

2. Cable operators base their economic analyses on technology and financial conditions rather than on "revenue requirements", and cable operators routinely write off assets which under telephone accounting would be retained in the ratebase.<sup>4</sup>

Cable is wrong that telephone companies base investment and other business decisions on "revenue requirements;" in fact, telephone companies make these decisions based on present value cash flow analyses just as do other industries, including cable. Revenue requirements are determined at the macro level in regulatory proceedings by regulators, not the telephone companies.

Moreover, the fact that telephone companies are subject to depreciation rules that have not kept pace with changing competitive conditions and technologies puts telephone companies at an artificial disadvantage when they compete with cable. As a result, cable's argument actually supports streamlining the Commission's existing depreciation rules and permitting telephone companies to institute capital recovery programs that depreciate their existing plant at a rate that matches its economic life. To establish regulatory parity, these reformed depreciation rules should apply equally to telephone companies and to cable.

3. Cable systems' reinvestment rates are triple those of the LECs.<sup>5</sup>

Whether or not this is true, this claim reflects nothing more than that fact that cable is in a growth phase.<sup>6</sup> By applying price caps to cable, the Commission will encourage continued investment while protecting consumers from cable's price gouging.

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<sup>4</sup> Comments of Continental Cablevision at 23-24.

<sup>5</sup> Comments of Continental Cablevision at 24.

<sup>6</sup> See supra note 3.

4. Book value and classical utility ratemaking is rooted in the asset conversion cycle and does not accurately reflect future earnings. Cable is valued on the basis of cash flow<sup>7</sup>.

The market value of a telephone company, like a company in any other industry, is based on the future expectations of cash flow. Again, however, cable's argument counsels strongly in favor of applying price caps to cable. This will give the cable incumbents the flexibility and incentive to manage their businesses most efficiently and to maximize the value of their businesses.

5. The beta factors of cable companies are over 80% higher than those of the LECs. The cost of debt capital is higher for cable. Cable television market valuation is based on its long term return of investment, not on low risk profits from monopoly rents.<sup>8</sup>

As the cable incumbents recognize, the riskier leverage positions taken by cable are the cause of their higher betas. The reason that the cable incumbents have been able to take riskier leverage positions, however, is because they face no competition in their local franchise areas and have a safe source of monopoly revenues to pay back their high debt loads; unlike telephone companies, they have also been free to set their rates at levels that are free of subsidies to achieve societal objectives such as below cost dial tone line rates. If the cable companies wish to have lower betas, they will deleverage their franchises and applying price cap regulation will give them the flexibility to do so.

6. Cable operators have historically run their businesses for long term cash flow, growth and capital appreciation. They have not focused on the immediate and steady earnings which characterize LECs.<sup>9</sup>

Again, this is simply a financial reflection of the growth phase experienced by cable companies over the last several years; price caps provide incentives for continued investments and growth.

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<sup>7</sup> Comments of Continental Cablevision at 24.

<sup>8</sup> Comments of Continental Cablevision at 25.

<sup>9</sup> Comments of Cole, Raywid, & Braverman at 22.

7. In a growth industry, like cable, "per subscriber" price reflects a buyers expectations.<sup>10</sup>

Cable is right that the per subscriber price to acquire existing cable systems reflects, at least in part, buyer expectations that they will be able to continue earning monopoly profits. In fact, as TCI has conceded in another forum:

It is clear from the record that a cable television operator enjoys a de facto monopoly over the provision of cable television services within the area defined by the franchise. ... There is no goodwill in monopoly. In a monopoly context, customers return, not because of any sense of satisfaction with the monopolist, but rather because they have no other choice.... Thus, because the franchise restricts alternative service providers and confers upon the operator a de facto monopoly, all of the value of the expected repeated patronage becomes part of the franchise rather than some other customer intangible.... [T]he value of the franchise is the value of the supernormal return which possession of the franchise permits the operator to derive from the monopoly market.<sup>11</sup>

The cable incumbents' argument does not counsel against applying price caps to cable. It does, however, counsel against permitting cable operators to earn a return on the portion of any purchase price they paid that is attributable to a monopoly premium. As a result, in any cost of service proceedings that are conducted to establish reasonable rates before applying price caps, cable operators should only be able to earn a return based on a reasonable value for the tangible assets of the cable system -- they should not earn a return on any monopoly premium paid in acquiring those assets.

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<sup>10</sup> Comments of Continental Cablevision at 24-25.

<sup>11</sup> Reply Brief for the Petitioner, TeleCommunications, Inc. v. Commission of Internal Revenue, Docket No. 268-89 (May 1, 1990) at 91, 94 and 111.

8. Book value does not properly reflect the going concern value of a fully staffed, trained, and operating cable system. Acquisition prices above book value -- often viewed skeptically in utility ratemaking -- frequently reflect a buyer's prospective upgrade, improvements, and better utilization of the assets, as well as unrealized economies of scale or scope.<sup>12</sup>

Again, acquisition prices in the cable industry are more likely to "be predicated on the expectation that customers have no alternative to paying a rate for service that includes a monopoly rent component."<sup>13</sup>

9. LECs have a long history of cost-based regulation, which provides appropriate starting points for price caps. Cable does not have that regulatory history.

This is true but it does not weigh against applying price caps to cable. As Congress found, the result of cable's status as an unregulated monopoly is that cable operators have abused their monopoly power to the detriment of consumers. Cable's argument, therefore, means that the Commission must first set rates at reasonable levels before applying price caps.

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<sup>12</sup> Comments of Cole, Raywid, & Braverman at 23.

<sup>13</sup> Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, NPRM at 87 (released Dec. 24, 1992). In fact, cable systems are typically valued at three or more times their capital costs; a ratio of approximately one-to-one would be expected in a competitive industry. See Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, MM Dkt. No. 89-600, Report at 37-38 (released July 31, 1990).

**CERTIFICATE OF SERVICE**

I hereby certify that on this 11th day of February, 1993, a copy of the foregoing REPLY COMMENTS OF BELL ATLANTIC were served by U.S. mail, first class, postage prepaid upon the parties on the attached service list.

  
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