1. Basic Rates of Systems Subject to Effective Competition

Perhaps the most direct measure of the rates that would be charged if a system were subject to effective competition is the basic rates that are actually charged by comparable systems that are subject to effective competition. Indeed, the Act specifically directs the Commission, in crafting its approach, to take such rates into account. The Commission describes how, ideally, benchmarks based on rates for competitive systems would be derived.

The simplest approach would, as the Commission explains, be to calculate the average basic rate charged by competitive systems for basic service, and to establish a benchmark at a level sufficiently above this average level to provide a zone of reasonableness.[17/] To take into account the divergent number of channels offered by different systems, these benchmarks would be calculated on a "per-channel" basis -- or, alternatively, at least be calculated separately for different categories of systems, based upon the number of channels offered on the basic tier.

A more sophisticated technique identified by the Commission might take into account a greater range of variables that might affect a system's costs and, therefore, its competitive rate:

> If sufficient data were available, regression analysis or some other statistical technique could be used to determine how rates varied with such

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17/ See Notice, para. 41.

> characteristics affecting costs as homes passed per mile, number of channels, number of subscribers, the relative mix of buried and overhead cable, and the other factors described in Section 623(b).[18/]

This regression approach would better conform to the Act's requirements, because it would take into account various cost factors, as mandated by the Act.

There are, however, at least two potential problems with basing benchmarks on competitive systems -- one technical, the other substantive. The technical problem is, simply, that there might not be a sufficient number of systems facing effective competition from which to obtain valid benchmarks. The substantive problem is that the rates of systems that are, under the Act, subject to effective competition may be artificially low.

To be deemed subject to effective competition, a system must either have a penetration level, in its franchise area, of less than 30 percent, or it must face competition from one or more multichannel providers of video programming. Those competitors must offer comparable video programming to at least 50 percent of the households in the franchise areas, and at least 15 percent of the households in the franchise area must subscribe to one of them.[19/] There have not, to date, been a large number of instances of such head-to-head competition, and it may be

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18/ Id., para. 42.

19/ See 47 U.S.C. Section 623(l)(1).

impossible to obtain statistically significant results from a regression analysis run on so few systems.

This would not mean, however, that the rates of systems facing effective competition could not be used as a basis for establishing competitive benchmarks. An alternative approach, if the number of competitive systems turned out to be too small to yield significant regression results, would be to rely on the rates of competitive systems in comparison to the rates of all systems. Such a comparison could establish statistically meaningful benchmarks. The attached report of Economists Incorporated indicates how it might be done.[20/]

But this approach could still yield erroneous results to the extent that, as a general matter, the rates of cable systems facing head-to-head competition may be significantly below a competitive level -- i.e., a level that covers costs plus a reasonable profit -- or at least below a level that permits desirable investment in improved programming and facilities. Short-term price wars are common in cable overbuild situations. In part, this is because the new entrant in the marketplace often has no intention of investing in long-term competition but only seeks ultimately to be purchased by the more established competitor. There is a long tradition of such attempts at "greenmail" by cable overbuilders, and its effect is to suppress prices to levels that could not over the long term, support cable

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20/ See Owen, Baumann and Furchtgott-Roth, supra.

operations and, in particular, could not support the investment in maintenance, programming and technology that is necessary to the sustenance of cable television.[21/]

Therefore, if the Commission were to rely on the rates of systems subject to effective competition in establishing basic rate benchmarks, it would be necessary to adjust the calculations to correct for the artificially low rates of many such systems. Once such a correction were made, this approach would more directly identify the competitive rates for basic services that would be charged by systems with particular characteristics if they were subject to effective competition -- which is what the Commission's regulations are supposed to achieve.

