

filed within 30 days of the date a franchising authority releases to the public the text of its rate decision as computed under Section 1.4(b) of our Rules.<sup>394</sup> Oppositions can be filed within 15 days after the appeal is filed and must be served on the party appealing the rate decision. Replies can be filed within 7 days after the last day for filing oppositions and shall be served on the parties to the proceeding.<sup>395</sup>

148. Contrary to the view of NATOA, we do not agree that Section 623(b)(5)(B) of the Cable Act permits only a cable operator to challenge a rate decision.<sup>396</sup> Although this section requires the Commission to establish " . . . procedures for the expeditious resolution of disputes between cable operators and franchising authorities concerning the administration of such [basic cable rate] regulations," there is no explicit language in this section or in the legislative history to indicate that subscribers or other interested parties who participated in the proceeding could not file an appeal. Indeed, such a result is inconsistent with the section's goal of providing an opportunity for interested parties to participate in local rate proceedings. Since interested parties such as subscribers have standing to participate in rate proceedings at the local level, it follows that they should be permitted to file an appeal with the Commission if they participated at the franchising authority level and believe that the decision is wrong.

149. We also believe that the Commission should not conduct de novo review of local rate decisions and that the standard of review should be to determine whether there is a reasonable basis for the franchising authority's written decision. Since the Commission is in effect acting like an appellate court in such instances, it is appropriate to use the same standard of review -- that is, the Commission will defer to the judgment of the local franchising authority provided that there is a rational basis for the decision. This approach will

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<sup>394</sup> For the purpose of calculating the time period for filing appeals under Section 1.4 of the Commission's Rules, the first day to be counted is the day after the franchising authority releases to the public the text of its rate decision. It is immaterial whether the first day is a holiday (i.e., a Saturday, Sunday, or federally recognized holiday). An appeal of a local rate decision must be filed at the Commission by the close of business of the 30th day. If the 30th day falls on a holiday as defined above, the appeal must be filed on the next business day. See 47 C.F.R. § 1.4.

<sup>395</sup> Cf. 47 C.F.R. § 1.115(d) (pleading cycle on applications for review).

<sup>396</sup> See NATOA Comments at 66 n.34.

not only expedite review but also be less burdensome on our administrative processes. Furthermore, we believe that the jurisdictional framework of the 1992 Cable Act prohibits us, during appeals where a franchising authority is still validly certified, from establishing rates different from the franchising authority. In such circumstances, the Act only permits our direct regulation of rates in cases where a franchising authority's certification was revoked or disallowed.<sup>397</sup> As a result, if there is no rational basis for the rate decision, we will remand the case to the franchising authority with instructions on how to make the result accord with Section 623 of the Act and our guidelines for determining reasonable rates.<sup>398</sup>

(3) Notification of Availability of Basic Tier

150. In order to ensure that subscribers are adequately notified of the availability of basic tier service, the Notice proposed to require that operators provide written notice of such availability to existing subscribers within 90 days or three billing cycles from the effective date of the Commission's rules governing rate regulation. The Notice further proposed to require that such information be included in any sales information distributed prior to installation and hook up and at the time of installation.<sup>399</sup> We also sought comment on the appropriate form and content of such notice.

151. Although most of the commenting parties agree with the 90-day/three billing cycle notification,<sup>400</sup> some parties favor an exemption for those cable operators who can demonstrate that they have made notification in the twelve months prior to

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<sup>397</sup> See Communications Act, § 623(a)(6), 47 U.S.C. 543(a)(6).

<sup>398</sup> We recognize that appeals of local rate decisions involving cost-of-service showings may be filed prior to our resolution of the Further Notice of Proposed Rule Making on cost-of-service standards. Until we adopt final cost-of-service standards, rate decisions that are appealed to the Commission will be reviewed using general cost-of-service principles. Cable operators who believe that they have been aggrieved by the local franchising authorities' decision may request a stay of that decision from the Commission. However, such stays will be evaluated under the strict standards normally accorded requests for stay, and will not be routinely granted.

<sup>399</sup> Notice, 8 FCC Rcd at 530, para. 89.

<sup>400</sup> See, e.g., GTE Comments at 19 and TCI Comments at 57; but see Dover Comments at 22-23 (supporting a monthly notification requirement printed directly on the cable bill).

the effective date of the rate regulations.<sup>401</sup> In addition, NYSCCT asks that the Commission not preempt similar local notification requirements. NYSCCT also recommends a requirement that a cable operator maintain a public file of copies of the notifications it sent to subscribers.<sup>402</sup> Some commenters oppose including the required basic notification at or prior to installation,<sup>403</sup> while TCI opposes an annual notification requirement, claiming that notification of basic service availability upon initial subscriber sign-up should be sufficient to inform the cable subscriber.<sup>404</sup>

152. We believe that cable operators should notify subscribers of the availability of basic tier service within 90 days or three billing cycles from the effective date of the rules adopted in this proceeding and should similarly notify new subscribers at the time of installation.<sup>405</sup> However, cable operators who can demonstrate that they have satisfied the notification requirement in the twelve months prior to the effective date of the cable regulations will be exempt from the initial notification requirement, provided that their notice conforms to the format and content requirements we establish. We believe that this approach offers the best balance between the public's right to know about the availability of a basic service option, and the need to minimize the administrative burden on cable entities.<sup>406</sup> We agree that such notification should be

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<sup>401</sup> See Continental Comments at 48; Cole Comments at 38-39.

<sup>402</sup> NYSCCT Comments at 26.

