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February 10, 1993

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BY FEDERAL EXPRESS

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

Re: In the Matter of Implementation of Sections
of the Cable Television Consumer Protection
and Competition Act of 1992 - Rate Regulation

MM Docket No. 92-266

Dear Ms. Searcy:

On behalf of the Greater Grand Rapids Area Cable Commission and the Cities of New Ulm, Minnesota, and Savage, Minnesota, please find enclosed for filing in the above-referenced docket an original and nine copies of **Reply Comments**.

Please feel free to contact me if you have any questions.

Very truly yours,



Susan Rester Miles

cc: Greater Grand Rapids Area Cable Commission
City of New Ulm
City of Savage

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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

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Implementation of Sections of)
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Protection and Competition Act)
of 1992)
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MM Docket 92-266

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

**REPLY COMMENTS OF GREATER GRAND RAPIDS AREA CABLE COMMISSION
AND CITIES OF NEW ULM, MINNESOTA, AND SAVAGE, MINNESOTA**

February 10, 1993

Submitted by:
Hessian, McKasy & Soderberg,
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Pursuant to the Notice of Proposed Rulemaking ("NPRM") adopted by the Federal Communications Commission (the "Commission") on December 10, 1992, the Greater Grand Rapids Area Cable Commission and the Cities of New Ulm, Minnesota and Savage, Minnesota (hereinafter collectively "Minnesota Cities") hereby submit their reply comments in the above-referenced docket. The Minnesota Cities previously submitted, on January 27, 1993, their initial comments in this docket and do not intend to repeat those comments here. Instead, they will limit their reply comments to further discussion of the methodologies of setting rates for the basic service tier and cable programming services, anti-evasion rules, and the effective date of the rules.

I. THE DIRECT COST METHOD OF SETTING BASIC SERVICE RATES SUPPORTED BY THE MINNESOTA CITIES IS PREFERABLE TO OTHER PROPOSED METHODS.

The Minnesota Cities in their initial comments supported a method of determining rates for basic service based on determining the direct cost of signals plus a nominal contribution to joint and common costs. Simply put, the basic service tier would be priced to recover directly assignable programming costs for the channels on that tier plus a proportionate contribution to the system's joint and common costs allocable to cable services. That contribution would be measured by overall joint and common costs divided by the number of usable activated channels on the system.

The Minnesota Cities agree with the comments of the United States Telephone Association (p. 12) and the Consumer Federation of America (p. 84) that at this time there is insufficient data

available regarding the rates charged by systems subject to effective competition to provide an adequate basis for an "effective competition" benchmark.¹ Hopefully, this situation will change in the near future, at which time it would be appropriate to employ an "effective competition" benchmark as a means of setting rates for basic service. That time is not now.

Moreover, it is apparent from many of the comments submitted that it would be impossible for the Commission to establish a suitable nationwide benchmark rate for basic cable services. For example, InterMedia unrealistically suggests that the Commission set benchmarks which take account of the following individual factors: cost of capital; urban/rural character of system; number of subscribers; system penetration; system configuration; channel capacity and activated channels; and capital investment in headend per subscriber. InterMedia also seeks Commission approval of automatic pass-throughs for "municipal costs," including taxes; retransmission consent fees; and an inflation factor. Such "individualized" adjustments to benchmark rates can be a greater burden than a simplified cost approach.²

¹ Even the National Cable Television Association admits this deficiency: ". . .there are likely to be so few cable systems subject to effective competition of this sort. It may be difficult to use statistical methods to explain reliably the sources of variation of rates within a small sample." *NTCA Comments, Appendix A, p. 10.*

² The proposal by the National Cable Television Association suffers from the same shortcoming. Its proposed benchmark based on rates charged in communities with effective competition would have to be adjusted using statistical analysis to account for differences in the number of channels, the extent of "bundling" charges for equipment and rates, and "other factors."

In contrast, rates based on directly assignable costs can be determined in accordance with the following simple formula:

$$\frac{P + J}{C} = R$$

where **P = basic tier programming costs**; and

J = proportionate share of joint costs; and

R = Basic Revenue Requirement

P and J are based on accounting data from an historical 12-month period. The J in the above formula is calculated:

$$(E + B) \times .15$$

where **E = 76.703 joint/common costs allocable to cable services**

- leased access revenue
- advertising and home shopping revenues

and where **B = 76.702 rate base x benchmark rate of return on investment**

The accounting standards set forth in Appendix A to the NPRM present an acceptable means of tracking costs for this formula, with a few minor adjustments. For example, proposed rule 76.701 in Appendix A of the NPRM would require two minor adjustments: (1) the expense categories should exclude an amortization of goodwill; and (2) since interest would be recovered via return on investment, it should be excluded as a separate expense for ratemaking purposes. Further, the allowable rate base categories set forth in § 76.702 should exclude both goodwill and construction work in progress. Also, the Minnesota Cities echo

the comments of the National Association of Regulatory Utility Commissioners that to the extent cable plant is used for the provision of intrastate telephone services, the Commission and local franchising authorities must be able to separate a share of the investment of such plant from the cable rate base. Finally, all accounting data should be maintained on an individual system basis.

The Minnesota Cities further believe that determination by the Commission of a benchmark rate of return applicable to all cable systems' basic rates is both consistent with Congressional intent and would ease the administrative burden on franchising authorities. This is the component of rates where monopoly rents can most frequently be found. Moreover, this benchmark could be determined based on data from systems with effective competition. The degree of risk of investing in such firms should not deviate materially from system to system.

