are able
10 to get the signals right off the air and our bypassing the cable
11 industry. Are you familiar with that problem?

12 THE WITNESS: I'm familiar with DBS, yes, ma'am.

13 COMMISSIONER GARCIA: Should that continue to progress,
14 do you think that cable industry as we know it today may become
15 a thing of the past?

16 THE WITNESS: No, I do not. First, I think DBS is
17 more honored in the illusion than the actual fact. COMSAT
18 has declared its intent to go with direct broadcasting satellites
19 for pay only. There plans, as outlined by Mr. Sherrick, the
20 Chief Executive Officer of COMSAT they intend once they
21 get permission from FCC which may be several years away to
22 launch. Several satellites from which they direct signals to
23 home on a pay-basis only. That is the only way they can make
24 out. There are a number of problems in that. If you are already
25 on cable and you are getting all of this, why would you want
to go to the expense of buying a satellite receiver and pay

1 COMSAT for something you are already getting? I think COMSAT
2 believes its major markets will be in those areas which are not,
3 if I may use the words "cable licensed." However, all of these
4 are futuristic plans. On the other hand, having gone through
5 hearings in 1975 and 1976 with meager comments about the
6 satellite, I am the last person in the world who will tell you
7 that technology advances with such speed. Who knows what will
8 happen? I can only state to you the plans of COMSAT which the
9 leader in that.

10 COMMISSIONER GARCIA: There are a lot of individuals
11 that were doing there own. I wonder if that is comparable to the
12 policy of home taping in the motion picture industry?

13 THE WITNESS: The answer is it could be. The main
14 problem in the piracy area is people are buying, I guess you
15 would call it, "earth stations" or decoders that are blatently
16 viewed by people saying why pay for something you can get free
17 and stealing off of satellite transmissions to its subsidi-
18 raries and affiliates. My judgment is at some point those
19 figures would have to be scrambled. Then they will make a
20 machine that will decode. We are taking this up with Congress.
21 It is piracy and out right thievery. We hope to do something
22 with the Congress on this. Indeed, Congressman Pryor of North
23 Carolina introduced the beginning of what are a series of bills
24 that we deal with stealing off the air.

25 CHAIRMAN BURG: Mr. Feldstein, are you going to do the
cross examination?

1 MR. FELDSTEIN: Yes.

2 CHAIRMAN BURG: Proceed.

3 MR. FELDSTEIN: As a preliminary matter, Madam Chairman,
4 I would move to strike the entire testimony presented this
5 morning so eloquently by Mr. Valenti. This proceeding is a
6 narrow one. It is supposed to be looking at the effect of
7 inflation and maintaining the constant dollar rates in the
8 subsection of the Communications Copyright Act. We are not here
9 to revise deficiencies in the Act or whether or not cable ought
10 to pay on a different basis or different rate. Mr. Valenti
11 admitted it is for the Congress. We are not here to re-examine
12 the scheme adopted in '76 nor I allege is it relevant whether
13 cable is or is not profitable.

14 Furthermore, Mr. Valenti has offered no data, no
15 exhibits to support his rather dramatic presentation as to the
16 worth or value of distant signals, as to the impact of the
17 current copyright rates on the copyright owners nor to the
18 factors of profitability involved in cable television. Thus,
19 he has not supported his testimony in addition to the fact that it
20 is a relevant testimony. NCTA would move to strike his testimony
21 in its entirety.

22 MR. ATTAWAY: May I respond?

23 CHAIRMAN BURG: Yes.

24 MR. ATTAWAY: I think it is abundantly well known that
25 Mr. Valenti is an expert on Section 111 of the Copyright Act, and
its legislative history. Mr. Valenti is also very knowledgeable

about the events and circumstances in the communication business and particulary cable television. I think both of those matters are of primary interest. First, the legislative history in 111 and Chapter 8 which you will be interpreting to a large extent. Secondly, the circumstances of the cable industry and whether or not extenuating circumstances should be considered in your decision. I think Mr. Valenti is more than qualified as an expert witness on both of these issues and has done so.

CHAIRMAN BURG: Mr. Feldstein, the Tribunal declines your offer. Proceed please.

CROSS-EXAMINATION

BY MR. FELDSTEIN:

Q You have talked about the history of the 1976 Act. Is it not true that when S22 was being considered that at that time two Supreme Court cases had ruled that cable television was not liable for any copyright payments for secondary transmission under 1909 Copyright Act.

A Yes, that is true. The Supreme Court pointed out under 1909, which came along before radio, satellite and cable, etc, they were incapable of dealing with new technology. I said it is up to Congress to handle. All we have is a 1909 law which is as outdated as the buggy and carriage.

Q Cable television was not liable under that law?

A That is true.

Q You have talked about how cable televison marched relentless lobbying campaigns and was eminently successful.

1 As a person who was a part of the campaign, I thank you for the
2 credit. Is it not true that you and your conferees lobbied
3 equally--relentlessly, for a legislative reversal of the Supreme
4 Court cases. Counsel, I don't want to tell the victor how lob-
5 bying is carried on. There are 4,000 cable systems in the
6 United States. The NCTA had local constituents in everyone of
7 those 4,000 locations. They were able to marshal the local
8 banker and the local insurance man and the local cable operator.
9 There were only 435 congressional districts. They were in
10 every one of them unfortunately.

11 As one Senator told me, "Jackie, I would to help you
12 on this, but we have no movie producers in my state, but we
13 have a lot of cable operators, and I want to hear about
14 it. The merits of the case, I want to understand it because
15 you don't have any constituents and cable does. New York and
16 California was all we could muster."

17 As you well know, counselor, when you are dealing with
18 the Congress, local constituents become prime sources of your
19 lobbying strength. You had it, and we did not.

20 Q I did not ask you how we succeeded, Mr. Valenti. I
21 asked you whether your side initiated the aches to make cable
22 television liable and reverse the courts' holdings that it was
23 not liable?

24 A I think Senator McClellan came to some of those con-
25 clusions without my prodding.

1 Q Did you lobby in favor of that result?

2 A Yes, we lobbied in favor, but we were out lobbied.

3 Q Would you not agree that the 1976 Act, since we were

4 lobbying in one direction and you were lobbying in the other

5 direction, was a compromise?

6 A I don't call it a compromise. I call it a disaster out

7 of whose wreckage. We tried to extract what we could.

8 Q Did you ultimately agree to what was embodied in the

9 1976 Act?

10 A In the same way it agrees to give away a gold chain

11 when the mugger has a knife at his belly. Yes, we agreed. But

12 we agreed because I was afraid they were not only going to

13 take my gold necklace, but my Washington credit card. I

14 decided we better stop flow of blood at one percent because

15 I have no doubt that cable would have it down to one-tenth of

16 one percent before it is all done.

17 Q I am a Washington critic. On be half of my organiza-

18 tion, is suspect the story might be topped opposite if we had

19 a cable witness on the stand. Nevertheless, ultmimately,

20 Mr. Valenti, you signed an agreement between MPAA and NCTA which

21 outlined the terms ultimately embodied in the '76 legislation?

22 A Yes, I signed it.

23 Q Was part of the 1976 to which you agreed an agreement

24 that the rates for the existing distant signals would be

25 reviewed by the Copyright Royalty Tribunal for the purposes

which you have outlined every five years?

1 A We agreed to a number of things. What we never agreed
2 to was the gutting of the power of the Copyright Royalty
3 Tribunal.
4 Q Mr. Valenti, number one, you have not answered the
5 questions. Number two, I quote you from a paragraph of that
6 agreement. " The Tribunal may also adjust statutory rates to
7 reflect changes in terms of constant dollars in the average
8 basic subscriber rates throughout the cable history, etc.,
9 except as specified above, the statutory rates shall not be
10 adjusted in," in paragraph nine. This document has your
11 signature on it. Would you like to see the document?
12 A I don't need to see the document. I think counsel
13 has to know the circumstances under which it was signed. You
14 and I, both, know those circumstances. You can quote that
15 document to me until we are both blue in the face. The facts
16 are we knew what the House Judiciary Committee wanted to do,
17 and we were told what they wanted to do with the Copyright
18 Royalty Tribunal and its powers. I knew I did not
19 have the votes in the committee. You had the votes. Number
20 three, I knew if we did not sign the rates, we were going down
21 lower. We signed what we had to sign. I signed, but I never
22 agreed. All I did was sign a document I was forced to sign
23 in order to get a bill. You don't have to tensile this over
24 with a lot of legal gloss. The facts are there.
25 Q Mr. Valenti, you have testified this morning to the

1 what I consider an irrelevant point, the rates in this Act
2 are too low. I understand why the seller of any product
3 allege that his prices he was receiving were too low. Implied
4 in your testimony was the desire for a more marketplace oriented
5 result than admitted, not properly the Tribunal's consideration
6 in this proceeding.

7 Have you not admitted before, have you not stated
8 before, in other context that the marketplace in cable television
9 retransmission would not work?

10 A Well, I don't know what I said four years ago.
11 You might quote me I suppose. That's in a political contest.
12 I suppose that's a reasonable thing to do. But I'm a lot wiser
13 now than I was four years ago when that Act had taken place.
14 I care not what you quote. I think though that Mr. Emerson
15 says that "Foolish consistency is the hobgoblin of little minds."

16 I know how I feel today based on the experience
17 gained in the last four years. So, I'm saying to you that I do
18 believe, today, a marketplace full copyright liability procedure
19 would work.

20 Q Mr. Valenti, that is a change in the views which you
21 have expressed publicly. Madam Chairman, I would like to
22 enter for the record that in the 1974--excuse me--that you
23 could take official notice of the transcript of the hearings
24 before Congressman Castlemeyers' Copyright Subcommittee in
25 1974, where at page 758, Mr. Valenti answered to a question

about possible marketplace solutions stated: "In all honesty I have to tell you that I think there would be administrative difficulties in free play of the marketplace. This is what the compulsory license was created to avoid such administrative difficulty. A compulsory license covering all signals lessening paperwork, lessening everything."

In his statement, which is reprinted in full on page 709 of the record, in talking about a just and reasonable rate, Mr. Valenti stated,"What is just and reasonable?" Differences of opinion exist on that issue. We have no marketplace experience for what is fair for us and reasonable for cable.

COMMISSIONER JAMES: Counselor, excuse me for just a minute. You said that was in 1974?

MR. FELDSTEIN: Yes.

COMMISSIONER JAMES: What bill was that in relation to?

MR. FELDSTEIN: S2223.

COMMISSIONER JAMES: Was the Copyright Tribunal or Commission included as part of that bill?

MR. FELDSTEIN: I believe it was. It was a bill that was substantially identical at that time to the Senate bill which included the Tribunal.

COMMISSIONER JAMES: What was the Senate bill, was that the S22?

MR. FELDSTEIN: That was S22, or possibly the proceeding one, S453. I'm not certain.

1 COMMISSIONER JAMES: But to the best of your
2 recollection, the bill that Mr. Valenti was testifying before,
3 there was some consideration in that bill for an agency that
4 would administer this?
5 MR. FELDSTEIN: Yes. For the record, I will provide
6 you with exact citations, the number of reports; for you, for
7 the record, I will provide the precise answer to that question.
8 COMMISSIONER JAMES: The easiest way is probably to
9 ask Commissioner Brennan.
10 COMMISSIONER BRENNAN: I agree with the answer.
11 MR. FELDSTEIN: Do I have a ruling that this may be
12 incorporated into the record?
13 CHAIRMAN BURG: Yes, you do.
14 BY MR. FELDSTEIN:
15 Q Now, Mr. Valenti, you have testified to the value
16 of distant signals to cable television systems, and you have
17 mentioned the Hart Study. Do you recall in the Hart Study what
18 the second most desired service the respondents answered to?
19 A No, I do not.
20
21
22
23
24
25

etp-1

CHAIRMAN BURG: Mr. Feldstein, you may proceed.

BY MR. FELDSTEIN:

Q Mr. Valenti, I was asking you about the Hart Study. You said you did not know what the second criterion was. The second most popular criterion that was asked. Is that correct?

A Are you repeating the question?

Q Yes.

A The answer was no I do not know.

Q You know now?

A Yes.

Q You had an opportunity to refresh your recollection?

A No. I asked my counsel.

Q Mr. Valenti, do you know what cities the questions were asked?

A I can save you a lot of questions by saying I don't know much about the details of the Hart Study. I read the presentation of the Hart Study some months ago. One thing I did remember from the Hart Study, which I thought was pertinent to this hearing, was the importance that the Hart Study placed on the distant signal exportation.

If you have any more questions about the Hart Study, I would have to get it and look at it. That is the one extraction that remains in my mind that I thought was pertinent to this hearing.

Q Without setting that conclusion in context, you have not read the Hart Study?

etp2

A No. You did not understand me. I said I read the Hart Study some time ago. I read that. An important conclusion that they reached was that distant signal courage was crucially important to cable operators. I went further to say if you want to quiry me further about the Hart Study, I would have to get a copy of it and go over it with you.

My memory is not persuasive about the Hart Study at this time.

Q Do you intend to submit the Hart Study since you have relied on it as an exhibit in this proceeding?

A I will leave that up to my counsel.

Q I submit that reliance on any aspect of the Hart Study out of the context of the entire study is not probative You have stated, Mr. Valenti, that your recollection refreshed upon asking counsel, that the second criterion of importance to people who were potential subscribers to cable television is the availability of so-called pay cable?

