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NORTHLAND
COMMUNICATIONS
CORPORATION

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January 26, 1993

Ms. Donna R. Searcy, Secretary
Federal Communications Commission
1919 M Street NW
Washington, DC 20554

Re: Comments of Northland Communications Corporation
MM Docket 92-266 Rate Regulation

Dear Ms. Searcy:

Enclosed herewith for filing with the Commission are one original and four copies of the Comments of Northland Communications Corporation concerning the Notice of Proposed Rule Making in the above-referenced proceeding.

Very truly yours,

James A. Penney
Vice President and General Counsel

Enclosures
cc: Alexandra Wilson (w/encl.)
Robert L. Pettit, Esq. (w/encl.)
Steven R. Effros, Esq. (w/encl.)
JAP/ap.BB32

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, DC 20554

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| In the Matter of | ) | |
| | ) | |
| Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 | ) | MM Docket 92-266 |
| | ) | |
| Rate Regulation | ) | |

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FEDERAL COMMUNICATIONS COMMISSION
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To: The Commission

COMMENTS OF NORTHLAND COMMUNICATIONS CORPORATION CONCERNING THE NOTICE OF PROPOSED RULEMAKING RELEASED DECEMBER 24, 1992

Date: January 26, 1992

Northland Communications Corporation herein comments on the FCC's Notice of Proposed Rule Making ("NPRM")[1] in the above-captioned proceeding. Northland Communications Corporation ("Northland") is a small MSO serving approximately 150,000 subscribers in nine states.[2] It is only for administrative ease that we refer to Northland as a consolidated entity. In fact, Northland is composed of 15 cable operating companies, each of which is separately financed and each of which must meet the terms and conditions imposed by its lender(s). We urge the Commission to carefully consider the needs of small businesses like the Northland companies. Even though we are an MSO and are able to enjoy some of the managerial and other economies of scale thus afforded, each of the cable systems we operate is a small business that

[1] FCC 92-544 (released December 24, 1992).

[2] California, Georgia, Idaho, Mississippi, North Carolina, Oregon, South Carolina, Texas and Washington.

is very sensitive to the costs of complying with governmental rules and regulations.

I. Introduction.

Northland operates 77 separate headends and provides cable service to nearly 190 communities under requirements imposed by 157 franchise agreements. Our largest headend serves 8,824 subscribers, our smallest serves 55 subscribers, and the average number of subscribers served per headend is 1,868. Thirty-one headends, or approximately 40 percent of the total, serve fewer than 1,000 subscribers; 23 headends, or approximately 30 percent of the total, serve fewer than 500 subscribers; and, 15 headends, or approximately 20 percent of the total, serve fewer than 250 subscribers.

The average Northland cable system is 34-channel capable and has 26 programmed channels. Approximately 58 percent of Northland's systems have a "basic service tier" (consisting of 11 channels of programming on average) available to subscribers for an average price of $14.42 per month (exclusive of franchise fees and sales taxes). Northland's standard basic package (consisting of 22 channels of programming on average), is available to subscribers for an average price of $21.11 per month (exclusive of franchises fees and sales taxes).

Nearly 69 percent of the estimated homes passed by Northland's cable systems subscribe to one or more of our services. Northland's highest penetrated system, located in Hico, Texas, serves 92 percent of the estimated homes passed. Northland's lowest penetrated system, located in Kemp, Texas, serves 13 percent of the estimated homes passed.

Northland is a member of the Community Antenna Television Association ("CATA"). John S. Whetzell, Northland's President and Chief Executive Officer, is a member of the board of directors of CATA.

Northland is not a member of the National Cable Television Association ("NCTA"). We do not believe the NCTA adequately represents the interests of small cable operators, especially those serving predominately rural areas. Unlike many NCTA members, Northland does not own interests in nationally or regionally distributed programming suppliers or advertising interconnects. The focus of Northland's six-member executive management team and Northland's 272 other employees is on providing high-quality cable service to small cities and towns.

Northland is adamantly opposed on First Amendment grounds to any form of rate regulation, whether by local franchising authorities or by the Commission. We believe the power to regulate the rates charged for cable services will have a profound effect on the nature and content of the services offered, and we fear such regulation will lead inexorably to government-controlled speech. There can be no dispute that governmental control of rates puts the on-going economic viability of the cable industry in the government's hands. Such a result is patently at odds with the philosophy underlying the First Amendment and the long history of jurisprudence related thereto.