2. Past Regulated Rates

Another alternative proposed by the Commission is to look to the rates of cable systems when they were subject to regulation as a surrogate for competitive rates, and to adjust those rates upward to take into account increased costs and expenditures in

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21/ The well-established strategy of "competition" by overbuilders who drive short-term prices -- and long-term investment -- down in hopes of being bought out by the incumbents has, not surprisingly, resulted in a large number of such buy-outs, causing The Federal Trade Commission to investigate the problem. See "FTC Clamping Down on Buyouts of Large Cable Overbuilders," Communications Daily, Aug. 16, 1990, p.5. The strategy often works because, as one cable executive pointed out, "[s]ometimes it's more economical to buy out rather than to hemorrhage financially." Id. Indeed, an attorney for the Competitive Cable Association, while objecting to the term "greenmail," has conceded that "there is no question that some people will take the opportunity to put the squeeze on the incumbents." Id. (emphasis added).

the years since rates were deregulated. After a two-year transition period, the rate deregulation provisions of the 1984 Cable Act took effect at the end of 1986. Therefore, the Commission proposes to "develop individual benchmark rates for systems operating in 1986 based upon the 1986 per-channel rate for their lowest tiers".[22/]

While it may be possible to identify "competitive" rates based on past regulated rates, the task may be much more difficult than the Commission suggests. The core problem is two-fold. First, it is simply wrong to assume that regulated rates were established at appropriate "competitive" levels. To the contrary, all evidence indicates that city councils and other regulators suppressed cable rates significantly below such levels.[23/] Second, even if regulated rates had not been sub-competitive, it would be wrong to assume that adjusting those rates by an amount that simply reflected average inflation in the United States would reflect rates that, for today's cable systems, would be sufficient to cover expenses plus a reasonable profit.

22/ Notice, para. 44.

23/ From 1972 (when the Commission first affirmed local rate regulation) to 1986, cable rates increased at a rate that lagged the rate of inflation by 72 percentage points (based on estimates of Paul Kagan Associates, Inc. and data from the Bureau of Labor Statistics).

It was precisely because of a suspicion that regulators were keeping rates artificially low that Congress deregulated rates in 1984. Indeed, evidence at that time showed that had basic rates in 1972 -- when basic service consisted almost exclusively of retransmitted broadcast signals and access channels, since satellite service did not yet exist -- simply been allowed to keep up with the Consumer Price Index, they would by 1984 have been 58 percent higher than their actual regulated level. In any event, the best evidence that regulated rates were sub-competitive can be gleaned from the effects of deregulation in 1986.

As has been noted, the most obvious effect of deregulation is that rates went up. But, as we have previously observed,[24/] those increases in rates were generally accompanied by increases in penetration -- increases that significantly outpaced the smaller annual increases in penetration that were occurring under regulation. Had the rate increases that occurred after deregulation represented a move from competitive to supracompetitive rates, penetration should have come down. The vice of monopoly pricing is that rates exceed competitive levels while output is below what would be purchased by consumers at competitive prices. If rate increases were instead accompanied by increased penetration, this indicates that the increases must

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24/ See Introduction, supra. See also NCTA Comments in Docket 90-4.

have been used to make the product more attractive to consumers, not to capture monopoly profits. In other words, the rate increases enhanced consumer satisfaction and represented a move towards -- not away from -- competitive levels.

Therefore, pre-deregulation rates from 1986 cannot, without adjustment, be viewed as competitive even at that time. Moreover, even if it were somehow possible accurately to adjust those rates upward to a truly competitive level for 1986, it would still be a difficult task to determine how further to adjust them to reflect what would be competitive rates for 1993.

"Are there factors," the Commission asks, "other than inflation, that might cause per-channel rates from 1986 to be inappropriate in 1993?" There certainly are. Cable television is a service that is constantly growing, quantitatively and qualitatively. Not only do cable operators provide more program services each year to subscribers, but the quality of existing programming continues to improve. Thus, the cost of providing programming increases by much more than the rate of inflation.

As the Commission noted in 1990, "[t]here is no question that the number of programming services offered by cable systems has increased substantially since the passage of the Cable Act in 1984."[25/] Furthermore, "programming expenditures by the cable industry have increased dramatically."[26/]

25/ Report, Docket MM 89-600, 67 R.R.2d 1771, 1787 (1990).