A I was so informed.

Q Mr. Valenti, are you familiar with the structure of the pay cable industry today?

A I am familiar with it.

Q Do you know who the main pay cable distributors are?

A Yes, I do.

Q Who are they?

A Home Box Office is the biggest and the second is

etp3

1 Showtime; third is Warner.

2 Q Do you know what percentage of the product that they

3 display comes from your members?

4 MR. ATTAWAY: Madam Chairman, I object to this line

5 of questioning. I don't see what it has to do with this proceed-

6 ing. We are talking about retransmission of distant signals,

7 not pay cable. There is no compulsory license for pay cable.

8 MR. FELDSTEIN: Insofar as Mr. Valenti has intro-

9 duced the question of how much it costs him to make programming

10 in films and how profitable cable television is both of which

11 NCTA is not relevant to this proceeding, if it is relevant.

12 Certainly, the importance of the television which

13 contributes to the profitability of his members is a relevant

14 consideration.

15 MR. ATTAWAY: Madam Chairman, I would argue the

16 importance of the profitability of copyright owners is not

17 one of the factors to be considered in this proceeding.

18 MR. FELDSTEIN: In his opening testimony Mr. Valenti,

19 or opening statement counsel,raised the question of revenue

20 shifts in addition to the fact that the question of compensation

21 to the copyright owner as opposed to the profitability of cable

22 television is the parameter of the provision that we are here

23 for.

24 CHAIRMAN BURG: Mr. Attaway, you are going to be

25 overruled on your objection.

Proceed.

etp4

BY MR. FELDSTEIN:

Q Repeating my question, Mr. Valenti, do you know what percentage of product that these distributors pay cable is obtained from your members?

A What percentage?

Q Of their product is obtained from your members?

A The breakdown is mostly sports and movies. My guess would be over half.

Q Over half of HBO product is from your members. Do you know, Mr. Valenti, may I ask you what your gross revenue from that product on pay cable was at the date of enactment of the '76 Copyright Act?

A I am going to answer the question but I want to point out to you, counselor, that in the areas of pay cable all negotiations are traded in in the open marketplace.

We have problems with monopolistic practices of HBO. But the point is there is no compulsory license. Whatever you get is what a buyer wants to buy and a seller wants to sell and you agree on a price.

What we are talking about here is totally different. There is one arena where there is no open negotiations. Basic services.

So, I will answer your question, but I think it is so far afield from what we are dealing with which is keeping the dollar payable and full constant dollar level which is under a nonnegotiation atmosphere under a negotiating license.

I have stated all of that, 1979, I think the Motion Picture Association companies got about $80 million from pay cable in '79. I do not have the figures for 1980.

Q Do you have a figure for '76?

A No, I do not.

Q Do you have any idea what the growth in subscribers was in '76 to '80 to pay cable?

A In '76, pay cable operators received $65 million in pay cable. In 1980, cable operators received $800 million in pay cable. So, there was an increase of 1200 percent to the basic cable systems.

Q There would be, I presume --

A The source of Paul Kagan, Associate.

Q I presume the revenues to your members had equally large growth from '76 to '80?

A No, it did not.

Q You have stated that you don't have the figures on '76. Do you have a ballpark as to what percentage of increase that you had in '76 and '80 in your revenue from pay cable?

A My guess would be about five or six hundred percent.

Q What are your projections for growth in this area?

A The projections for growth in this area are not as growing as your own projections from NCTA. But we, obviously, the program suppliers expect to sell an enlarging amount of product to pay cable.

etp6

Q Mr. Valenti, you have responded in the context of this distant signal value, you have complained to this Tribunal that the rates set in the bill are unreasonably low. You have quoted or paraphrased from a portion of the cable television distribution decision recently released from the Tribunal in terms of alluding to the impact of distant signal courage of program suppliers.

Mr. Valenti, have you made these arguments to the Federal Communications Commission?

A Arguments about what, counselor?

Q The impact which you allege the distant signal has on program supply industry.

Q We have made a lot of important contentions to the FCC urging them not to abandon the exclusivity rules and their distant signal rule.

Q Did you argue such abandonment would injure the program supply industry?

A Absolutely. Syndicated exclusivity we felt would be great injury to us particularly.

Q Did the Federal Communications accept your arguments?

A By a vote of four to three they did not.

MR. FELDSTEIN: I would request that the Tribunal take official notice of three documents issued by the Federal Communications Commission. One is the syndicated exclusivity report 71 F.C.C. 2nd 951, 1979. The second one is the economic

etp7

1 Report at 71 F.C.C. 2nd 632 also of 1979. The third document,
2 the report and order released September 11, 1980, in the matter
3 syndicated exclusivity and distant signal courage which is at
4 Volume 45, Federal Register, commencing at page 60186.
5 I would just read one quote to the record from
6 page 60223. The Commission, incidentally, as I am certain you
7 are familiar, voted to eliminate the syndicated exclusivity.
8 COMMISSIONER JAMES: I have a question. Are you
9 going to ask the witness a question from this quote or are you
10 going to testify now? What are you trying to accomplish here?
11 MR. FELDSTEIN: I am asking the document be incorporat-
12 ed into the record. They are relevant to the testimony that
13 Mr. Valenti has given on the impact of distant signal courage
14 on his industry.
15 COMMISSIONER JAMES: You were indicating you were
16 going to read a quote?
17 MR. FELDSTEIN: I changed my mind.
18 MR. ATTAWAY: Would counsel refresh my recollection as
19 to what specific testimony of Mr. Valenti related to the im-
20 pact of distant signal on program owners?
21 MR. FELDSTEIN: Mr. Valenti stated in his testimony in
22 answer to one of your questions that the worth of distant sig-
23 nal is to cable television was not met on the other side by a
24 price which was equivalent to the worth of that programming or
25 the impact of the courage of that programming on program owners

etp8

THE WITNESS: I hasten to interject. Counsel is misquoting. I was quoting pages 45 and 46 of the Copyright Tribunal's decision. Those were not my words. Those were the words of the Copyright Tribunal.

MR. FELDSTEIN: I agree that you did that. You also spoke to the impact on you.

THE WITNESS: I won't argue the question because I think it is a tenuous one.

MR. FELDSTEIN: The record will reflect what Mr. Valenti said. I ask that these documents be entered into the record as official documents.

BY MR. FELDSTEIN:

Q Mr. Valenti, you have testified to the large increase in costs in industry. You have stated some figures and some conclusions you are prepared to submit a back up data on the increase and components of the costs of producing feature films and prime time programming product?

A I would be glad to submit to this Tribunal how we go about determining the negative cost of a film.

Q That was not the question I asked.

A We do not collect data on television programming. If you will recall my testimony, I said I was quoting from Variety. Variety said that prime time programming costs had increased 77 percent over the percent of '76 to '79. You can certainly go to Variety how they come to those conclusions.

tp9

I would be happy to submit to this Tribunal the structure of making a movie in '76 and the structure of making a movie in 1979-80 to let you see the difference in those costs.

MR. ATTAWAY: Madam Chairman, Mr. Valenti's testimony on that point related to a choice of an index to reflect inflation. We will have a chart in connection with Mr. Cooper's testimony which compares to prices of television stations with the CPI and the PCE.

I believe that will testify Mr. Feldstein's request for data on this topic.

BY MR. FELDSTEIN:

Q Mr. Valenti, insofar as he is relying on something in Variety and does not have the back up data but has volunteered to submit some costs, I would reserve the right to examine the material which I do not have and possibly be able to recall Mr. Valenti to examine him on the material. They are the ones that have stated the costs are relevant to the Tribunal's consideration.

MR. ATTAWAY: Only to the extent that it affects the choice of an index.

BY MR. FELDSTEIN:

Q With regard to the choice of an index, Mr. Valenti, you have stated although witnesses will testify to it, the index will be the CPI, consumer price index. That is a consumer index. You then went on to testify to the great increase in

etp10

cost to your companies which is a factor of production when one looks at national inflation. There are two indices: production and consumption indices.

Would you rather see the Tribunal use a national production index?

MR. ATTAWAY: Mr. Valenti is not competent to testify as to the relative worth of one index over another. I object. I will present an expert witness to testify on that issue.

CHARIMAN BURG: Sustained.

BY MR. FELDSTEIN:

Q Mr. Valenti, you have testified to the great and increasing profitability of the cable television industry. During the break, I went out and called my broker because you convinced me that I had been missing the boat.

Mr. Valenti, do you own any cable system?

A I wish I did.

Q Have you ever owned any?

A No.

Q Do you have personal knowledge as to the component of cable television?

A I did not want to get into a debate to you. What I testified to was the fact it is well known that cable systems are giving away 20 percent of their equity. You don't give away 20 percent of your equity unless you are handsomely fiscally based.

etpll

Q On what do you base that?

A Common sense. Only an idiot would give away 20 percent of his business. He cannot give away 20 percent until the other 80 percent is profitable. Indeed, that is why the scandals in the cable system is existing today. Maybe we ought to call John F. Berry who did an article for the Post.

If you look at the corporation, you don't need my testimony to do that. You may have called your stockbroker, but the last report I have show that the cable systems are doing very well in the stock market; whereas, some of my companies are not doing so well.

Q Mr. Valenti, are you telling this Tribunal that you have no personal knowledge of the cost involved in cable television, of the profit, the possible profit of turnaround, building a large city system, the rate of return internally?

A I have knowledge of that.

Q You have testified to it?

A I have testified to what?

Q The profitability of cable television.

A I testified to what Mr. Hoffman of Bache said. The Warburg Paribus Becker Report, articled in journals that have not been rebutted by any cable industry. That is the source of my testimony. Experts who deal with it everyday.

Now if they are wrong, I think it is incumbent on NCTA to rebut the testimony. I don't say that I am an expert. Mr. Hoffman and other people are.

etp12

Q Are they here today? Can I cross-examine them?

A They are not.

Q Are you offering their reports in evidence?

A We are both perhaps getting irrelevant. We are here to find out whether or not inflation has so eroded copyright payments that in a two billed business in '77, '78 I mean, you paid some $14 million for your programming. Now that is all you paid.

What this Tribunal is trying to figure out is how much have we lost through inflation in that paltry sum. That is all we are here to discuss. It seems to me we could use our time more valuably by sticking to that.

Q I believe in the issue of the constancy of the copyright payable is the sole relevant issue. I did not introduce the cable payments. You are relying on statements outside of this court. The documents are not available in addition to the people.

A I will ask my counsel to present to this Tribunal the Warburg Paribus Becker Report which will document in vivid and lucid detail the profitability of 13 publicly held cable which they examined and reported on.

Q Fine.

Mr. Valenti, in testifying you have said two things. You have said how much your costs have gone up. You have also made a big point about how profitable cable television is. How profitable, how have profits faired with your member companies

etpl3

in the time period involved?

MR. ATTAWAY: Madam Chairman, I believe that question is totally irrelevant to this proceeding.

MR. FELDSTEIN: Since the provision under which the Tribunal is operating speaks in terms of compensation to the copyright owner, it seems to me that profits, if the profits of the cable television are any way relevant, which I continue to contest, certainly, the profits of the copyright owner must be relevant.

CHAIRMAN BURG: Would you explain that to me, Mr. Feldstein?

MR. FELDSTEIN: The provision under which you are operating in this proceeding states that you are trying to continue to make the copyright owner whole based on what he was being paid in 1976. Mr. Valenti has stated that he feels that what the cable television operator can afford to pay is somehow relevant to that.

What I am stating is if that is relevant, then, certainly, the profitability of the copyright owner is also relevant.

MR. ATTAWAY: I would disagree.

CHAIRMAN BURG: Are you objecting, Mr. Attaway?

MR. ATTAWAY: Yes.

CHAIRMAN BURG: I will sustain the objection.

etp14

MR. FELDSTEIN: Insofar as, I will repeat, the material that was alluded to during Mr. Valenti's testimony is, as promised, submitted for the record and exchanged with us, we would like to reserve the right to at our discretion return to the witness stand to cross-examine him on this data.

CHAIRMAN BURG: So noted.

MR. ATTAWAY: To make sure I understand, you want the Variety tabulation and the Warburg Paribus Becker Report.

MR. FELDSTEIN: You may submit what it is you have relied on in Mr. Valenti's testimony.

I have no more questions.

CHAIRMAN BURG: Mr. Attaway.

REDIRECT EXAMINATION

BY MR. ATTAWAY:

Q Mr. Feldstein's earlier questions seemed to leave the impression that the protagonist before Congress and the copyright debate were debating whether or not there should be a compulsory license with the prodcuer's side arguing for assignment of copyright liability and NCTA arguing against it.

I recall an agreement entered into by NCTA called the Concensus Agreement. Are you familiar with that?

A Yes.

Q Isn't it true at that time in '72, NCTA committed itself to work for the establishment of copyright liability through new legislation to correct the loophole in the 1909 Act that resulted in two Supreme Court decisions saying cable

antiquated act?

A I have not read the Concensus Agreement in quite some time, but I do recall that that was part of the Concensus Agreement that Cable Association agreed that it would be liable for copyright payments.

Q Mr. Feldstein also quoted from the legislative history of that act, a statement that I made concerning the difficulty of cable systems at least at that time working out a marketplace arrangement with program producers for the direct licensing of product.