If rate regulation in the form proposed is found to be Constitutionally permissible, Northland suggests that the Commission must exercise great control over and establish powerful safeguards to prevent local franchising authorities from stifling the speech and suppressing the editorial discretion of cable operators. Several

Northland systems now provide a locally produced news and information show, "Northland Cable News," which in many cases is the only local news available on a daily basis to our cable communities. Rate regulation by a local franchising authority could have a particularly chilling effect on the program content of Northland's news productions. We fear that under the proposed regulations Northland will be prevented or strongly deterred from hiring the experienced staff or purchasing the equipment needed to produce a first-class news show. We also fear that a too active investigation into corruption or mismanagement in local politics could cause the franchising authority's regulators to unduly delay processing or deny an otherwise wholly-justified rate increase.

II. Rate Regulation Methodology.

The Commission initially finds that a benchmark method for regulation of cable service rates should be adopted. It is also proposed, at the same time, that cost-of-service regulation on an individual system basis could be applied to cable systems seeking to justify a rate above the benchmark. Northland believes this is a practical direction for rate regulation considering the extremely limited time frame for implementation, the small amount of available information, the market forces already in effect, the need in terms of consumer welfare, and the possible negative effects.

It is Northland's experience that rates to a large degree already are determined by competition, demographics, costs and political pressures applied by franchise authorities. If the goal is to achieve a rate that is theoretically close to what "perfect competition" would

establish, it is our view that most systems are already close to such a rate, if not at the perfect competition rate. An example may help illustrate some of the competitive factors that create an elastic demand for cable television services.

A. Woodburn, Oregon: An Example of Market Forces Determining Rates.

1. Market factors. Woodburn is located approximately 25 miles south of Portland, Oregon in the relatively flat Willamette Valley. The population consists of approximately 35 percent senior citizens, most over the age of 65, and it has large Spanish and Russian speaking populations. The Russian population generally does not have television sets because of religious reasons. The area has excellent off-air reception of six broadcast stations. Only 50 percent of the homes subscribe to cable television.

2. Cost factors. Over 35 percent of the distribution plant was required by the terms of the franchise to be constructed underground. However, the population is spread out in such a manner that the system's density is only 25 subscribers per mile of plant. Property taxes are abnormally high in Oregon, and such taxes alone amount to $.45 per subscriber per month. Maintenance of an underground system requires a high cost of reinvestment in the system each year. Last year, our capital expenditures reached $98,000, or $2.63 per subscriber per month.

3. Franchise factors. Our franchise requires a five percent franchise fee, and the base on which it is calculated includes all revenue generated by the system. Despite its small size (3,150 subscribers), we are required to maintain a public access programming studio, which had to be modified extensively to meet the new accessibility standards required under the Americans with Disabilities Act. Recently, in order to renew our franchise, we were required to donate over $7,000 of equipment and pay $55,000 to the City for public, educational and governmental access production equipment. This represents an aggregate access-related contribution of almost $21 per subscriber.

4. Rate of Return. Even though Northland built the Woodburn cable system over ten years ago, the company has yet to earn a profit. The current rates are $14.75 for a basic service of 16 channels, and $20.80 for an expanded basic service of 36 channels. The number of subscribers is extremely sensitive to price. Only after a number of years of marketing, restructuring our channel line-ups, and

offering excellent service, were we able to achieve penetration rates over 35 percent. Even today, our cash flow is only barely sufficient to cover interest costs on moderate debt and necessary capital expenditures; it is not sufficient to pay required principle payments.

B. Suggested Implementation.

Northland stresses that only a moderate form of rate regulation is necessary to meet the objective of ensuring that rates are reasonable. Most of the controls are being determined by the marketplace. Detailed and costly versions of rate-of-return or cost-based regulations are appropriately reserved for public utilities. Public utilities offer services that are necessities and most often enjoy exclusive franchises. Their revenues are significantly higher, and thus the cost of regulation is a lower percentage of total revenue. Because market forces, cost factors and franchising authorities directly or indirectly control cable operators' rates, regulation by the Commission can offer only marginal benefits. Therefore, we emphasize the least burdensome method will be less costly to the government and the industry, and this in turn should provide the most benefits to consumers.