26/ Id.

Finally, simply as a practical matter, relying on past regulated rates would be highly problematic. It would be no simple task to identify accurately the rates charged by all cable systems seven years ago, in 1986, much less the number of activated channels and other relevant variables.

In sum, devising a benchmark that relied upon past regulated rates would require identifying appropriate adjustment factors. Those factors would have to take into account not only inflation but also the extent to which regulated rates were artificially low and the extent to which costs have risen more rapidly than inflation. This is a formidable task, which seems less likely to result in benchmarks that accurately reflect competitive rates than an approach (such as the one described in the attached report) that is based on the actual rates of systems subject to effective competition.

3. Average Rates of Cable Systems

A third approach described by the Commission would simply rely on the average per-channel rates of all cable systems as the basis for identifying competitive benchmark rates. Under this approach,

> [s]ystems whose rates exceeded the average rates for all systems by more than a specified amount, or by more than a specified percent, or systems which ranked among the highest few percent (e.g.,

> top 2-5 percent) in terms of rates would be assumed not to have rates that were reasonable.[27/]

What is missing from this approach for basic rate regulation, as the Commission acknowledges, is any measure at all of the extent to which average industry rates reflect "competitive" rates:

> Unadjusted, however, the benchmark would not reflect competition but merely average performance in the industry; if monopoly profits were reflected in the rates of at least some industry segments, they would be incorporated in the average rate.[28/]

If, however, there were some way to adjust average industry rates to take into account the absence or presence of competition, such an approach might provide a feasible and appropriate way of establishing basic rate benchmarks that meet the Commission's statutory mandate. And, as we have previously discussed, there might indeed be such a way -- a way that relied both on the rates of all systems and the rates of "competitive" systems.

Comparing average industry rates with average rates for "competitive" systems would provide an empirical basis for determining whether and to what extent average industry rates would need to be adjusted to serve as appropriate competitive

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27/ Notice, para. 46.

28/ Id., para 47 (emphasis added).

benchmarks.[29/] It may turn out to be the case that there is no statistically significant difference in rates attributable to the absence or presence of effective competition, in which case average industry rates can be relied upon, unadjusted, to establish rate benchmarks. If, on the other hand, effective competition as defined by the Act seems to result in lower rates, then a corresponding discount factor or "competitive adjustment,"[30/] will have to be applied to any averages based on overall industry rates. It would, as suggested previously, be most appropriate to calculate such averages for different categories of systems, taking into account any factors that appear to explain significant variations in rates among systems.

Once such adjusted average rates were calculated, it would, as the Commission suggests, be necessary to determine the appropriate range of presumptive reasonableness above the average. A zone of reasonableness based on the existing distribution of basic service rates after the competitive

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29/ As discussed in Part I.B.1, supra, such an adjustment should be based not simply on the difference between average industry rates and average rates for competitive systems but on a more sophisticated statistical analysis that identifies how much of that difference is attributable to the presence or absence of effective competition. Also, as noted, average rates of competitive systems will need to be adjusted upward to take into account price war and "greenmail" situations that are common in instances of competitive overbuilds.

30/ See Owen, Baumann & Furchtgott-Roth, supra.

adjustment, is necessary to take into account the widespread variation in costs among systems.

In sum, while simply using average rates of all cable systems, with no reference to competitive systems, could not reliably be adopted as a means of identifying competitive rates for purposes of basic rate regulation, a benchmark approach that adjusted average industry rates on the basis of rates of competitive systems could meet the statutory test. Ideally, as discussed above, benchmarks could be calculated solely on the basis of current rates for systems that face effective competition. But if the number of such systems is too small to permit the sort of regression analysis necessary to yield reliable results, then a combined approach that also relies on overall average industry per-channel rates would be a the best alternative.

Indeed, given the number of systems involved, using a large industry sample to establish the relationship between rates and underlying factors may be a more reliable alternative. "Competitive" systems can then be used to adjust the level of rates.