<sup>403</sup> See Continental Comments at 48; Cole Comments at 38-39; but see Minnesota Comments at 18 (supporting a requirement for such notification to be included in any sales information distributed prior to hookup and at the time of installation).

<sup>404</sup> TCI Comments at 57.

<sup>405</sup> If the cable operator is required to notify subscribers about additional receiver connections and the need for additional equipment to view all must carry stations pursuant to Section 76.56(d)(3) of the Rules, this notification may also include the notice of basic tier availability described above. See 47 C.F.R. § 76.56(d)(3).

<sup>406</sup> To the extent that this notification requirement for basic tier availability conflicts with local franchise agreements or rules, we are preempting local regulations. Section 623(b)(5)(D) requires that the Commission adopt rules in this area in order to ensure that subscribers are notified of the availability of basic tier service. Any further local regulations would appear to be inconsistent with Section 623(b)(2)(B), which requires that we

included with the cable bill so that it is not lost in promotional material.<sup>407</sup> We also have been persuaded by cable operators that it is not feasible to require that this notice of basic tier availability be included in all sales literature prior to installation and hook up because much of this promotional material is beyond the control of the cable operator. However, it must be given to a new subscriber at the time of installation.

153. We also do not believe that the form and content of this notification should be left to the discretion of local franchising authorities. On the contrary, Section 623(b)(6) explicitly requires the Commission to adopt procedures on notification of basic tier availability. The legislative history of this section further states that the Commission is directed to adopt both "standards and procedures to assure that subscribers receive notice of the availability of the basic service tier."<sup>408</sup> We interpret this language to require some type of federal standard as to the form and content of the notification. Accordingly, we will require that cable operators not only state that a basic tier service is available but also set forth the price of the service and list the services that are included. This notification should be in a written form which "clearly and conspicuously" informs the subscriber of the above information in a manner similar to the annual privacy act disclosures of Section 631 of the Communications Act.<sup>409</sup> Finally, although we are not adopting a requirement that a cable company maintain in its public inspection file copies of its notifications of basic service availability, if challenged, the cable company will bear the burden of proving that it is in compliance.

c. Regulation of Basic Service Tier Rates and Equipment

(1) Components of the Basic Service Tier Subject to Regulation

(a) Introduction

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avoid administrative burdens on cable operators and franchising authorities. Moreover, the adoption of different local standards would make it difficult for an MSO to develop a single billing insert which could economically be used across all franchise areas.

<sup>407</sup> See Dover Comments at 22-23.

<sup>408</sup> House Report at 85.

<sup>409</sup> Communications Act, § 631(a), 47 U.S.C. § 551(a).

154. Statutory requirements. The Cable Act requires each operator to offer its subscribers a separately available basic service tier to which subscription is required for access to "any other tier of service."<sup>410</sup> The statute requires this basic tier to include: (1) all local commercial and noncommercial educational television and qualified low-power station signals carried to meet carriage obligations imposed by Sections 614 and 615 of the Cable Act; (2) any public, educational, and governmental access programming required by the franchise to be provided to subscribers; and (3) any signal of any television broadcast station that the cable operator offers to any subscriber, unless it is a signal that is secondarily transmitted by a satellite carrier beyond the local service area of such a station.<sup>411</sup> Section 623(B)(7)(B) permits the operator to include additional video programming signals or services in the basic tier, as long as the charges for their services conform to our basic rate regulations. Qualified franchising authorities are to be the primary regulators of rates for this basic tier of service, with the Commission regulating only in certain circumstances.

(b) General Requirements

i. Background

155. The statute requires that "must-carry" local television signals, as defined by Section 614 and 615 of the Communications Act, must be included in the basic service tier. In the Notice we sought comment on the tentative conclusion that Section 623(b)(7)(A)(iii) makes any local signal qualified for must-carry status but carried pursuant to retransmission consent a basic tier channel. We also asked parties to address whether retransmission consent channels would be classified as mandatory basic service channels if an operator had satisfied his signal carriage obligations with the carriage of other stations. Finally, we also sought comment on the tentative finding that operators may add any number of programming services to the basic tier, provided that such services are subject to rate regulation.<sup>412</sup>

ii. Comments

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<sup>410</sup> Communications Act, § 623(b)(7)(A), 47 U.S.C. § 543 (b)(7)(A).

<sup>411</sup> Communications Act, § 623(b)(7)(A), 47 U.S.C. § 543 (B)(7)(A).

<sup>412</sup> Notice, 8 FCC Rcd at 513.

156. Most commenters agree with our tentative conclusion that any local signal, whether carried pursuant to must-carry or retransmission consent and regardless of whether the cable operator has satisfied signal carriage obligations, must be placed on the basic tier.<sup>413</sup> Others, however, argue that whether a retransmission consent channel is carried on basic or on another tier should be a matter for negotiation between the cable operator and the broadcaster.<sup>414</sup> Finally, commenters agree that operators may add any number of programming services to the basic tier and that such services would be subject to rate regulation.<sup>415</sup>

### iii. Discussion

157. We find that any domestic television broadcast signal carried by a cable operator must be placed on the basic tier, whether the channel is must-carried or carried pursuant to retransmission consent. Section 623(b)(7)(A) requires "any signal of any television broadcast station that is provided by the cable operator to any subscriber" to be carried on the basic tier (emphasis supplied). The only exception is signals "secondarily transmitted by a satellite carrier beyond the local service area of such station."<sup>416</sup> There are no exceptions for

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<sup>413</sup> See, e.g., Time Warner Comments at 12; Miami Comments at 6-7.