During the process of establishing benchmarks, the Commission should consider the ramifications of setting the "price caps" too low for too many systems. Consider the fact that market forces do presently deter unreasonable rates and that the Commission does not have adequate cost information. A low set of price caps may subject too many cable systems unfairly to an overly burdensome cost-based regulatory system. We believe that a reasonable rate in the short term must allow enough cash flow for the cable operator who has moderate debt to maintain compliance with applicable bank covenants, to service

debt, and to make adequate capital expenditures to accomplish re-investment into the cable system.

We believe the Commission currently does not have adequate information to establish benchmarks to satisfy even these requirements, much less to evaluate properly each of the factors mandated by the Cable Television Consumer Protection and Competition Act of 1992 (the "1992 Act").[3] However, we believe that over the next two or three years, the Commission can amass adequate information to establish more precise price caps. In the interim, therefore, we suggest the Commission should adopt the philosophy of regulating rates over time, by phasing in its regulations rather than attempting an immediate impact, which could, in turn, lead to unfair and unreasonable negative results.

We suggest that the Commission establish several benchmarks according to major classifications such as system size, density, etc. and gather rate averages under each class. We further suggest that the rate caps be set at least two standard deviations above the mean. Anything less assumes that too many operators currently have their rates too high, and this assumption cannot be verified by accurate data.

We also suggest there be no rollbacks in rates for any rate greater than the relevant price cap, effective when the price caps are established, but instead a prohibition of further increases unless a cost-based appeal allows it, or the next year's price cap moves above

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[3]Communications Act, Section 623(b)(2)(C), 47 U.S.C. Section 543(b)(2)(C)

it. This will provide a basis for the beginning of meaningful rate regulation without major financial shockwaves, which are unnecessary and unreasonable and which would adversely affect individual and institutional investors, cable lending institutions, the quality of service provided by operators, and the quality and quantity of programming options. The Commission's regulatory standards should serve primarily as a check on prospective rate increases.

We propose that the Commission, in determining price caps, establish a specific amount on a per subscriber basis for state and local taxes. Any amounts over this specific amount would then be allowed to be passed on to the subscriber over and above the price caps, if necessary. These taxes are often the largest source of rate variance. The following table depicts actual 1992 examples of two sources of taxes on a per subscriber basis:

Franchise Fees and Property Taxes on a Per Subscriber Basis

| | | Costs are Per Subscriber/Per Month | | |
|---|---|---|---|---|
| System | Subscribers | Franchise Fees | Property Taxes | Total |
| Yreka, Ca | 3,878 | $.49 | $1.15 | $1.64 |
| Woodburn, OR | 3,177 | .75 | .43 | 1.18 |
| Crockett, TX | 2,489 | .77 | .37 | 1.14 |
| Philadelphia, MS | 3,768 | .96 | .15 | 1.11 |
| LaConner, WA | 2,053 | .52 | .27 | .79 |
| Lamesa, TX | 3,633 | .50 | .23 | .73 |
| Starkville, MS | 7,058 | .31 | .17 | .48 |
| Oakhurst, CA | 3,153 | .00 | .23 | .23 |
| Sequim, WA | 5,178 | .07 | .15 | .22 |

Furthermore, setting a specific amount for these types of taxes allows the Commission more accuracy in setting a mechanism to adjust benchmarks over time.

The Commission, in establishing mechanisms to adjust the benchmarks over time, should be cognizant that several significant costs are totally beyond the control of the cable operator. Often these costs increase much faster than inflation. Among these costs, other than state and local taxes, are programming costs charged by cable programming networks, co-op and city-owned pole rates (which are unregulated), worker's compensation, and health insurance. Furthermore, we are facing two future significant costs in retransmission fees and regulatory legal fees.

Northland recommends that the Commission propose benchmarks for 1994 and release a Further Notice of Proposed Rulemaking so that operators may comment on the mechanisms used in the proposed estimation. We also propose that the Commission survey cable systems for cost information and programming information, so that it is possible to understand the critical economics that take place in various systems. This process would insure that the Commission can comply with the 1992 Act and allow reasonable rates without undue burden.