The formula presented assumes that there are no expense (other than programming) or rate base accounts directly assignable to basic service. Instead, basic service is assigned an arbitrary 15 percent share of all cable service joint expenses and rate base.

The revenue calculation which results from this formula can be readily transformed into a rate per channel per subscriber. Using that rate, a cable operator could be permitted to add or remove channels from the basic tier(s) at its discretion, increasing or decreasing the rates by the prescribed rate per

channel. Therefore, the cable operator is not penalized for adding programming or shifting programming from the cable programming tiers to the basic service tier.

As will be discussed below, the direct cost approach also fits well with the Commission's obligations to assure reasonable programming rates.

II. THE COMMISSION SHOULD ADOPT THE DIRECT COST APPROACH FOR SETTING CABLE PROGRAMMING RATES.

One of the significant advantages of using the direct cost formula described above for setting basic service rates is that it can be easily applied to cable programming rates as well. Once the franchising authority has determined the per channel/per subscriber rate, that rate can be adjusted and applied across the board to cable services (except for premium and pay per view). This will greatly assist subscribers and franchising authorities in determining whether to file complaints with the Commission challenging the reasonableness of cable programming rates.

Cable programming rates would be calculated by adding together the direct programming costs for cable programming services and 55 percent of joint and common costs. The per channel/per subscriber rate for cable programming services could be readily established once the overall cable programming revenue requirement is known.

As can be seen, 15 percent of joint and common costs would be recovered through basic rates, while another 55 percent would be recovered through cable programming rates. The remaining 30

percent of joint and common costs would be assigned to premium and pay-per-view services.

If for some reason the cable operator has additional costs which are not recovered by applying the direct cost approach to basic and cable programming services and the actual cost approach to equipment, that does not mean that the rates are confiscatory. It must not be forgotten that premium channels return monopoly profits to system operators which remain untouched by the Cable Act of '92. Although premium channel and pay-per-view rates are unregulated, it does not follow that their earnings should be completely disregarded when a cable operator claims a taking of property.

Once the cable programming costs are known, it is a simple task for a franchising authority to determine what a reasonable rate should be for cable programming services. That is because the franchising authority will already know the total amount of joint and common costs in order to assign 15 percent of that amount to basic service. Thus, if cable programming rates exceed cable programming costs plus 55 percent of joint and common costs, the franchising authority will have strong evidence that the cable programming rates are unreasonable. The franchising authority may then decide to file a complaint with the Commission regarding those rates. This "quick look" approach to cable programming rates should prove a tremendous asset to the Commission in dealing with potential complaints emanating from 11,000 different systems.

Another advantage of the proposed formula is its built-in incentive factor. An increase in the number of subscribers over the number built into the rate formula would produce a higher rate of return for the cable operator, assuming no change in productivity. Like the price cap method of setting rates for local exchange carriers, the cable operator could retain all or a portion of its earnings realized from maximizing its efficiency. Thus, operators will have an incentive to keep costs down.³ Conversely, a decrease in the number of subscribers will erode earnings, assuming no material change in operating costs. Thus, operators will have an incentive to offer programming of a quality which will keep subscribers from leaving the system.

III. PROOF OF EVASION DOES NOT REQUIRE A SHOWING OF INTENT.

InterMedia states in its comments (p. 37) that "a finding of evasion would not be appropriate" unless "some requisite level of unlawful intent was demonstrated by a cable operator." The '92 Cable Act makes no mention of a showing of intent. Instead, Congress has indicated that the Commission by rule may establish that certain practices are to be considered per se evasive, and therefore are prohibited under the act.

The most effective tool that can be given to franchising authorities to prevent abusive rate increases and retiering practices is to ensure that regulators have the authority to reduce existing rates and to order refunds of any unreasonable

³ Of course, the operator would still be required at all times to meet applicable technical standards and customer service standards.

rates charged from October 5, 1992 and beyond. Further, the Commission should make it clear that **any** change in pricing or tiering structure which increases the price per channel of basic service, or which increases the "basket" price of basic service, equipment, and installation will be considered a rate increase triggering local franchising authority rate review jurisdiction.

IV. THE REGULATIONS MUST BECOME EFFECTIVE IMMEDIATELY.

InterMedia states in its comments (p. 39) that "it will be impossible for operators to establish rates until the must-carry and retransmission requirements of the Act are implemented." Thus, InterMedia suggests that the earliest time when the rate regulation rules should take effect is October 5, 1993, the date by which broadcasters must elect retransmission consent. The Minnesota Cities agree with the comments of the National Association of Telecommunications Officers and Advisors, however, that this argument is invalid and is inconsistent with Congress' directive to have rules in place by 180 days after the enactment of the Cable Act. The rules should take effect immediately, with a short phase-in period to permit franchising authorities time to enact ordinances consistent with the Commission's pronouncement.

CONCLUSION

WHEREFORE, the Greater Grand Rapids Area Cable Commission, and the Cities of New Ulm, Minnesota and Savage, Minnesota respectfully request the Federal Communications Commission to

adopt rules at once which prescribe a direct cost of service methodology for setting rates for basic and cable programming services.

Dated: February 10, 1993

Respectfully submitted,

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