<sup>414</sup> See, e.g., Cole Comments at 8; NYSCCT Comments at 13.

<sup>415</sup> See, e.g., Nashoba Comments at 14-15; NAB Comments at 11; Cole Comments at 10; Austin Comments at 21.

<sup>416</sup> Nashoba and The Falcon Group urge the Commission to clarify that "superstations" may be carried on a tier other than the basic tier even if the cable system receives the signals by microwave and not by satellite. See Nashoba Comments at 20-21; The Falcon Group Comments at 11-12. We adopt this clarification. Section 623(b)(7)(A)(iii) excepts from required carriage on the basic tier broadcast signals "secondarily transmitted by a satellite carrier beyond the local service area of such station." The statute thus defines the excepted signals by how they are transmitted, not by how a particular cable system receives them. Moreover, it is clear that Congress intended that superstations not be required basic tier channels outside of their local market coverage area. See Conference Report at 64 (deleting requirement in House amendment that superstations be carried on the basic tier). A superstation does not become a local broadcast station simply because a cable system receives it by microwave. It would frustrate congressional intent to require a cable operator to carry superstations on the basic tier simply because that operator actually receives the signals by microwave.

signals transmitted pursuant to retransmission consent or for additional broadcast signals carried beyond the operator's must-carry requirement. The components listed in the statute, however, are specifically labelled "minimum contents." Section 623(b)(7)(B) clearly states that a cable operator may add additional video programming signals or services to the basic tier, with those additional services subject to basic tier rate regulation.

158. Two commenters raise issues with respect to PEG channels. Nashoba argues that only PEG channels actually carrying PEG programming should be required to be on the basic tier. Nashoba reasons that Congress required that PEG channels be included on the basic tier to promote the availability of educational and governmental programming at the lowest reasonable rate. Moreover, Nashoba notes that franchising authorities must provide procedures to permit operators to use for other programming those designated PEG channels not being used to provide PEG programming.<sup>417</sup> We agree with Nashoba that only those PEG channels actually used for PEG programming must be carried on the basic tier. The congressional purpose--to provide all subscribers access to channels carrying PEG programming--would not be effectuated by requiring a cable operator to "load up" the basic tier with channels designated, but not used, for PEG programming. If any portion of the channel is used for PEG programming, however, the channel must be carried on the basic tier unless if, as we discuss below, the franchising agreement explicitly permits carriage on another tier. A cable operator carrying such a channel on other than the basic tier (unless pursuant to a franchise agreement) will be required to move that channel to the basic tier immediately should that channel begin to carry any PEG programming.

159. Nashoba and the Falcon Cable Group argue that the Commission should not require placement of PEG channels on the basic tier unless the franchising agreement so requires.<sup>418</sup> NATOA contends that we should allow franchising authorities to require placement of PEG channels on other than the basic tier.<sup>419</sup> All of these parties base their arguments on the House Report language, which states that "it is not the Committee's intent to modify the terms of any franchise provision either requiring or permitting the carriage of such programming on a

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<sup>417</sup> Nashoba Comments at 21-22 (citing Communications Act, § 611(d)(1), 47 U.S.C. § 531 (d)(1)).

<sup>418</sup> Nashoba Comments at 22; the Falcon Cable Group Comments at 12-13.

<sup>419</sup> NATOA Comments at 69.

tier of service other than the basic service tier."<sup>420</sup> The House Report then discusses at some length the importance of providing all cable subscribers access to PEG channels.

160. We decline to adopt the interpretation urged by Nashoba and Falcon, which would allow a cable operator to carry PEG channels on a non-basic tier unless the franchising authority required carriage on the basic tier. We agree with NATOA, however, that franchising authorities may require carriage of PEG channels on a non-basic tier. Thus, if a franchise agreement is silent as to the tier on which PEG channels must be carried, the cable operator must carry them on the basic tier. The statutory language states that PEG channels required by the franchising authority to be provided to cable subscribers must be carried on the basic tier; the legislative history states only that the Committee did not intend to modify specific provisions in the franchise agreement regarding placement of PEG channels on non-basic tiers. Given this clear congressional direction and the evidence of the importance attached to PEG channels, we require a cable operator to carry PEG channels on the basic tier unless the franchising agreement explicitly permits carriage on another tier.

161. Finally, NATOA argues that the Commission should not preempt franchise provisions governing the number of channels that must be on the basic tier, or provisions in franchises entered into before 1984 that require cable operators to place particular programming services on the basic tier.<sup>421</sup> Certain cable operators disagree.<sup>422</sup> Time Warner, for example, argues that under "a new regulatory regime which directly constrains the rates for a specific set of services in order to promote localism, cable operators should not be bound by anachronistic requirements for a 'fat' basic tier."<sup>423</sup> We agree with Time Warner that the statutory definition of the basic service tier preempts provisions in franchise agreements that require additional services to be carried on the basic tier. First,

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<sup>420</sup> House Report at 85. The House provision was enacted into law, so the House Report is relevant in determining congressional intent.

<sup>421</sup> NATOA Reply Comments at 22. Several state attorneys general argue that cable operators should be required to offer as a "basic tier" a set of services comparable to that offered on January 1, 1992. AG Comments at 11. For reasons discussed in this paragraph, we decline to impose such a requirement.

<sup>422</sup> See, e.g., Time Warner Comments at 13; Continental Comments at 71.