Is it not true that when you made that statement the powers of the Tribunal in the legislation before Congress at that time were very broad and the Tribunal was permitted to make a marketplace determination in setting new rates once they reviewed two statutory rates which you said were just picked out of thin air?

A That is essentially correct. That is six years ago which is about 100 light years in legislation and technology. A great many things have changed.

Q Mr. Feldstein also asked some questions on the revenues of your member companies from pay cable. I know you don't have all of these facts and figures before you, but could you give us your best judgment as to the relative or the ratio of revenues to your member companies from pay cable and from the television syndication market which is the market directly impacted by cable broadcast signal retransmissions?

etp 16

Q The pay cable market, as I said, is about, the royalty payments in '78, aggregated some $13 million. The syndicated market is four or five hundred million dollars.

Q The $12 million was a compulsory license fee. I am talking about pay cable revenues.

A The only figures I have at hand is the 1979 from MPAA which is over $80 million.

Q The point I want to make is is it true the syndication to your member companies are much, much greater than pay cable revenues?

A Yes. By far.

Q All right.

A final point concerning the FCC decision on signal courage and syndicated exclusivity. Have you looked at that decision that was released by the Commission?

A Yes, I did.

Q Is it true that one of the major factors that went into that decision to deregulate cable television was the fact that Congress had passed copyright legislation and that this Tribunal had the authority to adjust the rates at least for new programs that would be permitted under the deregulation of cable by the FCC?

A Yes. It went ad naseum in our importuning to the FCC saying youcannot deregulate cable when cable is already favorably regulated. Cable wants to get rid of the shackle of compulsory license just love, health, happiness, and money.

1 They love it. You cannot, by unlocking the exclusivity rules
2 so long as you keep the compulsory license.
3 Also, FCC believed, and we were unable to change
4 Chairman Farris and his cohorts beliefs that the syndicated
5 exclusivity rule was put on by FCC in the absence of a copy-
6 right bill and now we have a copyright bill there is no need
7 to keep the exclusivity even though one goes even to 15
8 Congressmen on the House. As a matter of fact, Judiciary
9 and Commerce Committee wrote the FCC and urged them to delay
10 action until Congress had a chance to revise it that the
11 Congressmen understood the sensitivity and vital connection
12 with the copyright bill and the syndicated exclusivity rule.
13 Indeed, Chairman Castlemeyer to Chairman Farris
14 stated when that bill was passed by the House the fact that
15 there is a syndicated exclusivity rule waved heavily in the
16 way they structured that bill.
17 The bill itself says changes in the syndicated
18 exclusivity rule and changes in the distant signal courage
19 were going to trigger a review by the CRT. But said Chairman
20 Castlemeyer they did not envision an abolition of the syndicated
21 exclusivity rules. In spite of that, FCC took the action it did.
22 MR. FELDSTEIN: I fail to see how the abolition
23 of the rule in the regard to the rules regarding the proceeding
24 that might come before the Commission is relevant.
25 MR. ATTAWAY: I did not bring it up. I must have
thought it has some relevance.

etp18

MR. FELDSTEIN: He did not but not on this point.

CHAIRMAN BURG: Proceed Mr. Attaway.

MR. ATTAWAY: That is all.

CHAIRMAN BURG: I think we will now recess for lunch. Thank you, Mr. Valenti. We will return here at 1:30 this afternoon.

(Recess at 11:45 a.m.)

etp

A F T E R N O O N  S E S S I O N

CHAIRMAN BURG: Mr. Attaway, I see you are prepared with your next witness.

Mr. Cooper, would you stand, please, to be sworn?

Whereupon,

ALAN R. COOPER

was called as a witness and, having been previously duly sworn was examined and testified as follows:

DIRECT EXAMINATION

BY MR. ATTAWAY:

Q Would you state your name and occupation for the record?

A My name is Alan R. Cooper, Vice President of the Motion Picture Association of America.

Q Would you describe your academic background and work experience that qualifies you as an expert witness in this proceeding?

A I have been involved in various executive positions in the broadcasting business since 1952. During the 28 years I have been a Vice President for Planning, National Broadcasting Corporation, James B. Kobak, Inc. (Media Consultants), Program Research Director of the Public Boadcasting Service, and since the end of '77 with the Motion Picture Association.

Academically. I have an undergraduate degree of Psychology, graduate studies at various unversities. Indiana, Princeton, and New York Universities relating to economics,

etp2

statistics, and other fields that may be pertinent to this situation. Cable industry. I have been with cable since 1962, while I was at NBC.

In 1962, just a historical interest, I prepared a report for management. I would like, if you would, to quote briefly from it one paragraph.

In 1962, I prepared a report called, "The Community Antenna Business," for NBC. At that time these were perhaps only a million "community Antenna Television" system subscribers. We are 18 million now. The paragraph reads:

Our general conclusion is that CATV's have a legitimate 'raison d'etre' and that most of the present systems will survive and prosper for long time. Considering the profit potential and minimum risk, NBC might very well consider an investment in this business."

Subsequently, NBC accepted this advice. The Corporation Planning Department, whch is one of the units that reported to me, began an investigation and we uncovered several systems which NBC subsequently purchased.

These systems particularly with respect to the administration supervision was handled by my Corporation Planning Department by personnel that reported to me. I have hands-on experience with the cable systems in Kingston, New York and Seattle, Washington and in the suburb of Los Angeles, and in California.

etp3

1 I am also the author of many published papers,
2 including several related to cable television. I wrote a
3 major article for Television Age, published in May 14, 1973,
4 edition. The headline of the article was "Most cable growth
5 projects are blue sky' says consultant; sees only 20 percent
6 saturation by '80," written at the time when at least 60 percent
7 of the 75 million TV households in 1980 would be attached to
8 an electronic umbilicus."
9 In the Publisher's Letter in the June 2, 1980,
10 issue of Television Age, Sol Paul comments: "In the early
11 '70's, Allen R. Cooper, now with the Motion Picture Association
12 of America, wrote a piece in Television/Radio Age, predicting
13 that cable penetration by 1980 would reach 20 percent of U. S.
14 television homes.
15 Arbitron has just announced that cable penetration
16 in the U. S. is at the 20 percent level, up 65 percent over the
17 past five years. Cooper's projection was right on target."
18 Other articles in various professional journals
19 deal with satellite communications, "narrowcasting," and other
20 subjects.
21 MR. ATTAWAY: Thank you.
22 Madam Chairman, at this time, I would like to
23 introduce a number of exhibits that we will use with his
24 testimony. These exhibits have been given already to Mr.
25 Feldstein. Rather than introducing them one at a time as
they come up, I would like to have them marked Copyright

etp3a

1 Owner Exhibits 1 through 10.

2 Mr. Cooper, did you prepare these exhibits or if
3 you did not, did you supervise their preparation and check them
4 for accuracy?

5 THE WITNESS: Exhibit 1 consists of the CRT
6 questionnaire that was placed into the record this morning
7 by the Chairperson Burg. Exhibits 2 through 8, were prepared
8 entirely by me including the rough charts which are rough but
9 they are my own.

10 Exhibit 9 is based upon data furnished to me by
11 Raul Rodriquez, counsel for the National Association of
12 Broadcasters based upon data contained in Paul Kagan newsletter
13 called, the subscription.

14 I will give you the exact name. The series is
15 called Cable TV Regulation.

16 I have gone through every issue of Cable TV
17 Regulation that was used by Raul in preparing this material
18 and confirmed the accuracy of it. Exhibit 10 is based upon
19 data -- Exhibit 10 consists of data assembled by Fritz Attaway,
20 also from the same Paul Kagan source.

21 Again, as I have indicated, I have gone through
22 every issue of the Paul Kagan Cable TV Regulation Newsletter
23 and confirmed that not only are these verbatim phrases from
24 those regulations, from that newsletter, but it is also
25 complete to the extent it covers every system such as the ones
presented in Exhibit 10.

BY MR. ATTAWAY:

Q One of the primary issues in this proceeding is the extent to which basic cable subscriber rates have increased from October 1976. The Tribunal has collected some evidence on this question in the form of a questionnaire which it sent to all cable systems that filed statements of account and paid copyright royalties to the copyright office.

Have you examined the questionnaires that were returned to the Tribunal from cable systems?

(CO's Exhibits 1 through 10 were for identification and received in evidence.)

etp5

A I have personally reviewed in the CRT's files all questionnaires returned by so-called long form systems. The questionnaires are segregated in the CRT's files based upon the type of form submitted by the cable system in reply.

These are short form for cable systems that filed form 1's which have income of under 41,500 semiannual period. Forms 2 or intermediate form which applies to cable systems with gross receipts semiannually above 41,500 but less than 160,000, and the long forms which are filed by cable systems with revenues over 160,000 per semiannual period.

My examination was exclusively restricted to the long form responses. I found in the file long form or questionnaires numbered L-1 through L-653. I have examined the complete file and have extracted information from each of those questionnaires.

For the record, there are two questionnaires that were not in the file. Numbers, if it is pertinent, there were two that did not exist. Actually there were only 651 that I did examine.

Q Why did you confine your examination to the long form questionnaires?

A The principal, there are several principal reasons for that. First, only the long form systems may be pertinent to the resolution of the CRT inasmuch as these long form systems are the only ones that file on a DSE basis. Number 2, the long form systems have over the preceding four report periods

etp6

accounted for approximately 90 percent of the total copyright royalty payments. It is felt that the responses from these systems alone would have most probative value as far as the Commission is concerned.

Q It is correct, is it not, that the Tribunal's authority to adjust the rates in this proceeding is confined to those systems that pay under a DSE basis?

A I believe so. I believe so.

Q Mr. Cooper, would you describe your examination of this Tribunal questionnaire and indicate your findings to the Tribunal?

A I have here the original charts from which the exhibits that you have were made. Perhaps, there is a little color in them occasionally it might be easier for you to handle. Your exhibits are exact photo reproductions.

CO-2, Exhibit 2 is headed, Basic Rates of All Long Form Cable Systems, October 19, 1976, versus April 1, 1980. On the face of the chart you will see that the reference number is that these data are based upon 620 cable systems.

I have previously testified there were 653 numbered forms in the file. All but two of them were there when I looked through the file. However, for the purpose of this comparison, I've used only those systems, the 620 of them, that indicated a single rate, the single standard rate, for the first set in 1976, and a single standard rate first set in April of 1980. So, I had a complete comparison of exactly the same in 1976, and

etp7

in 1980. I tabulated each one of those. This first chart lays on the bottom side, the horizontal axis as the standard rate going for less than $4 to $10 and higher. On the vertical axis, we show the percent of cable system in each of those two periods charging rates in those areas.

This solid line is the 1976, and the dotted line is for 1980. You will see that the two curves are virtually identical, except at this place by a $1 figure. In 1976, 28 percent of all cable systems were in its peak, which is in between $6 and $6.50.

In 1980, you will see that the peak is the same level between $7.50 and $8. I have shown on the right-hand side the results of developing an average from the 620 systems. The average rate in 1976 was $6.60 and a half cents. In 1980, it was $7 and 60 and 66 one thousandth of a dollar.

The increase between the two period was 15.150 percent on the average. You may be interested in the extreme level here at the $9 situation. Two percent of all cable system charge had a standard rate first set of $9 or more in 1976. That figure rose to 8.2 percent in 1980. Nine dollars or more. Are there any questions?

COMMISSIONER GARCIA: Just a minute. Don't take that off, yet, please.

I have answered my own question.