4. Cost-of-Service Benchmark

Finally, the Commission proposes an alternative benchmark approach under which it "would use engineering, operating, programming and other cost data gathered in this rulemaking to construct the costs of an 'ideal' or 'typical' cable system or

systems, possibly on a per channel or per subscriber basis."[31/] The principal advantage of such an approach seems to be that it would take cost factors identified by the statute into account more directly than approaches based on the average rates of competitive systems or of all cable systems. Those other approaches take such cost factors into account, but less directly, using regression analysis and other means to identify different cost-based factors that explain variations in cable rates and require separate categories of systems for purposes of benchmarks.

The principal disadvantage to this approach, however, is that the data necessary to construct an "ideal-type" cable system not only is not being gathered in this proceeding but simply does not exist in any meaningful or usable form. As noted above, there is no uniform system of accounting of the sort that would be required to compile aggregate data from all systems.

In sum, the cost-of-service benchmark approach, even if it were theoretically preferable to other proposed approaches, would be infeasible in practice. Other approaches based on the rates of all systems and systems facing effective competition would be more workable and no less accurate in achieving appropriate benchmarks.

31/ Notice, para. 48.

C. What is the Effect of Benchmarks, and How Are They To Be Adjusted Over Time?

Benchmarking is a useful method of establishing a starting point for determining whether a system's rate for basic service are "reasonable." If a system's rates are below its appropriate benchmark, local franchising authorities will be required by the Commission's rules to approve such rates. But what will be the effect of the benchmark on future rate increases? And how will the benchmarks be adjusted to take into account increases in the cost of providing cable service -- and improvements in the quality of cable service?

1. What Is the Effect of Benchmarks on Proposed Rate Increases?

While any existing rates below established benchmarks would be *per se* reasonable and permissible under a benchmarking approach, the Commission expresses some reservations about requiring franchising authorities also to approve automatically any subsequent rate *increases* that still result in rates below benchmark levels. Thus, the Commission asks "whether to include as a component of any benchmark alternative a price cap formula to limit how quickly systems with rates below the benchmark could raise their rates to that benchmark price."[32/]

32/ Notice, para. 34.

The Commission's reservations are, however, unwarranted. To impose such restrictions on future rate increases would simply punish those systems whose initial rates under the new regulation requirement were lowest and reward those whose initial rates were highest.

The new Act and the Commission's rules may contemplate -- and, indeed, require -- that cable systems reconfigure and reprice their service offerings. Some systems have already made such changes in anticipation of the new rules, although the specific benchmarks and rules established by the Commission may require further changes. Systems may subsequently determine that higher rates are necessary, either because they underestimated the rate necessary to cover costs under the newly configured tiering arrangement or because their costs have increased.

To require systems either to have established the highest permissible rates at the outset or to forgo any necessary rate increases up to the benchmark levels would be unfair to those systems that charged rates below the benchmark level. A system whose rates were <u>above</u> the benchmark could presumably have its rates reduced by city regulators only to the benchmark level, where the rate would be presumed reasonable. But a system whose rates were <u>below</u> the benchmark would be prohibited from raising its rates to the same benchmark level. Such an approach would only <u>ensure</u> that in the future, all systems would ultimately raise rates to the highest permissible level -- whether necessary to cover costs or not -- in order to maximize their flexibility to cover subsequent cost increases.

If the Commission were to adopt such an approach, it would, in any event, be necessary to provide a mechanism by which systems could pass through identifiable cost increases attributable to basic service -- at least so long as the system's rates remained below the general benchmark level. In particular, systems should be allowed to pass through any increases in the costs of their programming, in order not to stifle the continuing development of new program services and the continuing improvement in the quality of existing programming. Once an operator has been determined to be charging reasonable and "competitive" rates, its rates cannot become supracompetitive -- it cannot gain additional profits -- simply by increasing its rates to cover increased costs.