<sup>423</sup> Time Warner Comments at 13.

Congress clearly envisioned that broadcast "superstations" could be carried on a non-basic tier because the Act specifically exempts superstations from the requirement that all broadcast channels be carried on the basic tier.<sup>424</sup> This is evidence that Congress intended to limit the number of channels that cable operators could be required to carry on the basic tier newly subjected to local rate regulation. Second, the House Report specifically discusses the Committee's intent that franchise provisions requiring or permitting carriage of PEG channels on other than the basic tier were not intended to be preempted.<sup>425</sup> Had the Committee, whose provision on the composition of the basic tier was substantially enacted into law,<sup>426</sup> not intended to preempt provisions in franchise agreements specifying the contents of the basic tier, there would have been no need for the Report language on the specific question of PEG channels.<sup>427</sup> We thus do not believe that franchising authorities, with the exception of PEG channels discussed above, have the authority under the Act to require carriage on the basic tier of channels other than those set forth in the statute. Any other interpretation would permit local authorities to overrule the federal-state division of jurisdiction enacted by Congress.

(c) Buying-Through Basic Service to Other Tiers

i. Background

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<sup>424</sup> Communications Act, 623(b)(7)(A)(iii), 47 U.S.C. 543(b)(7)(A)(iii).

<sup>425</sup> House Report at 85.

<sup>426</sup> The only change from the House language that the Conference Committee made was to delete the requirement that superstations be carried on the basic tier. Conference Report at 64.

<sup>427</sup> Moreover, the Conference Report states that the basic tier must contain the signals required by Section 623(b)(7)(A) as well as "other video programming signals that the cable operator may choose to provide on the basic tier." Conference Report at 60 (emphasis added). This indicates that Congress intended to leave the composition of the basic tier beyond the minimum specified in the Act to the choice of cable operators. We also agree with Nashoba that the Act's preemption of local franchise control over the contents of basic service reflects a balance among competing interests: franchising authorities were given greater regulatory authority over basic service rates and cable operators were given greater discretion over the content of their basic service. Nashoba Comments at 14.

162. The statute defines basic service as a tier "to which subscription is required for access to any other tier of service."<sup>428</sup> The Notice sought comment on whether this provision precludes the offering of video services completely "a la carte" and without prior subscription to the basic service tier. Given the language of the statute which limits any "basic buy through" to other tiers of service, the Notice also asked whether Congress intended to permit consumers to purchase single-channel services on a stand-alone basis. The Notice also sought comment on whether the Act would preclude subscribers from purchasing a separate offering of a nonvideo or "institutional network" without first purchasing the basic tier.<sup>429</sup> The Notice also tentatively interpreted Section 623(b)(8)(A) as preventing an operator from requiring any purchase other than the basic tier as a condition for ordering other programming.

ii. Comments

163. Cable operators and Austin, Texas et al. argue that nothing in the Act requires cable subscribers to purchase the basic tier in order to receive programming on a per-channel or per-program basis or to obtain institutional network offerings, digital cable radio, interactive services, or non-video services.<sup>430</sup> These commenters reason that this interpretation comports with congressional intent not to regulate per-program and per-channel offerings and not to inhibit cable operators' ability to compete with distributors that offer such programming.<sup>431</sup> Additionally, these commenters note, this interpretation maximizes consumer flexibility and choice, a policy that underlies the Act.<sup>432</sup>

164. Broadcasters contend that any consumer who subscribes to the cable system for any purpose must subscribe to the basic tier. NAB bases its conclusion on Section 614(b)(7) of the Act, which states that must-carry signals "shall be provided to every subscriber of a cable system." Since must-carry signals must be on the basic tier, NAB reasons, it follows that all subscribers

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<sup>428</sup> Communications Act, § 623(b)(7)(A), 47 U.S.C. § 543(b)(7)(A).

<sup>429</sup> Notice, 8 FCC Rcd at 513-14.

<sup>430</sup> See, e.g., Cole Comments at 9; TCI Comments at 24-27; Austin, Texas, et.al Comments at 21.

<sup>431</sup> See, e.g., Cablevision Reply Comments at 38-39; TCI Reply Comments at 49.

<sup>432</sup> See, e.g., Cox Comments at 88-89; Sommerville Comments at 7; TCI Reply Comments at 47.

must take the basic tier.<sup>433</sup> INTV agrees that all subscribers must take the basic tier; it argues that without such a requirement, a cable operator could avoid offering a basic tier simply by offering services a la carte.<sup>434</sup>

### iii. Discussion

165. In examining the Act's language and legislative history, we find that Congress intended to require subscribers to purchase the basic tier in order to gain access to any video programming, including that offered on a per-program or per-channel basis. Section 623(b)(7)(A) states that each cable operator "shall provide its subscribers a separately available basic service tier to which subscription is required for access to any other tier of service." While a literal reading of this provision could lead to the conclusion, as some commenters urge, that purchase of the basic tier is not required for access to pay-per-view or per-channel programming, this subsection must be read in conjunction with other provisions in the Act. We interpret the anti-buy-through provision (Section 623(b)(8)(A)), which prohibits a cable operator from requiring a subscriber to purchase any other tier besides the basic tier as a condition for purchasing programming offered on a per-channel or per-program basis, as mandating purchase of the basic tier for access to per-channel or per-program offerings.<sup>435</sup> House Report language in

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<sup>433</sup> NAB Comments at 8-9.

<sup>434</sup> INTV Reply Comments at 1-6.