III. Establishing a Benchmarking System.

Northland agrees with the Commission that benchmarking as a regulation methodology has the potential to protect consumers from excessive rates and to reduce the burdens and inefficiencies of the process of regulation. We also are relieved that the Commission

realizes that an accurate benchmark system requires sound data, and yet there is a need to keep the burdens of data collection to a minimum. Considering these tradeoffs, the Commission solicits comments on what variables should be used for defining the classes of systems to which different benchmark rates should apply. Although Northland, in the short time afforded by the NPRM, could not conduct an exhaustive study, we have found several variables that may make it more efficient to develop an accurate benchmark system. In order of importance, these factors are: number of channels, system size, amount of state and local taxes, MSO size, and subscriber density.

A. Number of Channels.

The variable that seems to correlate most closely with rates is the number of program channels offered in the basic tier. Many systems offer 9-14 channels for a basic service while others offer a 30 to 40 channel basic service, thus the range for the great majority of systems start from a low of $10 per month to over $24 per month.

Northland believes that the 1992 Act requires operators to offer a 9 to 14 channel basic service even where no such offering previously existed. There has been much resistance from many operators to establish a low-cost basic service because it competes with the system's other programming services. For example, if a system offers a full compliment of broadcast networks (i.e., NBC, CBS, ABC, FOX and PBS), PEG channels, and a few public service satellite channels (e.g., C-SPAN, ME/U), and the off-air viewability of broadcast signals is marginal, this low-cost basic service competes as if the system were in a large metropolitan area having a full compliment of broadcast

signals with excellent viewability. However, the prospect of irrational regulatory behavior by local officials, along with the requirements of the 1992 Act, will likely cause near uniformity in low-cost channel offerings in the near future, except for smaller systems. The cost of offering a large number of channels requiring multiple satellite receiver antennas and related electronics is often too costly on a per subscriber basis for systems under 1,000 subscribers per headend. Therefore, a special allowance for number of channels should be considered for small systems.

B. System Size.

Northland's systems range from 8,824 subscribers on a headend to 55 subscribers on a headend; therefore, we will confine our comments to that range of systems. We are aware that the 1992 Act requires the Commission to develop and prescribe cable rate regulations that reduce the administrative burdens and cost of compliance for cable systems that serve 1,000 or fewer subscribers. We believe it is precisely this category of systems that offer the Commission its greatest challenge to balance the benefits of regulation versus the costs of regulation. The challenge is particularly acute with systems serving under 250 subscribers per headend.

We ask the Commission first to consider the aggregate economics of regulating systems of 1,000 or fewer subscribers per headend. Derived from information in the 1992 Television and Cable Factbook, the following chart gives a practical perspective of small systems:

| Size by Subs. | Number of Systems | Percent of Total | Subs. | Percent of Total Subs. in the U.S. |
|---|---|---|---|---|
| 500-999 | 1,405 | 12.67% | 1,002,126 | 1.9% |
| 250-499 | 1,465 | 13.21 | 525,000 | 1.0 |
| 249-under | 2,945 | 26.57 | 380,113 | .7 |
| Total | 5,815 | 52.45% | 1,907,239 | 3.6% |

As is evident, the majority of systems have 1,000 or fewer subscribers per headend, yet this majority serves only a very small percentage of cable subscribers. Thus, the prospect of maximizing consumer welfare with federal tax dollars is very dim, if even possible. Only a very cursory review can be practically rationalized. And yet, from the publicity of the 1992 Act, these communities expect rate regulation. Some of our most combative franchise renewals emanate from these very small communities.

A review of the microeconomics of small systems may clarify the picture even further. Northland does not offer more than 24 channels of service for systems serving between 500 and 1,000 subscribers, nor more than 18 channels of service for systems serving fewer than 500 subscribers. To do so would require multiple satellite dishes, greater investment in satellite receiver equipment, and a more expensive headend building with costly security and air conditioning. Even with limited channel offerings, the headend investment alone on a per subscriber basis is substantially higher for small systems when compared to larger systems with a full 35-channel line-up.