THE WITNESS: Exhibit 3 is headed Changes in Basic Rates to Subscribers. We show here in the left-hand side figures

etp8

1 you have just seen, $9.61 in 1976, and $7.61, in 1980 for an
2 increase of 15.150 percent which should be precisely the same
3 figures you had in Exhibit 2.
4 I have taken from various sources,presumably,figures
5 which would have pertinence in corroborating the validity of
6 the data we obtained from using the CRT survey. The next block
7 is from a Nielson Study that deals with cable systems with
8 3,501 to 10,000 subscribers that was included in the Cable
9 Association's filing with the CRT.
10 For those systems, the figure was $6.38, in 1976,
11 $7.40, in April 1980, for an increase of 15.99 percent slightly
12 higher than the figure we have shown here.
13 The next is from Kagan, Kagan report on all pay
14 cable systems. The Kagan material is restricted to the systems
15 of pay cable. I have taken all systems of pay cable in 1976,
16 and all of the systems as of December 31, 1979, from a booklet
17 called,The Pay TV Census, prepared by Kagan material. These
18 are the average: $6.72 in 1976, $7.53, for an increase of 12.05
19 percent.
20 The next is pay cable system from the Kagan Report
21 of 20,000 or more and it shows a lower figure of 10.43 percent
22 in terms of percentage increase.
23 The next to the last column on the right refers to
24 a mysterious set of data introducedin the NCTA exhibit attributed
25 to DLJ. We have asked counsel to identify that but we have not

etp 9

1 received a response. I assume there is one and the source is
2 fairly reliable. That shows a 12.41 increase in rates from
3 1977 to 1980.
4 The final column deals with only a one-year period.
5 This is one or two years. 1978, going to 1979. During that
6 two-year period, rates were up 7.1 percent.
7 We are dealing with all changes over a five-year
8 period. 1976, through 1980.
9 BY MR. ATTAWAY:
10 Q Of the studies, the Tribunal's questionnaire seems
11 to have covered the longest period of time relevant to this
12 proceeding, October '78, to April of this year?
13 A No. I think this Nielson Study submitted by NCTA
14 covers the same period. All other studies cover a shorter
15 period.
16 Q One of the major issues in this proceeding is
17 whether cable regulatory authorities have had a significant
18 restraining effect on the increases in basic cable rates.
19 Q Mr. Cooper, what information were you able to
20 extract from the questionnaire relating to this subject?
21 A It is one of the questions in the CRT's questionnaire
22 asked each cable system to indicate whether its rates were
23 subject to review by regulating authorities. The cable systems
24 were requested to answer yes or no to that question.
25 There is a tabulation of those responses. We
found that 72.3 percent of the cable system answered, yes, their

etp10

1 rates are subject to regulation and 27.7 percent answered, no,
2 indicating their rates were not subject to regulation.
3 We took these data only to try to develop a response
4 to a question raised by the Commissioner in this proceeding
5 and contained in Committee Report of the House, the question
6 as to the extenuating circumstances or the extent to which
7 rate regulations have kept rates fiscally low.
8 Rates have not kept up with inflation because of
9 the impact of regulating authorities on the situation. Our
10 Exhibit 5, indicates the rates of regulated long form cable
11 system March 1970, October 1976, versus April 1, 1980. These
12 curves should be familiar to you because they are the long
13 shown previously for all systems.
14 The impact is $6.50 with 27 percent of the cable
15 system in that category in 1976, of the regulated cable systems.
16 In 1980, the figure is also 27 percent. At this time, it is in
17 the category of $7.50 to $8.
18 COMMISSIONER GARCIA: Mr. Cooper, this difference
19 from Exhibit 2 in that Exhibit 2 we had less in 1980, charging
20 the medium; is that right?
21 THE WITNESS: Pardon me?
22 Yes. Exhibit 2, there were more. There were 28.1
23 versus 27.0.
24 COMMISSIONER GARCIA: Between the year '76 and
25 '80, in Exhibit 2?
THE WITNESS: This is Exhibit 2. The figures are

etpll

very similar, 27.0 and 27.4.

COMMISSIONER GARCIA: In Exhibit 2 by itself, in 1980, we had a decrease in the media of the percentile? We had 29 percent?

THE WITNESS: 28.1 in '76 and 27.4 in 1980.

BY MR. ATTAWAY:

Q There is a small decrease?

A Yes. There has been in the rate structure. There is a bulge over here which accounts for it.

In '76 for regulated cable systems the average is within a penny of the figure for all systems, $6.60, and six-tenths and $6.60, and five, one thousandths; $7.55 was 1980.

The increase was 14.315 percent which is roughly one percent less than the increase for all systems that were reported in Exhibit 2. In Exhibit 2, we reported 15.1 percent, 1 percent overall increase for all cable systems and here for regulated 14.3.

We willrecapitulate on a subsequent chart. Any further questions about the one on regulation? This is the identical chart. However, only for those systems that indicated they were unregulated in response to the CRT question.

We have, again, a very strong peak in 1976; 31.4 at the $6 and six and a half dollars. In 1980, the peak is between $7.50 and $8, at 28.4 percent.

CHAIRMAN BURG: Mr. Cooper, how many systems does this exhibit take in?

etp12

THE WITNESS: This is referenced in Exhibit 3, 4; 172 unregulated, 448 regulated. The average rate for all systems in '76 was virtually identical to that of the regulated cable systems. That is $4.60.

COMMISSIONER GARCIA: Exhibits 5 and 6 total Exhibits 2, is that right?

THE WITNESS: Exactly.

In 1980, the average figure for the unregulated system was $7.75, 74 and a half cents. That is an increase of 17.327 percent. The 17 percent increase for the unregulated systems.

One thing that is fascinating to me is the increase in rates above $9. In 1976, you will find 1.8 percent total of the unregulated cable systems had rates of $9 or higher. In 1980, it was 13 percent.

Here we put all three lines together. At this time on a percentage basis. We have taken the percentage increase in rate for each of the cable systems. Total, regulated and unregulated and computed the percent of cable systems that had a percentage increase.

The three lines are shown on this chart. They are labeled. I hope you can read them without color on your copy of Exhibit 7. You will notice that the lines are virtually identical here. There is a gap in this area. This gap in this area is where those littleglimpse are that account for difference in rates of regulated and unregulated systems.

tp 13

But to recapitulate, the average percentage increase, the regulated systems 14.315, 17.327, and 15.150 for all long form systems.

MR. ATTAWAY: May I interrupt you at this point. Is it correct the questionnaire shows there is only a three percent difference between the 72.3 percent of all systems that were regulated and therefore, presumably, subject to some type of regulatory restraint and the 27.7 percent of all systems that were not regulated and presumably not subject to any regulatory authority restraint.

THE WITNESS: That is correct, Mr. Attaway. The difference is 14.3, 17.3. Three percentage points.

The CRT questionnaire also asked cable systems, whether or not they had regulated cable systems, whether or not they had requested a rate increase between 1976, and 1980. In those instances where the cable systems rate in 1976, and 1980 was the same.

So, we have then a figure which is a component of our Exhibit 8 which is the cable systems, the regulated cable systems that had not requested a rate increase since 1978.

The answer was 17 percent of all regulated cable systems had not requested an increase since 1976. We have taken all the other questionnaires.

COMMISSIONER JAMES: Excuse me. Were all those systems in existence in '76?

THE WITNESS: Yes. The samples we have used,

etp 14

Commissioner James, as I pointed out earlier, were only those systems which we had a rate in 1976 and a rate in 1980.

COMMISSIONER JAMES: Okay.

THE WITNESS: We deal largely with the remaining 83 percent that had presumably requested an increase in their rates since 1976. These are all only the regulated cable systems.

As shown in our Exhibit 8, 83 percent did request an increase; 64.7 percent of all regulated cable systems or 78 percent of those who had requested an increase. You see that little figure in there? Seventy-eight percent of those that had requested an increase received the full amount or more of the amount requested. 12.5 percent of all regulated systems had received an increase in which they said it was less than the full amount they had requested.

That is 15 percent of all the cable systems that had requested an increase. In the case of 3.8 and 4.6 of those that had requested an increase, action was pending at the time of the survey.

Finally, we have this little block over on the right which is 1.6 percent of the cable systems of all regulated cable systems that had not raised their rates from 1976 to 1980. They said that the reason for it was that their request was denied.

Actually, it is only 1.9 percent of those that had made a request.

etp 15

CHAIRMAN BURG: Is that a nine or four?

THE WITNESS: It is a nine; 1.9 of those that had made a request said their request had been denied. This material, I assure you, is from the CRT survey for the long forms.

BY MR. ATTAWAY:

Q Before you remove that chart, if you add columns 1 and 3, you get 81.7 percent. Those are the systems that either did not requests rate increasesor did request one and received the actual amount that they asked for, 81.7 percent.

The remainder is approximately 19 percent from 100. I assume those would be the systems that may have been subject to some kind of regulatory restraint.

A Except we don't know what the action pending is.

Q But 81.7 percent either did not ask for a request or got what they asked for.

A Yes.

Q Thank you.

A There is some corroborating material on this I referenced earlier. Data in the cable TV Regulation Newsletter turned out by Paul Kagan Associates. I would differentiate between cable TV Regulation Newsletter and Paul Kagan's Pay Cable Reports. The TV Regulation Newsletter is not restricted to pay cable systems but includes all cable systems.

Starting in January of '76, Paul Kagan Associates began to publish in the Cable TV Regulation Newsletter a listing

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of every cable system that had requested an increase, the amount of the increase requested and the amount granted by the regulating authority for whatever other action was taken by the regulating authority.

I had indicated to you the data from this publication. Summary was made for us by Raul Rodriquez of NAB. These, essentially, are the figures that came from the Kagan Study. You will follow through in the earlier January-June 1976, which is out of the province of this hearing, 86 percent of the requests were granted.

The percent granted of the amount requested was 98 percent. That is how that is to be read. preceding up, let's go up to the top of the list to the latest data available on the January-June 1980.

The Kagan data indicates that 95.6 percent of the request for increases were granted by the regulating authorities and the percent granted of the amount requested was 99.7 percent. I think this largely confirms the findings that came out of the CRT survey with respect to the extent to which regulating authorities granted the full amount of the increase requested.

The average from January 1976, to June 1980, taking into account the different numbers of increases requested in each one of those periods is 19.9 percent of the requests were granted and the amounts granted represented 99 percent of the amount requested.

COMMISSIONER JAMES: I have a question. In this

etp17

1 Kagan Survey, I am trying to get the comparison between this
2 and the other exhibits. Do they take all the cable systems or
3 just the ones that long form?
4 THE WITNESS: All cable systems.
5 COMMISSIONER JAMES: We really can't make a compari-
6 son between the data, NR data based because we asked for the
7 whole system?
8 THE WITNESS: As far as regulating authority is
9 concerned, in virtually every instance they grant the request
10 and virtually every instance the amount granted is the amount
11 that was requested.
12 This is general rule that I think comes out of your
13 survey and the Kagan material.
14 COMMISSIONER GARCIA: Maybe this is what Commissioner
15 James was asking you. Looking at Exhibit 9 and Exhibit 8, does
16 that 91.9 percent compare with the 83 percent? Is that
17 a comparable number?
18 THE WITNESS: No. The 83 percent would be all
19 of the cable systems. There is not a number with this. The
20 83 percent is just a base for these numbers, the number of
21 increases requested in this period. Actually, I think we are
22 dealing and I made a note of it of the number of cases involved.
23 As I recall, the number of rate increases that were
24 involved in this, these were all requested in excess of 2,000
25 reported by Kagan Report.

etp18

BY MR. ATTAWAY:

Q Mr. Cooper, if you compare Exhibit 8 with Exhibit 9, it is true, isn't it, your column 2 would constitute 100 percent of the --

A That is correct.

Q The information, the universe examined by Kagan. Kagan is not concerned with cable systems?

A Eighty-three percent is the universe.

Q If you add column 3, 78 percent of column 2, the 100 percent Kagan is using, and you assume that column 4, the pending --

A Take the other one, too. The second column, too, should be added, 78 and 15. That gives you 93. And 4.6 in the pending assuming those would come out. That compares with the 91.9.

COMMISSIONER JAMES: Commissioner Brennan has already done that.

BY MR. ATTAWAY:

Q Kagan and the questionnaire results are pretty close, almost identical.

Mr. Cooper, in our previous pleadings filed in April of this year, we identified a rather dramatic new development in cable marketing practicing called tiering. We said the tiering and related developments such as free service offerings must be taken into account by this Tribunal in its decision. Would you describe this new marketing development and

tp19

how that affects the payment of royalties under the compulsory license?

A Yes. There has been a phenomena that a lot of people have observed within the past year, primarily. We are virtually, every application for franchises in major markets has included either of two particular characteristics.

One is teared basic services and the other one is free universal basic services. The tiered services concept relates to packaging, to bundling various groups of retransmitted signals and signals from other sources into single price units that are sold to, made available to subscribers.

There might be one. The first unit would include a smaller number of signals presumably primarily local signals and possibly a few distant signals. That would be the basic tier.

In the new bill or the applications for new systems, it is being either offered at a very, very low price or free to any subscriber. In the other rule, we go to an increased bundle, a larger bundle which now includes more distant signals and more advertiser supported programming. But still not pay cable.

This is called an expanded basic or tier two basic offer. This is where cable has offered the tier one free and

etp20 1 might be offered at $3 or $4 to subscribers for the so-called
2 second tier for expanded basic. The rule is go beyond that
3 to a third tier of basic services which include all services in
4 tears one and two and more distant signals and more satellite
5 distributed signals and perhaps local originations of some kind
6 or another. Still exclusive of pay cable services.
7 Over and above these, one, two or three tiers of
8 basic services, all of the franchise applications in a major
9 market include multiple tiers of pay cable services in addition
10 to that. For one or two or three of those things.
11 The result is that subscribers to the new systems
12 are being offered a large minimum use of packaging bundles of
13 service from which they can choose. The rates for those
14 packages or bundles will go from zero to perhaps $20 or $30 a
15 month per subscribing household.
16 This phenomenon of tiering has or is as I have indi-
17 cated most apparent and dramatic in connection with the
18 franchise applications for new systems. It is also a fact of
19 life with the cable systems.
20 We now have for about three or four years since
21 an enterprising operator in Louisiana started the practice of
22 tiered pay cable services. This is now a rather common, I would
23 say, method or system of marketing pay cable in cable systems
24 around the country. Less common but also apparent today and of
25 more significance in the future is the tiered basic.

etp21 1 There are cable systems now operating that have been in operation for a long time that have switched to a free service for basic subscription.

There are other cable systems that are offering expanded basic. The expanded basic in some instances is related to the furnishing to the subscriber a converter. There is generally an extra charge placed to the household for this converter.

Now, this converter charge is an interesting animal. It may be like, I think, an average of looking at several hundred statements of account maybe around $2 per month subscriber for the expanded basic service.

Sometimes this is included in the gross receipts reported by cable systems for copyright purposes. Sometimes it is put down in the other charges along with connection or disconnection or reconnection type charges that cable system make are not included for cable copyright.