Suppose, for example, that the Commission were to rule that systems whose rates were below the benchmarks could only raise their rates by half the distance to the benchmark in the first year and by the remaining amount in the following year. A system whose basic programming costs increased by more than half the distance to its benchmark should be allowed to recoup those increased costs. It would be bad enough to penalize a system for starting out with rates below the permissible maximum. But it would be even worse to prevent such a system from recognizing legitimate programming and equipment costs -- or to deter such a system from investing in better programming and facilities.

In sum, cable systems whose basic rates are below the Commission's benchmark levels for "reasonable" rates should be permitted, at any time, to increase their rates up to those

levels. If, however, the Commission adopts rules that limit how quickly after the adoption of benchmarks such systems' rates may reach those benchmarks, those rules should, in any event, allow systems to increase rates more quickly, if necessary, to cover increased basic programming and equipment costs.

2. How Often and In What Manner Are Benchmarks To Be Adjusted?

The Commission properly recognizes that any benchmarks established at this time will have to be adjusted periodically to take into account changed conditions:

> We also propose to establish mechanisms to adjust the benchmark itself over time. The adjusted mechanism might be a formula or, if the benchmark itself is calculated pursuant to a formula, might be incorporated within the formula. The Commission could also review the benchmark price and adjust it periodically based on appropriate empirical or market considerations.[33/]

If, as we have suggested, the Commission adopts a benchmark that is based upon basic rates charged by systems subject to "effective competition," the Commission could periodically re-examine the rates charged by such systems -- still taking into account, of course, the different factors that may affect rates among such systems. As an alternative to performing such recalculations every year, the Commission could recalculate less frequently but, in interim years, adjust the benchmarks by an appropriate index of changes in the cost of doing business.

33/ Notice, para. 34 (footnote omitted).

As the Commission notes, "such changes often are represented by the general consumer price index (CPI) or producer price index (PPI) compiled on a national or regional basis by the Bureau of the Census and Bureau of Labor Statistics."[34/] But as the Commission also notes, such indices may not be the best measure of cost changes in "a local service business such as cable television."[35/] Accordingly, the Commission asks whether some sort of local service price index (SPI) might be used as a more appropriate adjustment factor.

The Commission is right to suspect that local service prices tend to change at a different rate from the CPI or PPI, and, in some local areas, such as Alaska, these differences may be substantial. It may, however, be difficult to calculate local service price indices for each local area, and, therefore, an inflation adjustment to the rate benchmark might have to be based on a more readily available index. But systems should retain the right to demonstrate that their local service index has increased significantly more than the national index, and should be entitled to a higher benchmark ceiling where that is the case.

An inflation index -- whether CPI, PPI, or SPI -- will not, however, be wholly sufficient for determining necessary adjustments in basic rates benchmarks. Inflation indices typically reflect changes in prices for the same or comparable

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34/ Id., para. 38.

35/ Id.

products and services over time. But cable television is a service that is constantly improving quantitatively and qualitatively, over time. Inflation indices measure, at best, the extent to which last year's programming and last year's equipment would cost more this year. But they do not take into account the fact that this year's typical cable system offers higher quality programming and uses superior technology than last year's.

Some further adjustment, in addition to inflation, would be necessary to ensure that benchmarks allow the sort of improvements in programming and investments in technology that have made cable television more and more attractive to consumers each year. Thus, the Commission should measure the extent to which increases in programming costs and equipment costs exceed the inflation rate, and develop an additional adjustment factor based on such cost increases. Some such adjustment or, alternatively, the right to pass through program cost increases in excess of the inflation rate, is essential to allow wholly justifiable and desirable investment in programming.

D. A Safety Net for Special Cases

The Commission's basic rate benchmarks, if properly crafted and adjusted over time, will provide workable and readily applicable standards that define "reasonable" basic rates, taking into account rates charged by competitive systems and factors that may cause costs and rates to vary among systems. In light of the utter impracticability of requiring local franchising

authorities to engage in rational cost-of-service ratemaking and the arbitrary decisions that have historically resulted when franchising authorities have been given unfettered discretion to regulate cable rates, a benchmark approach best implements the Commission's statutory mandate.