Headend Costs by System Size[4]

| Headend Type | Headend Cost | System Size | Depreciation Cost Per Sub./Per Month |
|---|---|---|---|
| 35 Channels Fully equipped | $250,000 | 5,000 | $ .42 |
| | | 2,500 | .83 |
| | | 1,000 | 2.08 |
| 24 Channels Bare necessities | $125,000 | 2,500 | .42 |
| | | 1,000 | 1.04 |
| | | 500 | 2.08 |

Therefore, economies of scale limit our ability to offer a large number of channels, and yet the consumer is unwilling to subscribe unless we offer at least a certain minimum number of channels. The consumer is sensitive to a cable system's programming relative to the number of channels offered, in terms of value and in terms of available alternatives. If the consumer, for example, has five signals available off-the-air, there may not be enough incremental value for his or her individual tastes to obtain only five additional cable channels at a price of $22 per month. These very economic forces not only severely limit profitability in small systems, but also cause us to face substantial competition from "back-yard" home-owned satellite receivers.

The Commission selected two of Northland's cable systems for its recent survey. One, located in Kemp, Texas, serves only 62 subscribers, the other, located in Kerens, Texas, serves only 258 subscribers. An abbreviated discussion concerning each of these systems may shed more light on the microeconomics of very small systems.

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[4]Assuming a 10 year amortization, which is an optimistic length of time.

1. Kemp, Texas: An Example of Small System Economics.

History. In September 1985, Northland purchased four cable systems from Phoenix Cable Communications. The system serving Kemp was part of the package purchase. The system served only 65 subscribers and offered only 16 channels at a rate of $9.95 per month. Less than 20 percent of the households, at that time, subscribed to cable. The low penetration is likely due to the high proportion of senior citizens in the area and because all of the Dallas broadcast signals are viewable off-air. At the time of the Kemp system purchase, its revenue was running far short of meeting its monthly expenses. One example of the economics is that the headend rent was $200 per month, which equaled $3.08 per subscriber per month, or 31 percent of the monthly subscriber rate. We tried to negotiate the lease cost downward, but the lessor would not budge. We tried to sell the system to the city at scrap value, but the council quickly rejected the idea. Our only recourse after several years of trying many alternatives was to increase the rate over 100 percent to its present level of $22.75. Last year, the system finally achieved a positive cash flow of $647, which was not enough to meet necessary capital expenditures, and certainly not enough to contribute to interest costs to service debt. We are seriously considering dismantling the system, especially when we consider that the city's population is dwindling.

Although Kemp is an extreme example, we found it necessary to comment on it because the Commission selected Kemp in its recent survey. The other Northland system the Commission surveyed serves Kerens, Texas, and it also is a good example of very small system economics, as follows:

2. Kerens, Texas: A Second Example of Small System Economics.

History. The system serving Kerens, Texas was also part of the same group of systems purchased from Phoenix Cable Communications. The system serving Kerens had approximately 240 subscribers at the time of purchase and offered 18 channels in the basic service. The rate was also $9.95 per month. At the time of purchase, the system's monthly revenue was not sufficient to meet its monthly cash obligations. Northland has since added three additional channels to the basic service and the rate is now $21.25 per month. Although this system has never earned a profit using generally accepted accounting principles, in the last several years it has earned a cash flow sufficient to meet its portion of a modest debt service. Last year, Kerens generated a $32,054

> cash flow before interest costs and capital expenditures. The net cash flow after interest cost and capital expenditures was only $14,687. Estimating a capital outlay of nearly $280,000[5] to build this system in 1985, and without considering cash flow losses of past years, the current net cash flow amounts to only a 5.25 percent rate of return on the capital investment. We believe that this system cannot afford the burden of any additional federal regulations without severely adversely affecting proper maintenance of the system.

Northland suggests that the Commission allow a large variance in selecting benchmarks for systems of 1,000 or fewer subscribers per headend, especially those under 250 subscribers. We do not suggest benchmarks for such small systems be abandoned, because we believe it will create too much misunderstanding at the local level. However, we believe the Commission should establish price caps that are sufficiently high enough to account for all possible situations. We stress that the administration of rate increases be of a review nature only, allowing the operator to make the case for a higher rate at the time of notification and allowing the proposed rate to become effective after 30 days. The burden would be on the complaining party to prove the cable operator's case false, and the Commission would make the decision upon receiving the written complaint.