The fact is that there is, the subject is hot now in the cable world as the issue of tiering and universal free service. We are have included as Exhibit 10 every summary of new franchise applications made in major markets as published by Paul Kagan in the newsletter that we have referred to before.

I think that you ~~will see~~ there the precisely what I am talking about with respect to the free services, the tiered basic, and the tiered pay services. The problem, of course, that you will recognize and that Congress recognized, is the fact

1 that the extent to which cable service is given away where
2 there is a universalfree service, the amount of copyright no
tp 22
3 matter what the DSE schedule says, if I multiply any percentage
4 times zero, I come out with zero. I have been trying to track
5 down one of these systems in particular.
6 I just over the weekend I came across the fact that
7 there is a large cable system in Honolulu, Honolulu County,
8 called, owned by a group called TV Systems, Incorporated. In
9 the TV fact books for 1978, and '79, there is a basic rate
10 shown of six and a half, $7 for, per subscriber.
11 In the 1980 fact book which was published just
12 this past week, just about the time we got it, the basic
13 subscriber rate is now none. I have been looking very hard,
14 I tried this morning to get a copy of the 1980 statement of
15 account that may have been filed by this cable system. I do
16 know it filed in 1978 one. They paid a royalty fee of
17 $5,802.
18 In 1979 for the first period, they paid $12,587.
19 I truly suspect and it would be interesting if it proves out
20 that way that the payment for 1980 first period was $15. On
21 the basis of no basic subscriber rate.
22 Now this is a situation which is developing. As a
23 matter of fact, there was a report turned out also just within
24 the last few weeks by an organization that,consultants for
25 MPIA and,P and E, summarized the situation with respect to
tearing as follows. This is one of the four volumes of the

etp23

1 of the report. It says,"in an increasing number of instances
2 the lowest tier is being offered with no monthly service charge.
3 In some instances, this free basic tier includes most or all
4 of the retransmitted broadcasting signals which just a few
5 years ago were the only thing that cable had to sell."
6 I present that only from the standpoint of the
7 problem that is developing and a recognition given to this
8 problem in this report to the NTIA.
9 I would also like to quote to you from a pay TV
10 newsletter from September 12, 1980. This, again, is a Paul
11 Kagan publication.
12 It says, "It may be that a early Irvin Kahn
13 prediction comes to past. Ten years ago he said that the day
14 would come when cable operators would give away basic services
15 in order to get into the home to sell other things. A form of
16 that is happening currently but not quite the way a lot of
17 people envisioned it as Irvin first described it.
18 If you give away a form of basic in order to sell
19 the subscriber several tiers worth $20 or more per month, you
20 really have not changed the flow of revenue into the system.
21 You have only changed the direction in which it flows.
22 It may be hard to redirect revenue like that because
23 of proprietary interest in revenue held by regulatory authorities
24 and programmers."
25 I say to you it is the proprietary interest of
programmers that the cable television provisions of the Copyright

etp24

1 Act were designed to preserve. The CRT has a major responsi-
2 bility to carry out the mandate of Congress. The appropriate
3 action with respect to tiering must be taken now when this
4 practice is just beginning to be felt rather than at some
5 indeterminant future time when damage has been done. When a prac-
6 tice is established, it is more difficult to correct than if
7 nipped in the bud.

8 COMMISSIONER JAMES: I have one question. Going
9 to your Exhibit 10, St. Paul Minnesota, I think I
10 understand tiering but there is a system that I don't under-
11 stand that I was just exposed to about a month ago.

12 My son that lives in Columbus, Ohio. Every time
13 he pushes a button, it's a three-dollar charge. This is for
14 a movie or sports show. What kind of system is that?

15 Most of the things, I have looked through this
16 exhibit, is on monthly basis. Are they now coming up with a
17 system whereby every show you watch there is a charge for it?
18 He gets a monthly statement that varies every month.

19 THE WITNESS: What you are talking about, Mr. James,
20 is something which originally was called "pay per view."
21 Originally, when pay cable began, there was an effort made,
22 the concept that was most prevalent was that the rates and
23 fees charged subscribers to watch a movie, for example, would be
24 per movie or per sporting event or on a per event basis.

25 The system your son is probably subscribing to is the
Columbus, Ohio Warner Annex Q Cable System, which is one of the

etp25

1 advanced two-way systems that exists in the country today. In
2 order for pay per view to operate, it requires on the part of the
3 cable system the ability to say, okay, you can have this program.
4 Okay, you don't have it. And also to know you are watching it
5 for billing purposes. This is one characteristic of a two-way
6 system.

7 The pay per view concept apparently failed to take
8 hold. It is referred generally to be unfeasible with respect
9 to essential commonplace general forms of pay cable. People
10 who started with pay per view have switched to a monthly flat
11 rate rather than pay per view. Your son's system is an
12 inacronym.

13 COMMISSIONER JAMES: He showed me bills of $200
14 a month.

15 THE WITNESS: This is exactly the reason that pay
16 per view has been abandoned. But there are other kinds of bills
17 that people will pay. What you are dealing with there,
18 Commissioner James, is a marketplace situation. Presumably,
19 your son is responsible for making these decisions. That is
20 what that home figures that the pay system figures the pay cable
21 service is worth. $200.

22 I can assure you the fact that there are companies
23 and others who are supporting the pay cable industry have to be
24 satisfied with 20 percent of $10 is indicative, again, of a lack
25 of competition.

etp26

COMMISSIONER JAMES: The other question on Exhibit 10, on Tier 4?

THE WITNESS: St. Paul?

COMMISSIONER JAMES: Yes. American Heritage, parenthesis 80. Is that a total of 80 channels?

THE WITNESS: Yes.

COMMISSIONER JAMES: Does that include the 70 to 35 to 69?

THE WITNESS: Yes. Those are royal progression.

MR. ATTAWAY: Mr. Cooper, I am not through with my direct yet.

COMMISSIONER JAMES: I know it.

CHAIRMAN BURG: I know you aren't. I would like to ask a question, if I may be permitted.

MR. ATTAWAY: Yes, Madam. I didn't want you to think I was through.

CHAIRMAN BURG: In the St. Paul, Minnesota market, Mr. Cooper, throughout this Exhibit 10, I notice discounting is prevalent. The basic structure is quite prevalent. The only place I see it is in St. Paul, Minnesota that applications are guaranteed the rates for three years.

How often does that occur the guaranteed rate?

THE WITNESS: Some franchises contain a guarantee. It is possible, Chairman Burg. Some of the cable systems that have not requested a rate increase did so because their

etp27

franchise agreement that they signed with the authority precludes that. That is an extraordinarily rare situation.

CHAIRMAN BURG: That was my next question.

THE WITNESS: It is extraordinarily rare. We have a history of cable systems getting multiple rating increases over this period of time. They are relatively few. Anyone who asked. From your questionnaire, for example, I have gone through one of the good questions you have in there.

CHAIRMAN BURG: Just one.

THE WITNESS: One of the particularly good ones, asked these people who did receive a rate increase , asked why they did not. If you indulge me I would like to read some specific to you. I will give you, for identification, and your confirmation the numberof questionnaire that is involved.

I will only read a half dozen of them. L-30, HBO pay service offered, which was not included in franchise fee. L-26 because of additional subscribers and the addition of pay service. I keep calling these numbers somebody is going to yell bingo.

L-576, the basic rate is going to stay the same but through offering a service with multi-channels an additional rate will be added. This is an example, I think, of a tiering situation we are talking about.

L-242, subscriber growth has generated additional revenues adequate enough to offset the affects of inflation.

28etp

I wanted to bring you one of those. The main principal reason that I seem to cull from the answers given in that question why have you not asked for an increase is that it was a business decision not to ask for an increase.

Some of the bad answers were why didn't you request an increase and the answer given is not reuqested. That kind of thing.

In other places, they say we did not deem it necessary at this time. Very common answer. Those are business decisions on the part of the cable system. I don't fault them. If the cable system doesn't want to increase its rate, it is the cable system's business. Unfortunately, the Copyright Act is hedged upon the assumption that the rates will continue up in line with inflation.

The business decision on the part of the cable operator to hold his rates down for whatever reason interferes with the provision to copyright owners of the protection and benefits provided in the Copyright Act.

BY MR. ATTAWAY:

Q Mr. Cooper, with respect to guaranteed rates, if the cable operator in the process of bidding for a cable franchise guarantee as part of its franchise bid that basic rates will stay the same for a period of three or four years, can that be considered regulatory restraint or is it more of a marketing decision?

etp29

MR. FELDSTEIN: I object to that question. He is going to ask the witness for a legal conclusion.

CHAIRMAN BURG: Would you like to have a go at that?

BY MR. ATTAWAY:

Q Is a cable operator bidding for a cable franchise generally or is he ever subject to the regulatory authority of any state or local government? He is bidding for a franchise, right?

A Yes.

Q He is bidding for the right to control of the regulatory authority?

A He is bidding for a piece of the gold mine.

Q Is it not true that the guarantee of a basic rate at a certain level for a period of time is one of the things that a cable operator offers to a franchising authority in competing with other applicants for that franchise?

A Yes. It is the kind of inducement that the franchise bidder may present to a franchise authority. In my opinion, a lot of these promises and inducements included in the original franchise agreements are not kept. This is particularly true, and I think the record is very clear on that, with respect to access channels. A provision of a locally originated service and so forth.

Great promises are made and they are not kept. I would assume the same kind of validity and permanence can be

etp30

attributed to the promises made with respect to rate increases.

Q Going back to one of the questions that Mr. James asked, in order for a cable system to obtain revenues from pay cable, whether it be tape or pay for channel, Commissioner James mentioned his son had a bill of $200. In order to obtain those revenues, the cable system must first have the subscriber hooked up to basic, right?

A Yes. I know of no cable system period that offers only pay service. I was almost going to make a mistake. I was going to say no pay service. STV are pay service.

Q If a cable service wants to increase its pay cable or any other service, he first has to get the subscriber hooked up to basic?

A Yes.

Q There is considerable incentive to get the cable subscriber hooked and sell other services.

A Basic cable is the open sesame.

Q You have reviewed a rather large number of statements of account filed by cable systems, have you not?

A You bet.

Q What is the copyright office ruling? I don't know if it is a ruling. I have seen it in letters. You may have seen it as well with respect to revenues from tiered services. What is to be included in royalty base and what is to be excluded?

tp31

A I don't think there is any such ruling. I have never seen the copyright office question a cable system with respect to its statement of gross receipts. I think what you may be referring to is a ruling I encountered recently in going through statements of account where the copyright office has determined that every distant signal carried as part of a tier, let's say, is available only to expanded basic subscriber must be counted as if it were offered to the full cable system.

In other words, the DSE is not on a portion of the cable system that takes the expanded basic. But on the total gross receipts, I know from my experience that these forms, and that is not your problem, that is a problem that existed before many of us came into the act, are incredibly difficult in terms of determining what revenue is or is not being included in gross receipts.

Nor is it possible from those forms to detemrine the number of subscribers a cable system has. This is undeterminable from the statements of account filed by cable systems. We don't know where these revenues were calculated. You can't go back and reconstruct dollar for dollar what the gross receipts are from statements of account. You have a flat number saying these are my gross receipts for the semiannual period.

There is other data given in the front but what is included and not included it is not possible to determine from the statements of account. To the best of my knowledge, the copyright office has not sought to question any cable system's report

1 of its gross receipts.

etp 2 Q I think you have pretty well answered my next
32
3 question. But I would like to ask it anyway.

4 Say, we have a cable system in operation with a
5 structure like American Heritage Cable Systems' bid in St. Paul
6 Minnesota. If that cable system were filing a statement of
7 account how in the world would a copyright owner ever determine
8 whether it paid what it was supposed to pay and included in
9 this revenue basis what it was supposed to include in order to
10 police the payment made by that system?

11 A I guess the only way they would ever know, Fritz
12 is they would take each one to court and ask them to file
13 some sort of civil suite to produce their records. Otherwise,
14 they are not available from the current forms from the Copyright
15 Office.

16 Q From an examination of that form you just can't
17 tell?

18 A You absolutely can't tell.

19 Q On that same line going back to St. Paul, the basic
20 service tier included 595 and 745?

21 A The basic service tier 1, free. Seven channels.
22 American Heritage. Seven channels in the Canadian system.
23 If all I was willing to take were 19 channels offered by
24 Metrovision, they get the francnise and I take tier 1. I pay
25 nothing. The cable system pays nothing to Copyright.

Q They would not fill out any form?

etp 33

A I dont' know how they would handle the subscribers that paid zero, for example. Let's say they list 1200 subscribers but they show zero as their rate and another 1500 for 695, the present forms are not equipped for that.

But the real kind of a problem that I had alluded to before -- May I give the Commissioner a copy of this?

MR. ATTAWAY: What?

THE WITNESS: Two pages from the television fact book I referred to. It is fact book Number 48 and fact book Number 49, the 1980 edition that deals with the cable system that serves Honolulu County. This is the one that says in the 1980 Television Fact Book subscriber fee $40 installation, no monthly charge.

Now, that is not tiering. That is just zero. That is universal free service with a convenience.

COMMISSIONER JAMES: They would not fill out Form 3?