<sup>435</sup> Cox disagrees with our tentative conclusion in the Notice that Section 623(b)(8)(A) precludes cable operators from requiring the purchase of services in addition to the basic tier as a condition for ordering any other programming. Cox argues that cable operators should be permitted to offer a tier of cable programming services conditioned on the purchase of another tier of cable programming services. Cox Comments at 87. We agree. Section 623(b)(8)(A) of the Act only precludes operators from conditioning access to programming offered on a per-channel or per-program basis on purchasing intermediate tiers. See also House Report at 85 (repeating the provision's plain meaning). In the absence of some indication that Congress intended us to depart from the literal meaning, we decline to do so.

The New York State Commission on Cable Television argues that one channel can be a "tier." NYSCCT Comments at 13. We disagree. The general framework of the Act distinguishes programming offered on a per-channel or per-program basis from "cable programming services," which are offered as a package, or "tier." This distinction would be meaningless if per-channel or per-program offerings are considered "tiers."

the context of cable programming services bolsters our interpretation; it states that "[p]er channel offerings available to subscribers upon purchase of the basic tier can enhance subscriber choice and encourage competition among programming services."<sup>436</sup>

166. We decline, however, to extend this requirement to purchase the basic tier to those who subscribe only to non-video services such as digital cable radio and Personal Communications Services. While broadcasters argue that Section 614(b)(7), which requires must-carry signals to be provided to every subscriber, should be interpreted to require every subscriber of a cable system to take the basic tier, we cannot find that Congress intended to impose such a requirement on subscribers to non-video cable services. As TCI argues, these services do not relate to the underlying purpose of establishing a basic service tier, and many of these services do not even connect to the television receiver.<sup>437</sup> The basic service tier was established and must-carry requirements were imposed "to restore a competitive balance to the video marketplace."<sup>438</sup> Congress was concerned that without signal carriage requirements, cable operators could threaten competition in the video marketplace by dropping or carrying in a disadvantageous position local broadcast signals.<sup>439</sup> It follows, then, that allowing subscribers to a cable system to receive video programming without purchasing the basic tier would also disadvantage local broadcast signals vis-a-vis cable programming. This is not the case, however, when cable subscribers purchase only non-video services. Finally, a major purpose of the Act is to promote consumer choice and flexibility.<sup>440</sup> In the absence of congressional direction to the contrary, we will not force consumers who seek only non-video services to purchase the basic tier.

(d) A Single Basic Tier

i. Background

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<sup>436</sup> House Report at 90 (emphasis added).

<sup>437</sup> TCI Comments at 27.

<sup>438</sup> House Report at 47.

<sup>439</sup> House Report at 51 (emphasis added).

<sup>440</sup> See Senate Report at 77 (noting that unbundling allows subscribers to choose only those programs they wish to pay for).

167. The Notice<sup>441</sup> indicated that the definition of what services are subject to rate regulation as part of the basic tier appears to contemplate only a single tier. This would effectively amend the general "basic tier" definition that remains in the Communications Act from the 1984 Cable Act, defining "basic cable service" as "any service tier which includes the retransmission of local television broadcast signals" (emphasis added).<sup>442</sup> The Notice stated that the 1992 Cable Act appears to contemplate a single "basic tier" of service that is subject to local rate regulation and that includes the services defined in Section 623(b)(7)(A)(i), (ii), and (iii). If this were not the case, the Notice reasoned, the anti-buy through provision of Section 623(b)(8) could be frustrated through the marketing of cumulative tiers of "basic" service. Further, the Notice indicated that the consistent references in the statute to "the" basic tier (in the singular number) suggest that Congress intended the existence of only one basic tier, and sought comment on this tentative conclusion.

#### ii. Comments

168. Cable operators agree with our tentative conclusion that the Act contemplates the existence of a single basic tier. Otherwise, they argue, the bifurcated regulatory jurisdiction and the anti-buy through prohibition mandated by the Act could be frustrated.<sup>443</sup> Franchise authorities and consumer interests, however, argue that operators may offer more than one tier of basic service. They contend that allowing more than one basic tier increases consumer choice and promotes cable operators' marketing flexibility; such an interpretation would not frustrate the Act's anti-buy through prohibition as long as the purchase of any one basic tier provides access to other offerings.<sup>444</sup>

#### iii. Discussion

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<sup>441</sup> Notice, 8 FCC Rcd at 514.

<sup>442</sup> Communications Act, § 602(3), 47 U.S.C. § 522(3).

<sup>443</sup> See, e.g., Cole Comments at 10-11; Nashoba Comments at 16; Newhouse Comments at 6; Cole Reply Comments at 9-10; Continental Reply Comments at 7.

<sup>444</sup> See, e.g., NATOA Comments at 68 n.36; Austin Comments at 22; CFA Comments at 121.

169. As we recently determined in the context of our buy-through proceeding,<sup>445</sup> the plain language of the 1992 Cable Act leads us to the conclusion that for purposes of rate regulation, the Act contemplates the existence of only one basic tier. The statute makes several references to a single basic service tier.<sup>446</sup> Moreover, the Act's bifurcated jurisdictional scheme would be greatly complicated by allowing a cable operator to market more than one basic tier. Congress clearly intended for qualified franchising authorities to regulate only the basic tier, which is defined as that tier containing broadcast stations (except superstations) and required PEG channels.<sup>447</sup> Congress vested jurisdiction over "cable programming services" in the Commission. "Cable programming service" is defined to include any video programming other than that carried on the basic service tier or offered on a per-channel or per-program basis.<sup>448</sup> Thus, tiers other than the basic service tier are subject only to Commission jurisdiction. If such tiers were sometimes subsumed in an expanded "basic" tier, and hence sometimes subject to only franchising authority regulation, this would complicate and confuse regulation and likely lead to inconsistent decisions. Moreover, such an approach would frustrate or at least complicate implementation of the buy-through prohibition, which is intended to minimize the conditions that can be placed on a customer's access to programming of his choice.<sup>449</sup>

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<sup>445</sup> See Report and Order in MM Docket No. 92-262, FCC 93-145, adopted March 3, 1993.