C. Amount of State and Local Taxes.

State and local governments have been looking to cable systems as a new or larger source of revenue. For example, some states are abandoning historical costs as a basis for determining property tax and instead are deriving some sort of market value as a replacement tax

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[5]Estimated simply as $10,000 per mile for 16 miles of plant and $120,000 for headend equipment and other startup costs.

basis. This often has the effect of increasing the taxes several fold in a given year.

Several examples will illustrate the scope of the problem:

1. Yreka, California. In 1987, the local tax assessor decided that the entire enterprise value of the cable system would be subject to property tax. In previous years only the tangible assets of the business were subject to taxation. The assessed value jumped from about $419,000 to more than $4,200,000 in one year. Taxes went from approximately $4,600 to almost $46,000. The resulting increased cost is approximately $1 per subscriber per month.

2. Reedsport, Oregon. The 1988 assessed value for the cable system in Douglas County was $437,518. The next year the local tax assessor decided to convert from a "cost based" appraisal method to a "market based" method, using an arbitrary 50 percent deduction for intangibles. This resulted in an initial 1989 assessed value of $1,050,000. The assessment was appealed to the local Board of Equalization where the assessor was defeated. The assessor, however, continued the appeal to the state tax court. By the time the case was heard, the local assessor had revised his methodology to eliminate any deduction for intangibles, drastically revised most of his assumptions, and ended up with a recommended assessed value of $4,833,480, rationalizing that the entire enterprise value of the cable company was taxable for property tax purposes. The proposed increase in taxes amounts to $4.60 per subscriber per month. Taxes paid in 1988 were $11,663 based on an assessed value of $437,518. If the assessor's latest assessed value were to be used, it would result in annual taxes of approximately $129,000, an increase of $117,000 or 11 times the 1988 taxes. The tax court has yet to announce its decision in this case.

3. Kosciusko, Mississippi. The local assessor increased the assessed value of the cable system from $340,000 in 1991 to over $1,114,000 in 1992. Because the 1992 assessed value was more than three times the 1991 assessed value, so were the resulting taxes, which went from $6,753 to $21,281 in the same two years. This represents an increase of $.45 per subscriber per month.

In addition, local governments are not only increasing the franchise fee to five percent, but requiring that the base on which the fee is calculated to cover all revenue including service fees, advertising, converter rentals and installation. Moreover, state

governments are looking beyond sales taxes, and tax even the investment made for capital expenditures. Over the past several years many states have expanded the scope of goods and services that are subject to sales or use taxes. For example, the State of Texas recently changed its laws and now subjects several types of additional services to sales tax including payroll and collection agency services. In addition, the Comptroller of Public Accounts for Texas has taken the position that contract labor utilized in rebuilding cable television plant is subject to sales and use tax.

Most franchise agreements provide the franchising authority with the right to impose additional taxes other than franchise fees. For example, Stanwood, Washington is now charging a three percent utility tax in addition to a five percent franchise fee, each based on all revenues generated by the system.

State and local taxes can vary as much as $2 per subscriber per month, <u>not</u> including sales taxes. Therefore, Northland recommends that the Commission establish all price caps <u>net</u> of sales tax. Northland further recommends that the Commission assume a certain dollar amount of other state and local taxes in the price cap and allow all local and state taxes above this assumption to be passed through to the subscriber. For example, if a price cap is set at $15 for a 9 to 14 channel basic service of a certain size system and the assumption is stated that state and local taxes are no more than $1 per subscriber per month, the operator incurring taxes of $1.75 per subscriber per month would automatically be able to operate under an effective price cap of $15.75 without an administrative procedure. This would benefit

the consumer in two ways. First, it would be effective in creating a subtle tax guideline so local government officials would be less likely to raise taxes on this service, which is by any standard a regressive tax. Second, if this were effective in keeping taxes and thus prices down, more consumers would enjoy cable service (because demand for cable service is elastic) and therefore consumer welfare would be increased.