THE WITNESS: They fill out Form 1. Their revenues and I have that, too, there is basic cable revenues for 1979. The first reporting period were reported $1,144,289. If this report is correct, the next report they show will be gross revenues from basic cable zero. The copyright owners will be deprived of their royalties in excess of $1 million. What was in excess

MR. ATTAWAY: If you want to pass that out, I think it would be proper to illustrate your point recognizing that

1 you can verify the accuracy of that information.

2 MR. FELDSTEIN: The probity of this. Can we have

3 this marked as an exhibit?

4 CHAIRMAN BURG: This will be marked Exhibit 10A.

5 MR. FELDSTEIN: This, I assume, is a tier on their

6 Exhibit 10?

7 THE WITNESS: It is not a tiered service. We are

8 dealing with a system called in Honolulu County, a line called

9 subscriber rate. This is from the 1979 edition. The next

10 page is 1980.

11 COMMISSIONER GARCIA: The only way you get the

12 free tier is if you subscribe to one of other pay items.

13 THE WITNESS: No. You only have to raise your

14 hand and say I want to be connected. If you are willing to

15 have the cable service, the wire connected to your television

16 set, it may be required, Commissioner, that you pay an

17 installation charge.

18 COMMISSIONER GARCIA: And I can keep that forever

19 and ever?

20 THE WITNESS: That is correct. You would be tied

21 to the cable. You would receive the first tier free forever

22 and ever, as long as they keep their promise.

23 COMMISSIONER GARCIA: I see. So, the 20 percent

24 I talked to counsel about this morning, does that take tiering

25 into consideration?

etp35

THE WITNESS: We have a proposal with respect to tiering. It is a special problem which needs special handling.

COMMISSIONER GARCIA: I am aware of that. What are the members or are you the wrong witness to ask that?

THE WITNESS: I am the wrong witness to ask that.

CHAIRMAN BURG: I am dying to find out that Exhibit 3, the NCTA, Exhibit 6, the DLJ. We will find out at some point, Mr. Feldstein.

CHAIRMAN BURG: Back on the record.

CROSS-EXAMINATION

BY MR. FELDSTEIN:

Q First, I would like to note that in one of the initial questions Mr. Attaway asked Mr. Cooper whether this proceeding just involved the DSE paying systems; I would note this is a two-part proceeding. The legal conclusion drawn by Mr. Cooper is incorrect. We are also adjusting the dollar limitations for the smaller systems. So for the record his answer was not correct.

Mr. Cooper, you have pulled a couple of pages from the Television Fact Book on Honolulu, Copyright Owners Exhibit 10-A. Do you know whether this system has any tiers?

A I do not.

Q Do you know what they might charge for other services?

A What kind of other services?

Q Well, other tiers.

A Basic service?

Q No, whether they have any tiered services such as those which are proposed in your Exhibit 10 by other people.

A I do not know this.

Q You do not know that. To repeat what you said, you therefore do not know what kind of basic service revenue they reported on their 1981 Statement Account form?

A That's correct. We were unable to find 1980-1 Account form to date.

Q So you can draw, therefore, no conclusion that they are therefore paying less than they were for copyright?

A I have no such conclusion. I am merely assuming that if their new rate is zero for basic that they would have filed a Form 1 Statement of Account and paid $15.

Q That is an assumption.

A So stated.

Q On your Exhibit 10, you show for example, we have talked about the American Heritage proposal. You have told us that the copyright office requires that all revenues from tiers with broadcast signals be included in the basic service revenue.

A No, sir. That is not what I said. What I said was that all DSEs developed as a result of tiered service would be included in the DSE account for the full system. The copyright office and I repeat it, and I confirmed this during our recess, has absolutely no way of determining gross receipts, the meaningfulness, the completeness and the accuracy of those statements. They do not know whether any tiered services are included in gross receipts or excluded.

Q They don't have any way of confirming the basic service rates of a simple 12 channel system, do they?

A They do not.

Q Therefore, their confirmation power in that regard is the same?

A They have no confirmation power.

Q You have spoken of tiering as some kind of a trend.

jk-3

1 You have Exhibit 10, in which you present 21 examples. Do you
2 know how many of these have been granted?
3 A No, sir. I do not. Perhaps one or two.
4 Q Are you familiar with the operation of any that might
5 be in operation?
6 A I am not.
7 Q Do you know whether these tiers all have to be taken
8 before a subscriber can take one of the pay services?
9 A I don't know this, but I'm quite certain they do not
10 all have to be taken. That is, a subscriber getting universal
11 free service can also subscribe to any one or more of the tiers
12 of basic service. I think this is basic to all of the tiering
13 proposals.
14 Q Do you know how many systems and therefore how many
15 subscribers are today operating under any kind of a tiered basic
16 basis, not tiered pay?
17 A I know personally of only a few systems now that are
18 tiered, tiered basic.
19 Q Would that be, therefore, a small number of subscribers?
20 A That I know about personally? That I know about
21 personally, yes, the answer is a small number of subscribers.
22 Q Do you know in any of these proposals what is on the
23 tiers, on the first tier, second tier, etc.?
24 A There are more details concerning some of the proposals.
25 These were included in our filing in this proceeding made earlier
this year. We had more details concerning several of these same

new franchise application markets. This with substantial detail indicating the types of programming contained in each tier.

Q Is it fair to say as a general matter that these tiers contain both broadcast and cable-originated non-broadcasted material?

A All basic tiers?

Q As a general matter.

A No, are you speaking about all basic tiers?

Q Non-pay tiers, yes. It's a mixture of --

A It's a mixture of transmitted -- retransmitted signals and other types of services including advertiser supported services and local cable origination.

Q On those systems that you are familiar with which operate a tiered basic service, are you familiar with what percentage of the subscribers take only the free or reduced price beginning tier?

A I have data, for example, with a tiered, expanded basic system in the place in Massachusetts in mind. This is owned by Colonial Cablevision. If memory holds true, the expanded basic tier over the 1979 one period represented about 20 to 25 of the total subscribers to that system. I have that statement of account with me if you wish to examine it.

Q I notice that as I go through these tiering proposals, the various proposals, there seems to be, indeed there is a marked pattern that by the time you get up to tier two, three, four, that the subscriber is now paying at or above the general

1 average for cable that you showed in your rates from CRT
2 surveys. Would you know what percentage of the subscribers
3 on a tiered system that is in operation who might therefore be
4 paying that amount of money?
5 A I don't think there is enough information available.
6 I really can't answer that, Mr. Feldstein.
7 Q If a large percentage of people were taking the
8 expanded tiers with distant signals on them and a small percentage
9 were taking the free, reduced service, would the average rate
10 per subscriber on that system then be within the range of the
11 average rate on a system which simply had basic?
12 A No. My professional estimate would be that it would
13 be substantially lower.
14 Q But you have no data on that?
15 A I have no data on that.
16 Q Reference to the Paul Kagan exhibit which is still up
17 on the easel, that is No. 9, I believe. Is it Exhibit 9?
18 A That's Exhibit 9, yes, sir.
19 Q Are you familiar with the methodology which that
20 publication uses to collect that data?
21 A I am not.
22 MR. FELDSTEIN: That concludes my cross-examination.
23 REDIRECT EXAMINATION
24 BY MR. ATTAWAY:
25 Q Mr. Cooper, just one or two more questions. When
you stated that the copyright office has no present ability to

verify the gross receipts reported by a simple "untiered system," does or do copyright owners presently have any ability to verify those numbers through independent sources? At least make an estimate.

A I think the answer is negative. I think the best the copyright owners can do in terms of obtaining verification would be to bring civil action against a cable system.

Q Haven't we used the television fact book to estimate what gross basic subscriber revenue should be, and haven't we in the past compared those revenues with what was reported by cable systems?

A You can do that except that you have to take the risk that the TV fact book data are probably a year old by the time they are published and so you're, in terms of its verification capability or usefulness, is questionable with respect to the number of subscribers and the rates charged. It's a year old.

Q Typical, yes, but at least --

A At least you know you're in the ballpark.

Q All right. With respect to systems that engage in tiering, isn't the task of trying to verify the accuracy of any statement much more difficult because of complicated structure of these new systems?

A It would be impossible.

Q That is the point I wanted to elicit.

You stated that on the basis of your present knowledge, you are personally aware of only a few systems that

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1 engage in tiering, such as shown on Exhibit 10. What is your
2 professional estimate of the degree to which tiering will
3 become present in the cable industry during the next five-year
4 period, say until 1985?
5 A I think by 1985 probably subscribers with at least 50
6 percent, cable systems, 50 percent of all subscribers, will be
7 tiering basic.
8 COMMISSIONER GARCIA: Fifty percent?
9 THE WITNESS: Of all subscribers. I doubt if many of
10 the small systems, particularly the ones with 12 or less channel
11 capacity, will be tiering.
12 COMMISSIONER GARCIA: To the best of your knowledge,
13 when did tiering begin?
14 THE WITNESS: The earliest tiering, Commissioner Garcia,
15 that I know of involved pay cable and started in 1976 in Herbedoux,
16 Louisiana, H-e-r-b-e-d-o-u-x, and involved two tiers of pay cable.
17 And this was a beginning. Now, the latest figures that I have
18 seen, and it's from a trade article in Cable Television Magazine,
19 it has percentage figures and I'm not sure what the bases are.
20 It says 7 to 10 percent -- let me quote it correctly.
21 The article is from the August 15, 1980 edition of
22 PVC magazine. "Tiers, Types and Trends." It says, "This is
23 currently about 7 to 10 percent of operators assigned a sup-
24 porting programming to one of three tiered types. Expanded
25 basic, which MSO's report get 80 to 90 percent penetration of
cable households and new markets and cross-subscribers between

1 $1.50 to $2.00 more than basic service. Super basic and
2 extended basic are other terms for this tier." Then they have,
3 "pay channel wrap-arounds which play during hours when pay
4 services, such as HBO, Showtime, or the movie channels are
5 not operating. The cost of the wrap-around is included in the
6 pay tier service but subscribers that don't get pay, won't see
7 the wrap-around." Now, that is a reference to the inclusion of
8 retransmitted signals on paid -- as part of the paid channel.
9 Okay? This is different than retransmited signals being part
10 of the basic service. Then they have, "satellite service
11 clusters which bundle several satellite channels, whether ad
12 supported or not, and cost subscribers $2.95 to $6.95 per month.
13 The practice of tiering is on the rise. Especially in major
14 markets where expanded basic tiers can be written into fran-
15 chises at the outset and penetration of basic subscribers runs
16 at 80 to 90 percent. There is no question that the subject
17 of tiering, the expansion of mixed bundling of retransmitted
18 service and other program services throughout the offerings of
19 cable television service is prevalent and on the rise and viewed
20 as the coming thing."
21 COMMISSIONER JAMES: Mr. Cooper, going back to a
22 question asked by your counsel about verifying what goes on.
23 Isn't there really a way you can verify what is sent to the
24 copyright office as to what they pay by checking what in that
25 particular city they pay for that franchise? Isn't it usually
on a percentage of the gross receipts?

jk-9

THE WITNESS: Not all franchises are on that basis.

COMMISSIONER JAMES: Most of them are, though, aren't they?

THE WITNESS: I would think you are right, Commissioner James. Secondly, I don't know if that's public record.

COMMISSIONER JAMES: If there's a paycheck going into a city coffer somewhere down the line or a state coffer. The question may be is it the same rate. How do they come compute gross?

THE WITNESS: It may be for franchise purposes they combine all services. Income from all services and pay a percentage of say two percent of total gross revenues whether it's from basic or pay or any other service.

COMMISSIONER JAMES: That has not been checked, has it?

THE WITNESS: No, we are very much concerned, Commissioner James. It's really not a part of this proceeding, but the absolute, imperative need to police the statements of the account being filed by the cable systems.

COMMISSIONER JAMES: They may be one way of verifying because I'm sure the records in those cities are public records. You might be able to verify them.

THE WITNESS: Thank you, sir.

COMMISSIONER JAMES: That was free advice.

COMMISSIONER BURG: Thank you, Mr. Cooper.

MR. ATTAWAY: Madam Chairman, our next and last witness is Mr. Alexander Korn.

(Witness is excused.)

Whereupon,

ALEXANDER KORN

was called as a witness, and after having been first duly sworn, was examined and testified, as follows:

DIRECT EXAMINATION

BY MR. ATTAWAY:

Q Mr. Korn, would you state your name and occupation for the record, please.

A My name is Alexander Korn and I'm an economist and statistician.

Q Mr. Korn, would you briefly summarize and describe the assignment that was given to you by copyright owners in this proceeding?

A Yes. I was assigned the task of reviewing the provisions of the Copyright Revision Act of 1976 relating to the adjustment of the royalty rate schedule to maintain the real constant dollar value of the level. The legislative history on this point, financial data on cable systems and on cable television industry assembled by Mr. Alan Cooper, various analyses of price indexes and the comments of the copyright owners and NTCA in this proceeding. And I was asked to recommend a specific price index which would best serve this purpose to make the adjustment and a simple methodology to go about making the adjustment.

Q Would you list your qualifications for performing

this task?