But benchmarks, by their nature, cannot ensure that basic rates are perfectly competitive in each individual case. In some cases, to be sure, the benchmarks may allow rates that exceed an operator's costs plus a reasonable profit, while in other cases, the benchmark may be too low to allow recovery of such costs. The problem is that while errors of the first type could raise rates for cable service to artificially high levels, errors of the second type could prevent cable operators from offering service altogether. Requiring rates to be set at non-remunerative levels would diminish or eliminate the availability of cable service in a community -- and it would, in any event, be in conflict with the Fifth and Fourteenth Amendments to the Constitution, which prohibit rate regulation that prevents rates at confiscatory levels.[36/]

To avoid undesirable and unconstitutionally confiscatory errors of this type, a benchmark approach to basic rate regulation requires at least four types of safeguards.

36/ See, e.g., Smyth v. Ames, 169 U.S. 469 (1898).

1. A Matrix That Takes Cost Variables Into Account

First, as discussed previously, the benchmark approach should attempt to identify several variables that are likely to result in different rates among competitive systems. By establishing a matrix of benchmarks instead of a single, average benchmark for all systems -- by acknowledging, for example, that systems carrying satellite-delivered cable networks (for which they must pay) would typically have higher per-channel costs than systems carrying only broadcast stations (in the absence of retransmission consent fees). -- the Commission is likely to reduce the number of instances in which benchmark rates are non-remunerative.

Similarly, the Commission would likely find that systems with a large number of channels had a lower per-channel basic rate than systems with fewer channels. A benchmark that recognizes this difference would make it more possible for a system to add non-broadcast channels to its basic tier without having its permissible rate rise to an unacceptably high level.

It would also make sense to differentiate between systems with more than and fewer than 1,000 subscribers. Not only are small systems likely to have different costs -- and different rates; Congress also specifically directed the Commission to deal separately and specially with such systems to reduce their

regulatory burden.[37/] As the Commission has noted, "[t]he Cable Act of 1992 permits, and to some extent may encourage, if not require, a restructuring of service offerings."[38/]

2. The Right To Retier or To Create Multiple Tiers

Second, because benchmark rates for basic service may, in some instances, be inadequate, the Commission should ensure that cable systems have maximum flexibility to remove from the basic tier any services that are not required by the Act to be carried on that tier. Thus, cable operators who currently carry satellite cable networks in addition to broadcast stations and access channels on their basic tier should be permitted to reduce their per-channel costs by moving those networks to a non-basic tier of service. In 1990, the Commission confirmed that the law permits such retiering even when the basic tier is subject to rate regulation, "unless the franchising agreement requires that such service be carried on a basic tier that is rate regulated."[39/] That aspect of the law remains intact -- and it is critical to ensuring that basic rate regulation benchmarks do not impose unduly restrictive or confiscatory rates on cable operators.

37/ See Section 623(i).

38/ Notice, para. 5.

39/ Report and Order and Second Further Notice of Proposed Rulemaking, MM Docket No. 90-4, 6 FCC Rcd 4545, 4564 n.111 (1991).

Indeed, even where a franchise agreement does require that certain non-broadcast services be carried on the "basic" tier, this may still allow operators, in some instances, to retier their services in order to meet benchmark rates and to provide the sort of low-priced basic service that Congress seems to have contemplated. While the term "basic service" now has new statutory significance, it has often, in the past, been used to mean "non-premium service." For example, satellite networks such as CNN, ESPN, Arts & Entertainment, MTV and The Weather Channel have typically been referred to generically as "basic" cable networks, as distinguished from "premium" networks such as Home Box Office, Showtime and the Discovery Channel.[40/] The principal distinction was that premium networks were offered on a per-channel basis, while basic networks were offered only in a package. Thus, even when a system offered multiple tiers of service in addition to premium channels, these tiers were often referred to as "basic" and expanded or enhanced "basic" service, and the satellite networks on each tier were still referred to as "basic" networks.