<sup>446</sup> See, e.g., Communications Act, § 623(b)(5)(D), 47 U.S.C. 543(b)(5)(D) (subscribers must "receive notice of the availability of the basic service tier"); Communications Act, § 623(b)(6), 47 U.S.C. 543(b)(6) (cable operator must provide 30 days' advance notice to franchising authority of price increase "for the basic service tier"); Communications Act, § 623(b)(7)(A), 47 U.S.C. 543(b)(7)(A) ("[e]ach cable operator ... shall provide its subscribers a separately available basic service tier"); and Communications Act, § 623(b)(7)(B), 47 U.S.C. 543(b)(7)(B) ("cable operator may add additional video programming signals or services to the basic service tier").

<sup>447</sup> Communications Act, § 623(b)(7), 47 U.S.C. § 543(b)(7).

<sup>448</sup> Communications Act, § 623(1)(2), 47 U.S.C. § 543(1)(2).

<sup>449</sup> We also do not believe that the Act permits the operator to apply a different definition of "basic service" to one class of customers than it applies to others.

170. In American Civil Liberties Union v. FCC,<sup>450</sup> the court of appeals held that under the 1984 Act, a tier of service that incorporates, in a marketing sense, the basic tier is itself also a basic tier service, although a tier added to a basic tier for a separate charge would not be considered a basic service.<sup>451</sup> The Notice sought comment on the effect of the 1992 Act on the ACLU definition of basic service. Commenters who argue that the Act permits more than one basic tier also argue that ACLU is still applicable; that is, the marketing of a tier determines whether it is basic or non-basic.<sup>452</sup> Commenters who contend that the Act permits only one basic tier also contend that ACLU does not apply.<sup>453</sup> We agree. The ACLU decision interpreted the definition of basic service in the 1984 Act. As just explained, we believe that Congress intended only one basic tier for purposes of the rate regulation provisions of the 1992 Act.<sup>454</sup> Accordingly, cable operators must place all of the required components of the basic service tier (e.g., broadcast signals and PEG channels) in one tier and unbundle that tier from all other service tiers. The operator may not place the required basic tier services in one tier and also include them in another expanded tier, since this would thwart Congress' intent that there be a single basic tier whose rates are regulated by local franchising authorities.

(2) Regulations Governing Rates of the Basic Service Tier

171. In this section we establish the federal regulatory requirements that will govern rates for the basic service tier. We address first statutory requirements for regulation of the basic service tier. We conclude that the statute does not require the Commission to place primary weight on any of the statutory factors governing rates for the basic

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<sup>450</sup> 823 F.2d 1554 (D.C. Cir. 1987).

<sup>451</sup> For example, if an operator sells a \$10 basic tier and offers an additional set of channels for \$5, these would be a basic (\$10) and non-basic (\$5) service. However, if the operator offers a \$10 basic and a \$15 tier that includes the basic service and the additional service, both the \$10 service and the \$15 service are basic services under the ACLU holding. ACLU, 823 F.2d at 1566 n.31.

<sup>452</sup> See, e.g., Austin Comments at 25.

<sup>453</sup> See, e.g., Cole Comments at 11-12; TCI Reply Comments at 26 n.54; Continental Comments at 11-13.

<sup>454</sup> However, the 1984 Act's definition may continue to apply for other purposes, e.g. to franchise agreements grandfathered under Section 623(j) of the Communications Act, 47 U.S.C. § 543(j).

service tier, but that we may do so as part of a reasoned balancing of statutory requirements and factors. We then examine the relative merits of a benchmarking versus a cost-of-service approach as the primary method for regulating rates for the basic service tier. We conclude that we should incorporate a benchmark approach into our framework for regulation of basic service tier rates with an opportunity for cable operators to justify rates above permitted levels based on costs. We then address whether local authorities should be afforded the option of selecting cost-of-service regulation as their primary mode of regulation of the basic service tier. We conclude that they should not because such an approach would establish a regulatory regime for the basic service tier different from what Congress intended. We also examine whether our regulations should be designed to produce lower rates for the basic service tier than for other tiers. We conclude that any advantages in producing a low priced basic tier are outweighed by the incentives that this could create for cable operators to reduce offerings on the basic service tier. Accordingly, we conclude that our regulations will be tier-neutral in terms of benchmark rate levels for the basic and cable programming service tiers.