A My qualifications to do this analysis and make these recommendations are for the past three years I've been doing consulting work as a broadcast economist. Prior to that, I was an industry economist for 12 years in the Broadcast Bureau of the FCC in Washington, D.C. For 10 of these years, I was chief or acting chief of the Research Branch, responsible for economic, statistical and analytical broadcast studies. I supervised the preparation of and authored many major original studies, including the "CATV Television Interface" in 1970, one of the first studies that actually estimated impact of cable television, and new entry of independent TV stations in 1977. I also reviewed and evaluated the economic impact studies submitted to the FCC by parties to rulemaking and other proceedings. I advised the staff and the commissioners on all economic aspects of broadcast policy matters. I prepared economic analyses covering subjects such as TV network operations, UHF handicapped, concentration of control of broadcast stations and newspapers, broadcast station sales, impact of cable TV on audience and revenue of local TV stations, independent station operations, VHF drop-ins, financial analysis of broadcast stations and the accuracy of audience ratings.

I also supervised the processing of the FCC TV annual programming report and the annual broadcast financial report. I testified in April 1980 as an expert witness before this Tribunal in the matter of distributing the cable royalty payments.

1 That was the "Gone With the Wind" session.

2 Prior to joining the FCC, I was controller of an
3 electronics for four years and a marketing consultant for six
4 years. Prior to that, I had 10 years of Government service as
5 statistician and economist with the War Production Board for
6 three years and the War Assets Administration for four years.

7 I also held statistical positions in the Census
8 Bureau and other departments. I hold a B.S. degree from the
9 City College of New York and have done graduate work in
10 economics and statistics in Columbia University and American
11 University.

12 Q Thank you. You are here today to try to reach a
13 formula for maintaining the real constant dollar level of
14 cable royalty payments as they would have existed in 1976.
15 Mr. Korn, what are the relevant factors that must go into this
16 determination?

17 A The word "constant" when you're talking about
18 constant dollar levels has to refer to a base period and,
19 fortunately, that's one of the clear things in the statute.
20 It says which existed at the date of enactment of this Act,
21 which was October '76. So we know we are talking about the
22 dollar level as of October '76.

23 Now the Tribunal is given the task of adjusting the
24 payments to maintain the October '76 constant dollar level.
25 This means that the royalty payments should be made in not
current dollars but in October '76 dollars.

jk-13

1 Now, if national monetary inflation went up, say
2 50 percent, as an example, that means it would take $1.50 now
3 to buy what it took a dollar to buy in October '76. The
4 royalty payments should be adjusted accordingly, all other things
5 being equal.
6 Before recommending a method for making this specific
7 adjustment, there are several associated items which were
8 mentioned this morning which have to be covered, and to answer
9 your question, I will just list them, give my recommendation,
10 and then I will go into them in detail.
11 First, there's the selection of the appropriate
12 price index against which to measure this constant dollar. I
13 would recommend the Consumer Price Index which is published
14 by the Bureau of Labor Statistics monthly and covers all urban
15 consumers and all items.
16 The second question is just what base is the Tribunal
17 adjusting, and here I will recommend, based on my reading of the
18 statute and the background, that it is the DSE percentages that
19 should be adjusted for form three cable systems and of course
20 the $80,00 and $160,000 gross semi-annual revenue limits
21 that divide the small systems from the large systems.
22 Thirdly, should there be just one adjustment for
23 five years or should it be made more often? I recommend that
24 a semi-annual price adjustment be made simply by this Tribunal
25 publishing a price figure, which will show what the new cost
of living index is, and then each of the cable systems can make

1 their own adjustment to the work automatically when they
2 complete their statement of accounts and file the new amount
3 of money with their statement of accounts.
4 Fourth, is a question should there be one average
5 industry adjustment or should each cable system have its own and
6 I will recommend a worksheet, which I already mentioned, which
7 allows each cable system to determine its own royalty and
8 inflation surcharge based on its own subscriber rates. If a
9 cable system is raised to subscriber rates to keep pace with
10 inflation, then there will be no adjustment. In other words,
11 they pay on the same DSE schedule that is in the Act now.
12 Fifth, there's a special problem concerning tiering
13 that was just mentioned and how do you treat revenues from
14 cable systems that have tiers that have really low revenues
15 because they've artificially kept their rates down to gain
16 consumers or have made them zero. I will show that as far as
17 the reduction rates that will automatically be taken into
18 account when you take into account the rate change from '76.
19 As far as the zero --
20 COMMISSIONER GARCIA: Repeat for me what you just
21 said.
22 THE WITNESS: I will show and I'm just summarizing
23 my conclusion here, I will show later that, as far as those
24 systems that have reduced rates since '76, this will auto-
25 matically be taken into account when you take into account the
factor of the change in rates from '76 to current. As far as

1 those systems that had or have zero rates, have reduced them
2 to zero -- or, we'll start with the zero rate, the ones we
3 were just talking about, free service, I will recommend that
4 they be required to construct a revenue base, based on the
5 industry average subscriber rate on which they pay royalties.
6 I believe those are the major factors that had to be
7 considered. And, I will suggest a rather simple method, which
8 I will show on the worksheet, but actually will be included
9 in your Form Three form when you eventually do it, that will
10 require that the Tribunal publish twice a year the inflation
11 factor, the CPI. With that adjustment, each system can determine
12 on its own, if it is in either one of the small system
13 brackets and what its royalty constant dollar surcharge is.
14 Q Mr. Korn, the first factor that you mentioned was the
15 selection of the appropriate price index. How does one select
16 the most appropriate price index?
17 A If you ask an economist how you go about selecting
18 an appropriate price index, he'll say "it depends". If you ask
19 a good economist, he'll say "it depends on what you're going to
20 use it for." Okay, now here we know we're going to use it to
21 adjust royalty fee payments for retransmissions of TV programs
22 by cable systems.
23 Now, the Tribunal could choose a specific index which
24 is tailored to the business of TV programs. In other words,
25 it has a choice. If it chooses a business index that would
trace the trend of prices in these programs, or it could choose

1 a general consumer price index, which is the one I'm going to
2 recommend, which will treat copyright owners as general
3 consumers and say that their cost of living or their deflation
4 of their dollar is comparable to everybody else's.
5 Now, the reason I mentioned the specific business
6 index is that it is sometimes used -- and I think it could be
7 justified here. And, to illustrate this, we're going to pass
8 out Exhibit Number 11.
9 (CO's Exhibit No. 11 was marked for identification
10 and received into evidence.)
11 THE WITNESS: One of the indexes that the Tribunal
12 could use to represent prices of TV programs in the secondary
13 transmission is an obvious one. What were the prices in the
14 primary transmission. In other words, what prices are tele-
15 vision stations paying for these very same programs that are
16 being transmitted. And, a common index is the one published
17 by the FCC when it gathers information on television programs,
18 on television stations' costs.
19 The item that we show here is the syndicated
20 television program expenses, as reflected in that report by
21 the FCC. This is supposed to be the annual expenses that all
22 stations in the country pay for TV syndicated programs.
23 You will note that I've only taken the years '75 to '78
24 because there is no further information. So, it would be very
25 nice to have information up to date. But, the last information
we have in the FCC is '78. And, you will note there has been a

44 percent increase in the prices of television programs, which reflects the fact that the costs have gone up for them, as Mr. Valenti has told you this morning.

The CPI, which is a more general consumer price index for this period -- now this is going to differ from the actual period we're talking about, but just to make a comparison, went up 21 percent. And, the personal consumption expenditure index, which we'll also talk about, went up 19 percent.

Now, I'm just really showing you this to show that if you pick the CPI, you're not picking the index that would give you the highest inflation rate, that you could go to a business index, reflecting what these TV programs would -- the trend in the marketplace price.

Now, since I'm not recommending that, I'm not going into any detail on it. But, you couldn't use this raw figure. There would have to be certain adjustments if you're going to use it.

Q Mr. Korn, one quick question on the syndicated programming expense line, although you're not going to recommend that we use it. That line reflects the increase in costs of programs to television stations; does it not?

A More or less, yes, because there is a slightly different number of stations in those periods. But, essentially, that's what it is.

Q You're recommending the CPI. What is the CPI?

A The CPI is a price index. It measures changes in the

1 prices of a fixed market basket of goods and services bought
2 by consumers to meet their personal living expenses. And, the
3 index is issued monthly by the Bureau of Labor Statistics, with
4 a base of 1967 equal to 100. The market basket consists of 380
5 individual items grouped into expenditure classes. And, these
6 were selected based on a 1972-73 Consumer Expenditure Survey,
7 which was very expensive. They found out what consumers spend
8 their money for.

9 The weights assigned were what they spent their money
10 for at that time. The weights were assigned the items based
11 on the average annual expenditures by consumers in 1972 and '73.
12 Now, they take the price of these very same items every month.
13 And, to do that, they have to price over 650,000 food prices
14 in 2,300 different food store outlets. 70,000 rents charges
15 are priced every year from 18,000 rental units, and about
16 350,000 individual price quotations on other items are obtained.

17 Prices are obtained from outlets at 85 areas throughout
18 the country, statistically selected to give a good sample. And,
19 the weights for the market basket of goods and services were
20 chosen to represent the purchases of all urban consumers.

21 In other words, they take all people that live in
22 urban area and represent that, which is about 80 percent of the
23 population. They purposely exclude rural areas because that
24 would not be the same as the city people; they have different
25 patterns.

Q Mr. Korn, when was the CPI originally constructed,

1 the items constructed and how has it evolved since it was
2 first devised?
3 A Because of the controversy that now exists on some
4 of the CPI items, I think it would be a good idea to give you
5 a very short history, because these aren't new controversies.
6 They happened before.
7 During World War I, the surge of federal spending
8 set off an inflation spiral that caused a wave of strikes,
9 particularly in the ship-building industry. The strikes were
10 for higher pay because the cost of living went up.
11 Now, an Arbitration Board was selected by the
12 President. They finally settled the strike and gave a 30 percent
13 cost of living increase. But, in doing so, they realized
14 there wasn't any measure of how the cost of living went up. They
15 just pulled that figure out of the air to settle the strike.
16 The President asked the Bureau of Labor Statistics
17 to construct a price index on which future cost of living
18 adjustments could be made. Now, BLS came up with its Cost of
19 Living Index, at that time, was called the COL, Cost of Living
20 Index. It was based on a survey of 1918 buying habits of lower
21 and middle class income wage-earners, and the prices for 145
22 different goods and services.
23 This was the forerunner of the CPI. The index was
24 revised in 1940, in '54, in '64 and in '78 to reflect changing
25 habits. In other words, every eight or 10 years, they get rid
of the horse and buggy and put the automobile, et cetera, in the

1 market basket.

2 Now, during World War II, the Cost of Living Index
3 was attacked by Labor as not reflecting the true increase in
4 prices, and by business leaders, the opposite reason. The
5 Secretary of Labor, Francis Perkins, appointed a prestigious
6 committee to evaluate the index. This committee from the
7 American Statistical Association gave the index a clean bill
8 of health. But, the labor leaders, unsatisfied with that
9 report, issued their own report, criticizing the Cost of Living
10 Index, claiming that actually prices increased by 43 percent
11 during the same time the BLS index showed only a 23 percent
12 increase.

13 Now, one of the criticisms that they made was that
14 the index ignored quality deterioration. In 1945, the President
15 reviewed all the reports, and decided not to change the
16 index, but he decided to change the name of the index to the
17 Consumer Price Index, CPI.

18 In the late 1940s inflation had subsided. In 1948,
19 General Motors and the United Auto Workers agreed to an escalator
20 clause in their contract, which was the first time the CPI was
21 really used in the industry. Since that time, about eight
22 million workers are now covered by contracts that have some
23 indexing to the CPI. Also, many millions of Federal Government
24 retirees, and I believe military retirees have their annuities
25 tied to the CPI, as do all Social Security recipients at the
present time. The Tribunal itself has used the CPI for annual

1 adjustment of compulsory royalty payments for music licenses
2 by non-commercial television stations under Section 118 of the
3 Act.
4 In 1954, it was found that home ownership was not
5 properly being reflected because it was part of the rent index.
6 They didn't have a separate home ownership component at that
7 time. And, the CPI was revised to reflect the fact that
8 many people were owning homes and had a different market basket.
9 It included separate price components for home ownership.
10 With the advent of the Korean War, the CPI began to
11 soar again. In 1959, the Joint Economic Committee of Congress
12 had another report prepared for it. Many of the recommendations
13 in that report were adopted. Now, the CPI indludes single
14 people, as well as families, since 1964, and includes all
15 urban families; whereas, previous it included just wage-earners.
16 That was put in, in 1978.
17 Q Mr. Korn, the paper submitted by NCTA earlier this
18 year and also in the newspapers recently, we heard the CPI
19 over estimate inflation. Can you discuss this question?
20 A I'm going to go into a little detail on this because
21 my recommendation to you will be to stay out of the conflict
22 and let the experts decide it. If you will bear with me, I
23 will give you some key points in that argument.
24 During the last several years the CPI started to
25 soar again and we had double-digit inflation. Many economists
feel the CPI is overstating the actual rise in prices. There

1 have been two minor and one major criticism of the CPI. The
2 two minor ones are first that it does not reflect the better
3 quality that we are getting with the higher prices. That should
4 ring a bell because in the history there was one point where
5 Labor said it didn't reflect deterioration of quality.
6 A second criticism is that since the market basket
7 is fixed, it does not reflect the changing buying habits of the
8 consumers. The major complaint is that the CPI, as currently
9 constructed, overstates the cost of home ownership, specifically
10 the two major costs in the home ownership are the high prices
11 of houses and the high mortgage interest rates.
12 Q The first criticism you mentioned was that concerning
13 quality. How does that relate to the Tribunal's proceeding
14 here or does it?
15 A Some critics say as product prices go up, quality
16 often goes up with it, but there is no measurement of that.
17 Therefore, we are not really getting a proper reflection of what
18 the price rise was for. That may be true. But, when you stop
19 to think of it, how does one measure quality. No one has
20 really figured it out. How do you measure the effectiveness of
21 a new drug? The Bureau of Labor Statistics goes through great
22 pains in maintaining the consistency of its market basket.
23 For example, when new car models come out, they
24 match the old car model against the new one and actual price
25 change, subtle change in the same model, so they are getting the
same value in the current year as they had the previous year.