D. MSO Size.

Northland believes that it is important for the Commission to foster competition among multiple system cable operators. Industry concentration is generally considered bad for the consumer for a number of well-known public policy reasons, including diminished innovation, expenses associated with implementing and maintaining price controls, and a reduction in the number and variety of speakers. In considering that the Commission may not want to encourage the on-going trend of consolidation in the cable industry, some adjustments should be made to price caps according to the size of the MSO.

The largest MSO's have advantages in both the equity and debt markets, largely because of their size and vertical integration. For example, an MSO of a million or more subscribers often can place debt at the prime rate, whereas Northland may at best find a rate of 1.5 percent above the prime rate. This can have a substantial effect on the interest expense on a per subscriber per month basis. For example, a modest debt of $700 per subscriber at a one percent higher interest rate would cost the smaller MSO $.58 more per subscriber per month.

The largest MSO's also receive greater discounts on system maintenance material and new electronic and cable supplies, because of their volume. However, the most important advantage is in cable programming volume discounts. Northland has no way of knowing how much vertical integration and special volume discounts actually benefit the largest MSO's, but we expect it may reach as much as $1.50 per subscriber per month in some cases. According to published rate information, program suppliers afford significant discounts to large MSO's:

Program Discounts by Size of MSO

| Program Supplier[6] | Northland @ 150,000 subs | MSO @ 1,000,000 subs |
|---|---|---|
| ESPN | $ 0 | $.04 |
| CNN | .004 | .024 |
| MTV | 0 | .02 |
| Nickelodeon | 0 | .02 |
| USA | 0 | .02 |

Northland suggests that the Commission classify MSO's over 1,000,000 subscribers in a separate class of price caps with at least a $1.00 per subscriber per month differential.

E. Subscriber Density.

It has been long-established public policy to encourage investment into services for rural areas. The Rural Electrification Administration, for example, was formed to help finance the expansion of electrical power and telephone service in low-density rural areas. Cable television, on the other hand, receives no such federal aid, and yet cable television is extremely important to many consumers in these

[6] We understand that none of these program suppliers presently work with a small cable system buying co-op.

areas. In some rural areas, it is often the major means of news, weather, or other information on an expedient basis. The Commission should be aware of the costs related to low-density cable systems, in order that price caps do not inadvertently discourage further expansion into rural areas as well as the expansion of the number of channels and other services for rural cable systems.

The major cost of cable system construction is the plant investment itself. The debt markets serving a company Northland's size generally demand full repayment of loans within seven years. The plant lasts 15 years if all conditions (e.g., weather, road widenings, wear and tear) are relatively normal. So if we compare costs for 55 subscribers per mile and 20 subscribers per mile, we can approximate the following for two line extensions:

<u>55 subscribers per mile</u>:

| | | | | |
|---|---|---|---|---|
| $12,000 cost of building cable and electronics for a mile (aerial plant only) | ÷55 subscribers | ÷15 years | ÷12 months | = $1.21 cost per subscriber per month |

<u>20 subscribers per mile</u>:

| | | | | |
|---|---|---|---|---|
| $12,000 cost of building cable and electronics for a mile (aerial plant only) | ÷20 subscribers | ÷15 years | ÷12 months | = $3.33 cost per subscriber per month |

The economics certainly vary in building a mile of plant, but not enough to effect the substantial variance in cost per subscriber per month.

The cost differential does not exist only at the initial investment level, there are significant operating cost variables as well. The following table illustrates the differences in pole attachment costs per subscriber as the density of subscribers per mile changes:

Pole Attachment Costs on a Monthly Per Subscriber Basis

| System | Plant Miles | Number of Subs. | Subscribers per Mile of Plant | Annual Pole Costs per Mile of Plant | Pole Costs per Sub. per Month |
|---|---|---|---|---|---|
| Lamesa, TX | 60 | 3,633 | 60.6 | $199 | $.27 |
| Stephen-ville, TX | 129 | 6,908 | 53.6 | 196 | .31 |
| Statesboro, GA | 158 | 8,378 | 53.0 | 185 | .29 |
| Port Angeles, WA | 174 | 8,824 | 50.7 | 198 | .33 |
| Marble Falls, TX | 238 | 5,880 | 24.7 | 193 | .65 |
| Forest City, NC | 271 | 6,572 | 24.3 | 137 | .47 |
| New Caney, TX | 177 | 3,563 | 20.1 | 160 | .66 |
| Flint, TX | 391 | 7,112 | 18.2 | 163 | .75 |

The above-stated costs are averages for each of the specified systems, and the table clearly illustrates how a single expense item can vary as much as $.50 per subscriber per month over a density variance of 40 subscribers per mile.