172. We then adopt and address in more detail the requirements that will govern rates for the basic service tier. We first adopt the benchmark approach that will be part of our plan for regulating the basic service tier. In this regard, we discuss the various benchmark alternatives proposed in the Notice. We determine that the Cable Act of 1992 reflects a congressional conclusion that rates for cable service embody an ability to raise rates to unreasonable levels because of a lack of effective competition and that rates are potentially unreasonable to the extent they exceed competitive levels. We also explain that our industry survey confirms that rates of cable systems not subject to effective competition exceed competitive levels by approximately 10 percent on an average industry basis -- a difference we refer to as the "competitive differential." We determine, therefore, to adopt a benchmark approach based on the rates of systems subject to effective competition. Regulated systems with rates above competitive levels, as established by our benchmark formula, will be required to reduce their rates by up to 10 percent, which approximates the competitive rate differential. We additionally determine to examine in the Further Notice whether the Commission can, and should, exclude from the benchmark analysis the rates of systems in franchise areas in which fewer than 30 percent of households subscribe to the service of a cable system. Our preliminary analysis reveals that this would produce a competitive rate differential of approximately 28 percent. Use of this competitive rate differential could lead to further reductions in regulated cable rates.

173. We then explain how we will apply the benchmark system to determine a reasonable rate level for the basic service tier. Thereafter we will apply a price cap mechanism to that initial rate level to define future reasonable rates. We determine first that, for a given cable system, we will use the benchmark formula derived from our survey analysis to calculate the rate that would be charged by a similarly-situated competitive system. If the per channel rate being charged by the cable system is at, or below, this "benchmark" at the time the system becomes subject to regulation, its rate will be considered reasonable and will be the system rate to which the price cap governing future rate increases will be applied. Thus, systems with rates in effect at the time regulation begins that are below the benchmark will have their basic tier rates capped at current levels. For systems with rates at the time of regulation that are above the benchmark, we determine that the lawful rate for such systems will be determined by comparing their September 30, 1992 rates to the competitive benchmark rate derived from the benchmark formula. We conclude that the lawful rates for systems whose per channel rates exceeded the benchmark shall be the greater of the September 30, 1992 per channel rate reduced by the industry-wide competitive rate differential of approximately 10 percent, or the applicable benchmark, adjusted for inflation occurring between September 30, 1992 and the initial date of regulation.<sup>455</sup> For systems with below benchmark rates in effect on September 30, 1992, the lawful per channel rate shall be the benchmark rate adjusted for inflation. Local franchising authorities may require cable operators to reduce rates for the basic service tier to these levels. Cable operators that do not wish to reduce their rates to these permitted levels must justify their rates with a cost-of-service showing.<sup>456</sup>

174. We then establish and explain the price cap that will govern rate increases after initial rates are set under our benchmark approach as described above. We justify the use of a price cap to govern rates for the basic service tier, its application to rates below the benchmark, and explain the annual adjustment index. We then address external costs, i.e., costs that are not subject to the price cap and that cable operators may directly pass on to subscribers. We determine that

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<sup>455</sup> As we explain below, the permitted per channel rate as of the initial date of regulation is also adjusted under our requirements to accommodate franchise fees, equipment revenues, and changes in the number of channels offered by the system that have occurred since September 30, 1992.

<sup>456</sup> A system electing cost-of-service proceedings should be aware that its rates are subject to rollbacks below the benchmark level if the system's costs are shown to justify such lower rates.

retransmission consent fees incurred after October 6, 1994, other programming costs, franchise fees, costs of franchise requirements, including the costs of satisfying local franchise requirements for public, educational, and governmental access channels, and local and state taxes on the provision of cable television service will be accorded external treatment. We determine that for all external costs, except for franchise fees, external treatment shall be accorded only to costs that are incremental to those costs incurred prior to regulation or 180 days from the effective date of our regulations, whichever occurs first. The entire amount of franchise fees may be accorded external treatment up until the date of regulation because our benchmark calculations exclude franchise fees. In addition, we determine the permitted per channel rate should be adjusted to accommodate increases in external costs only to the extent those costs exceed inflation.

175. Finally, we address in this section issues arising when a cable operator seeks to make cost-of-service showings to justify basic tier rates above their existing or capped levels. We conclude that the record now before us is not sufficient to permit us to establish at this time cost-of-service standards for cable service by which these cost showings will be judged, and in particular the profit level that would justify a cable operator's existing rates for the basic service tier if above the cap. Instead, we determine that we will adopt and issue in the near future a separate Second Further Notice of Proposed Rulemaking to establish such standards. Pending resolution of the rulemaking we will leave local franchising authorities with the discretion to determine the cost-of-service standards they will apply to cost showings by cable operators.<sup>457</sup>

(a) Statutory Standards

i. Background.

176. The Cable Act of 1992 requires the Commission to ensure, by regulation, that rates for the basic service tier are reasonable.<sup>458</sup> It directs the Commission to adopt regulations designed to protect subscribers of any cable system not subject to effective competition from paying rates higher than those that would be charged if the system were subject to effective

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<sup>457</sup> In Section D of this Report and Order we adopt cost accounting and cost allocation requirements that will govern the manner in which cable operators must present costs for purposes of cost-of-service showings pending adoption of final cost-of-service standards.