1 That's about as close as they come to holding quality constant.
2 But, in any case, I'm not going to spend time on that because
3 no index measures quality. Therefore, my recommendation to you
4 is just discard that particular criticism.
5 Q What about substitution?
6 A That's an important one. When consumers substitute
7 one item for another because of high prices, the question is do
8 you want to change the market basket of items you priced to
9 reflect that. Now, the CPI is designed to deliberately hold
10 wage constant from year to year until they have a major
11 revision once every 10 years to change the market basket.
12 The reason is if the market basket were changed when-
13 ever the price changed, you would not know whether the index
14 went up because the price changed or because the market basket
15 changed. I think the best way to explain this is to quote
16 the Commissioner of Labor Statistics, Jeanette L. Norwood, who
17 said in a report to the National Association of Government
18 Labor Officials in Washington, at a meeting of January 21, 1980:
19 "Because a market basket change would amount to a change in
20 living standards, those whose income payments are adjusted by
21 the CPI would not be assured that their living standards
22 would remain at the same level. The purpose of such CPI
23 Cost of Living Adjustment which is called Indexation has
24 traditionally been to prevent people to purchase in today's
25 prices the bundle of goods and services they purchased in the
base period, thereby leaving them at least as well as they did

lw-24

then." She illustrates the point "if,in adjusting to a higher price, a family decides to forego its weekly restaurant dinner, the family is both changing its market basket and lowering it standard of living.

"If the objective of indexation is to insure purchasing power necessary to preserve the living standards, a measure used to index income should not reflect that kind of market basket change."

If you are going to drop going to a restaurant and the index is going to go down because you are now eating at home, you are not measuring change in prices, but your standard of living. Therefore, you have to keep the market basket constant to measure prices.

The Tribunal should accept Jean Norwood's reasoning. Keep constant the real dollar value. That couldn't be done if you change the market basket. The comparison must be the same items.

Q There are other indexes or indices--

A You can say it either way.

Q There are other indexes that change the market basket?

A Yes, the personal consumption expenses; the market basket change is with the prices every month.

Q The third criticism that you mentioned, criticism of the CPI concerned home ownership. That is an issue that has received a lot of attention recently. Most of us here are familiar with it. How do you think that issue should be handled

lw-25

1 by the Tribunal in this proceeding?

2 A Well, let me explain the conflict and I will give

3 you my opinion. At the present, the CPI home ownership

4 component includes month to month changes in five expenditures

5 of owning a home. These were put in because there was not

6 home ownership index in the 1950s, and they felt they needed it.

7 Now, the weight for three of these expenditures:

8 property taxes, insurance and maintenance and repairs represent

9 the average expenditures of all people living in their own

10 homes during the CPI based period, 72-73. Those that purchased

11 a home before the base period are represented in the index

12 only by those three expenditures.

13 In other words, if they did not buy a home in

14 that base period, these are the three expenditures. There

15 is not much argument about those three.

16 The weight for the other two expenditures: house

17 prices and mortgage interest costs are based on the small group

18 of families, about six percent of the total who actually

19 purchased a home during the base period. Thus, the CPI does

20 not assume that everyone buys a new home every month.

21 Now, the pricing for those items are consistent with

22 those used for other durable goods, such as refrigerators and

23 automobiles, which are often financed. The actual purchase

24 price of the home is counted in the month that it is purchased,

25 less the amount realized if they sold the previous home at

the same time. That is taken as a basic expenditure, as is

1 the interest on the mortgage loan taken over the expected
2 life of the mortgage; it is counted that month that the
3 mortgage is obtained. The expected life of the mortgage is
4 taken as half the term of the mortgage.
5 Obviously, when homes rise way up and mortgage
6 interests go way up, those two items which are weighted
7 heavily because they are taken in full in the month of the
8 purchase will tend to bring the CPI up even higher. Now,
9 economists disagree on whether these are the proper weights for
10 home ownership and they certainly disagree on what would be
11 other better weights.
12 Before I tell you three other alternative approaches
13 that economists have offered, let me give you the argument
14 for keeping it the way it is. In fact, that very question was
15 reviewed during the 1977 revision of the CPI, which was not
16 so long ago. With some modification, the current weighting
17 was retained. Those who favor the current approach argue that
18 most families live in their own homes and not rental homes.
19 They believe that the CPI should measure in today's prices
20 the cost of the purchase of the same kind of a house purchased
21 in the base period.
22 Owned homes should be treated exactly the same way as
23 the other durable good items I mentioned. If houses were sold
24 today and another of the same quality purchased, the consumer
25 making that purchase would have to pay the prevailing price
today. He would be forced to contract for a mortgage at today's

current rate.

According to this view, that is exactly what the CPI is supposed to measure, and it does so correctly. Now, other economists argue that a cost function approach would be better. They argue that a house should be regarded as an asset and CPI should not include the impact of rising prices on the value of assets such as houses. It is the cost of consuming the shelter provided by the house, not the investment aspect of home ownership, which are reflected in an index to keep real and become constant.

Now, the BLS staff is doing a great deal of research experimenting on house you figure out such a cost the function. It is not easy. Whereby, they would use -- they would have a function to show the shelter value of owning a home and the interest cost of equity, and then subtracting appreciation of the home.

Other economists have a different approach, the rental equivalent approach. This is in the CPI before they changed over. Take a house like the one you are living in. What does that rent for each month? The rent prices is therefore considered price of shelter for home owners. Finally, there is what is called an outlay approach. It is suggested that CPI home ownership components, because it used current prices for houses and mortgage interest rates, they claim the correct measure is what people are actually paying for housing. They exclude the cost of the house and use average interest

1 rates over a long period instead of current interest rates.

2 In other words, if you are getting a 30-year mortgage,

3 they break it up into 30 and get one-thirtieth this year, and

4 you pick up one-thirtieth of everybody else that year. It is

5 a moving average. An index using that average index would

6 result in a lower CPI, as would most of these other approaches.

7 The BLS staff is experimenting with different

8 methods described and publishers five experimental measures.

9 I'm going to pass out an exhibit which describes

10 these. I'm not going to go into detail on them,to give you an

11 idea of the complexity. It is Exhibit No. 12.

12 (CO's Exhibit No. 12 was marked for identification

13 and received into evidence.)

14 MR. ATTAWAY: May I interject a comment? This is

15 terribly dry. I apologize for subjecting everyone in this

16 room to it. However, it is basic to the Tribunal's decision

17 in this proceeding. If you can bear with us for a few more

18 minutes, we will be off of this subject and on to something

19 a little bit more exciting, I hope.

20 THE WITNESS: I think this is very exciting.

21 Now, it's possible that the home ownership component

22 of the CPI will be modified some time in the future, particular

23 if house prices and interest rates continue to rise faster

24 than other prices. Should there be a slump in house prices

25 and interest rates, the CPI's decline would be accelerated,

and the pressure for changing home ownership components would

fade away.

Just to make this more interesting, I'll refer to a Washington Post Article just the other day, Wednesday, September 24, 1980, which explains that August consumer prices went up moderately, and explains it as follows:

"The August increase followed a respite in July--". July was low, too. "--In which the Consumer Price Index actually stayed level for the first time in 13 years. Performance economists were quick to warn was almost certainly a fluke. The stability in July stemmed primarily from the fact that home mortgage interest rates, which had lifted the price index artificially last winter and the spring posted a sharp one-time decline. The decline in home mortgage rates continue to hold the price index down in August.

"Housing costs over the month rose a scant one-tenth of one percent." In other words, it has the effect both ways. It accelerates on the way up and decelerates the CPI on the way down, and would tend to balance out over the long run.

Personally, I believe that the CPI does give the home ownership components too much weight. But, my recommendation to this Tribunal is to stay out of this controversy and let the specialists, since they have a bigger staff than you do, let the Bureau of Labor Statistics really decide this. When they change, it will be reflected on the new CPI.

I certainly would reject the rental equivalent solution. Rents are frequently subject to rent controls. We

all know that rents have not increased as fast as the price of new houses and mortgage rates, and would artificially reflect a lower price for people that own houses, if it were substituted for the present housing components in the CPI.

BY MR. ATTAWAY:

Q Mr. Korn, the submission of NCTA earlier this year included a recommendation from Crandall favoring the use of the PCE Index instead of CPI. Would you compare these two indexes and tell us which one or why you are recommending the CPI in this proceeding?

A The Commerce Department, in balancing out the national accounts, which total up to the gross national product, has an item called Personal Consumption Expenditures -- PCE abbreviated. If those are corrected to constant dollars, instead of everyday dollars, but hold constant, the same way we're talking about, it can be used as an implicit price deflator, in other words, a price index, similar to the CPI.

By the way, the way they correct it is to use CPI information, various components of the CPI. Now, currently, the index called PCE is increasing more slowly than CPI, principally because it uses a rent equivalent for home ownership.

When home prices and mortgage rates increase, the PCI fails to reflect this. Now, I'm going to close by referring to Exhibit 13, which will summarize the advantages of the CPI compared to the PCE.

Why the CPI is better: it includes only urban

1 consumers, while the PCE includes rural consumers. I'm sure
2 there are not many copyright farmers, and also includes non-
3 profit institutions. And, even Mr. Valenti will agree that
4 they're not non-profit institutions.
5 The CPI is better because it has a fixed market
6 basket and measures only price changes. The PCE's market
7 basket changes with prices, and you can't tell whether the
8 index change is for price or for the items of the market basket,
9 the changing market basket.
10 The CPI is generally used as a Cost of Living Index
11 by industry unions and by the government. It includes some
12 measure of prices for home ownership; whereas, the PCE uses
13 a rental substitute measure for home ownership.
14 Finally, any tendency to over emphasize inflation
15 because of the home ownership factor is compensated for, or
16 partially compensated for by the opposite tendency when
17 interest rates decline and the fact that it excludes any
18 measure of income tax which, as you know, inflates faster than
19 the CPI due to the creep into the higher brackets. All indices
20 exclude -- all price indices exclude income tax because you
21 can't actually go out and purchase it.
22 However, when we're talking about a compensating
23 factor here, if income taxes were somehow included, it would
24 offset the fact that CPI is higher. It's also used by this
25 Tribunal to adjust royalty payments by non-commercial TV
stations. And, I would just recommend that you continue to use

it until the BLS changes it.

Q Mr. Korn, who uses the CPI?

A As I mentioned, it's used by industry in their labor contracts. It's used by government in Social Security payments, in the payments of military and federal employee retirees.

Q Who uses the PCE?

A I haven't found the PCE used as an index in any general way, as a consumer price index.

Q The CPI is constructed by the Department of Labor?

A Right.

Q The PCE is constructed by the Department of Commerce?

A Yes. But, you must remember, it was constructed for a different purchase. It's part of a balance of national systems to total up the gross national product. One of the items in total to the gross national product is the expenditures of all consumers. Because they have no other place to put it, institutions are, for example, in that item. It covers all -- the entire population, instead of just the urban areas.

Q Did you make an attempt to determine whether the PCE was used as a yardstick for the increase in cost of living by labor organizations or any similar activity?

A My inquiries at the Department of Commerce and at the Labor Department, I could not find any. I looked for some, but I could not find any.

Q But, you made inquiries both to the Labor Department

1 and the Commerce Deparrment?

2 A Right.

3 Since we're going on to another subject, I will just

4 as well stop here for questions on that, if there are any.

5 MR. ATTAWAY: Madam Chairman, this concludes our

6 discussion of the index. And the remainder of Mr. Korn's

7 testimony will deal with the construction of a formula for

8 adjusting the cable rates in this proceeding. I'd like to deal

9 with that in one piece, rather than be interrupted overnight.

10 If you intend to go for an hour, we can complete it today.

11 CHAIRMAN BURG: It will take an hour.

12 Mr. Feldstein, do you have any idea, what time you

13 will expend in cross examination?

14 MR. FELDSTEIN: Half an hour probably.

15 CHAIRMAN BURG: I think under those circumstances,

16 we will adjourn for today and pick it up.

17 MR. ATTAWAY: May I suggest that, in order to save

18 time, what we could do is allow Mr. Feldstein to cross examine

19 on Mr. Korn's testimony with respect to the index.

20 MR. FELDSTEIN: I prefer to do my cross examination

21 all at once.

22 CHAIRMAN BURG: We will adjourn until 10:00 tomorrow

23 morning in this room.

24 (Whereupon, the proceedings were adjourned at 4:00

25 p.m., to reconvene the following day, Tuesday,

September 30, 1980, at 10:00 a.m.)