A special case to note is Marble Falls, Texas, where one of the significant pole owners is a rural electrical co-op, which recently announced a pole attachment rate increase from $3 to $6 per pole per

year. Because a co-op's pole attachment rates are not regulated, we have no recourse but to pay or build our own poles. Constructing our own poles, however, only adds to the expense associated with serving rural areas.

Northland recommends the Commission consider authorizing a low-density service rate surcharge that would be billed to rural subscribers on a monthly basis to reflect the additional costs related to providing rural service. The industry typically charges these fees outside of the primary franchise area. Northland further recommends that the Commission increase the price caps by at least $2 per month for systems in areas that have fewer than 40 subscribers per mile.

Northland believes it is not feasible to establish system-wide basic service tier rates. We believe a literal implementation of the 1992 Act's requirement of a uniform rate structure "throughout the geographic area in which cable service is provided over [a] cable system"[7] would be extremely difficult to accomplish and would produce unintended and unwelcome results. From a practical standpoint, a large variety of a cable operator's costs are unilaterally imposed by a franchising authority and may differ significantly among various jurisdictions.

Examples of the costs that may be imposed by franchising authorities include: the percentage amount of and the revenue base on which franchise fees are calculated; the millage rate and the basis on which personal property taxes are calculated; the millage rate and the basis on which real estate taxes are calculated; the number of Public,

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[7] Communications Act, § 623(d), 47 U.S.C. § 543(d).

Educational and Governmental ("PEG") access channels required; initial PEG-related equipment requirements and on-going maintenance, replacement and upgrade requirements; PEG access support -- both initial cash expenditures and labor contributions; excise taxes, sales and use taxes; pole attachment and/or conduit use fees for municipally owned facilities; construction, maintenance and upgrade of municipal institutional networks; construction, maintenance and upgrade of emergency override facilities; mandatory line extension construction requirements; underground construction requirements; free cable service requirements for public schools, public hospitals and other municipal buildings (including the construction and maintenance costs associated with such services); direct costs associated with franchise compliance such as maintaining an office within the franchising authority's geographical limits, delivery of correspondence with regulatory agencies, delivery of maps and other construction plans, demonstrating compliance with customer service standards, demonstrating compliance with technical and engineering standards, and other inspection related matters; and costs associated with franchise renewal such as a franchising authority's legal and consultant's fees, application/processing fees, and other similar costs.

As the discussion elsewhere in these comments makes clear, it is not economically feasible in many cases for a cable operator serving low-density areas to construct a separate cable system for each franchise area. Recent technological developments, such as fiber optics, make the further geographical expansion of cable systems more

cost-effective and increase the likelihood that one system will serve multiple franchise areas.

Northland believes it is impractical and unfair to mandate system-wide rate averaging. Given the large number of cost factors within the control of franchising authorities, some may seek to reduce the costs imposed on their constituents. Several of Northland's franchising authorities have established franchise fees of only one or two percent, or have cut the number of PEG channels specifically to reduce the cost of cable service within their jurisdictions. If the Commission mandates rate averaging on a system-wide basis the discretion of franchising authorities will be diminished or eliminated altogether. On the other hand, a franchising authority, knowing that the costs it imposes on an operator will be distributed among the subscribers throughout the system, may be less concerned about the costs it imposes and the expenditures it requires, whether or not such are warranted by consumer needs or interests.

IV. Adjusting Benchmarks from Year to Year.

The Commission seeks comments on methods to adjust benchmarks over time. The Commission has made the tentative conclusion that a local service price index would be more appropriate than the Consumer Price Index or Producer Price Index for adjusting cable rate benchmarks. Northland believes that the benchmark system must avoid needless complexities and yet be accurate. As a priority, the Commission should concentrate on the first set of benchmarks and determine how they affect the marketplace, without alarming the financial markets about the long-term future of cable rates. Northland believes that a Second