Therefore, the Commission should not only reaffirm that the Act permits retiering of services, even from a regulated basic tier, unless the franchise specifically requires carriage of the services on the basic tier. It should also make clear that even

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40/ See, e.g., Paul Kagan Associates, Inc., Cable TV Programming, Dec. 30, 1992, p.4 ("Basic Network Ratings: Solid Start to New Season").

where a franchise imposes requirements regarding "basic" service, those requirements should not be interpreted to refer only to the single-tier basic service as now defined by the Act unless the franchise clearly so indicates. By ensuring that cable operators are permitted to retier to the full extent permitted by the Act, the Commission will reduce the instances in which its benchmarks impose non-remunerative and confiscatory rates.

3. The Right to Recover Overall Costs (Plus a Reasonable Profit) From Basic and Non-Basic Service

Third, as we will discuss in greater detail later, the Commission should ensure that, to the extent that benchmark rates for basic service are, for particular systems, non-remunerative, those systems at least are able to charge rates for services other than basic service that allow recovery of their overall costs of providing cable service plus a reasonable profit.

What this means, as a practical matter, is that in determining what rates for non-basic service are excessive and "unreasonable", the Commission should take into account the prospective effect of basic rate regulation. If, as we later propose, the Commission decides that "unreasonable" rates are those rates that exceed most of the industry's, it should adopt a standard based on the total rates charged for all services and equipment subject to regulation. Only if a system's total rates for basic service, equipment, and non-basic service so far exceed the norm as to be unreasonable should the system's rates for non-basic service be rolled back. Such an approach would provide a

safety valve by which systems could adjust their non-basic rates to ensure recovery of costs plus a reasonable profit in light of reductions in basic service revenues imposed by the Act and the Commission's benchmarks.

4. Cost-Based Rebuttal of Benchmarks

Finally, as the Commission recognizes, there must inevitably be some opportunity for cable operators to demonstrate that the rates required by the Commission's benchmarks simply are inadequate in light of a system's particular costs. Thus, the Commission's "preferred approach would be for rates to be governed generally by a benchmark, with cable operators permitted to justify higher rates levels based on cost-of-service ratemaking principles."[41/]

But the Commission's proposal to establish standards at this time detailing the methodology to be used by cable operators and franchising authorities for such cost-of-service rebuttals is ill-advised. It is precisely because the development of such standards and principles is so complex and difficult -- especially if the standards are to be meaningfully applied by local franchising authorities -- that Congress and the Commission have opted to avoid cost-of-service regulation as the principal approach to cable rate regulation. It is no easier to devise such standards for use "where cost of service ratemaking is used

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41/ Notice, para. 59.

as a 'safety net' to allow cable operators to defend rates challenged under a benchmark test"[42/] than to develop such standards as a general methodology for regulating cable rates.

Even if it were ultimately desirable to develop some system for standardizing accounting practices among cable systems and to establish a set of standards for applying meaningful and rational cost-of-service regulation to the cable industry, that is the sort of task, as the Commission has learned in other contexts, that takes years to complete. Taking the general framework, based on telephone utility regulation, that is set forth in Appendix B of the Notice and transforming it into meaningful standards for regulation of cable systems on a cost-of-service basis is hardly something that can reasonably be achieved in this fast-track proceeding.

The Commission can, however, adopt rules that reduce the likelihood that its benchmark approach will ultimately require resorting to litigation as to whether allowable rates are unconstitutionally confiscatory. To rule that cable operators must be entitled to rebut the applicable benchmarks is not necessarily to require full-fledged cost-of-service ratemaking. In the first instance, cable operators simply should be permitted to make whatever showing they choose in order to demonstrate to the franchising authority that its costs justify rates higher than the benchmarks allow. Franchising authorities should, at

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42/ Id., para. 61.