<sup>458</sup> Communications Act, § 623(b)(1), 47 U.S.C. § 543(b)(1).

competition.<sup>459</sup> In complying with this directive, the Commission must also seek to reduce the administrative burdens on subscribers, cable operators, franchising authorities, and itself, and it may adopt formulas or other mechanisms and procedures to achieve this objective.<sup>460</sup> Rate regulations must additionally take into account seven factors:

- (1) the rates for cable systems that are subject to effective competition;
- (2) the direct costs (and changes in such costs) of obtaining, transmitting, and providing signals carried on the basic tier including additional video programming signals or services beyond the "must carry" local broadcast television signals, and any public, educational, and governmental access programming required by the franchising authority;
- (3) only a reasonable and properly allocable portion, as determined by the Commission, of the joint and common costs of obtaining, transmitting, and providing signals on the basic service tier;
- (4) cable operator revenues from advertising on the basic tier or other consideration obtained in connection with the basic tier;
- (5) the reasonably and properly allocable portion of taxes and fees imposed by any state or local authority on transactions between cable operators and subscribers or assessments of general applicability imposed by a governmental entity applied against cable operators or cable subscribers;
- (6) the cost of satisfying franchise requirements to support public, educational, or governmental channels or the use of such channels or any other services required under the franchise; and
- (7) a reasonable profit, as defined by the Commission consistent with the Commission's obligations to ensure that rates are reasonable and the goal of protecting subscribers of any cable system not subject to effective competition from paying more for basic tier

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<sup>459</sup> Id.

<sup>460</sup> Communications Act, § 623(b)(2)(A) and (B), 47 U.S.C. § 543(b)(2)(A) and (B).

service than subscribers would pay if the system were subject to effective competition.<sup>461</sup>

177. In the Notice we tentatively concluded that Congress intended that our regulations embody a standard of reasonableness for basic tier rates that reflects a reasoned balancing of these statutory goals and factors. We further tentatively concluded that Congress did not mandate that we give greater or primary weight to any one statutory goal as we formulate regulations to govern rates for the basic service tier, but did intend to leave the Commission discretion to determine in the rulemaking process the comparative weight to be assigned to each of the seven factors.

ii. Comments.

178. Commenters generally agree that implementing regulations must reflect a reasoned balancing of the statutory goals and factors.<sup>462</sup> Many commenters, however, envision implementation of rate regulation of the basic service tier that would place greater weight on some factors than others.<sup>463</sup> Several commenters contend that the statutory goal of protecting consumers from paying more for basic service than if the system were subject to effective competition is the overriding goal that Congress intended to achieve and that the balancing of the other statutory factors must not conflict with this goal.<sup>464</sup>

iii. Discussion.

179. The Cable Act of 1992 requires the Commission to establish regulations that will assure reasonable rates for the basic service tier, but does not explicitly define "reasonable." Instead, it requires that regulations be designed to achieve statutory goals and to take into account the enumerated statutory factors. While some commenters have presented regulatory alternatives that would place more or less weight on some statutory factors in making this determination, nothing in the plain language of the Act mandates that all factors must be weighted equally as we implement our rate setting requirements,

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<sup>461</sup> Communications Act, § 623(b)(2)(C), 47 U.S.C. § 543(b)(2)(C).

<sup>462</sup> See, e.g., Armstrong Comments at 18; CIC Comments at 1-11; Cole Comments at 20; Continental Comments at 21-22; NATOA Comments at 39.

<sup>463</sup> See generally paragraphs 176-177, supra.

<sup>464</sup> NATOA Comments at 40; NYConsumers Comments at 7-8; Rapids Comments at 23.

or that any one factor or set of factors be given primary weight. Nor does the legislative history suggest a contrary conclusion. Accordingly, we conclude, as we tentatively did in the Notice, that our regulations will comply with the statute if they reflect a reasoned balancing of all the statutory goals and factors. In particular, our regulations will satisfy the standard established in the statute (1) if they establish a measure of reasonableness that takes each factor, including the rates of systems subject to effective competition, into account and (2) if, overall, they are designed to "protect" subscribers from paying rates for their cable service that are higher than if the system were subject to effective competition. In the following paragraphs of this subsection, we explain how our regulations meet this two-pronged test.

180. As discussed in para. 14, supra, the findings in the statute that cable operators not subject to effective competition are able to exercise undue market power, the overall structure of the statute, and the statutory goals clearly permit the Commission to exercise its discretion by placing relatively greater weight on the rates of systems subject to effective competition in fashioning a standard of the reasonableness for rates for the basic service tier, if there is a reasoned basis for doing so. Given the results of our industry survey, which reveal a significant differential between basic tier rates of competitive and noncompetitive systems -- and higher tiers as well -- we determine that under the statute, we can, and should, in the public interest, place primary weight on the rates of systems subject to effective competition. Accordingly, our regulations governing rates for the basic service tier are aimed toward achieving rate levels for that tier that are closer to rates of systems subject to effective competition. We explain in later sections of this Report and Order how we take into account other statutory factors for the basic service tier.

(b) Benchmarking versus Cost-of-Service Regulation

i. Background.

181. In the Notice, we identified benchmarking and cost-of-service regulation as the two generic approaches the Commission could use to meet the Act's requirement that rates for the basic service tier be reasonable.<sup>465</sup> We included as one benchmark alternative a price cap approach to regulation of cable service rates.<sup>466</sup> We tentatively concluded that a benchmarking approach to rate regulation would best comply with the directives of the Act by enabling the Commission to achieve reasonable rates

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<sup>465</sup> See Notice, 8 FCC Rcd at 518-19.

<sup>466</sup> Notice, 8 FCC Rcd at 522, paras. 49-52.

at lower cost and with less administrative burden than traditional cost-of-service regulation could.<sup>467</sup> Although we proposed to adopt a benchmarking alternative in the Notice, we also concluded that cost-of-service regulatory principles could play a secondary role for cable operators seeking to justify the reasonableness of rates that do not meet our primary benchmarking standard.<sup>468</sup> We solicited comment on both our analysis of the various alternatives we set forth for rate regulation, and on the tentative conclusions presented in the Notice.

ii. Comments.

182. The majority of parties addressing the proper regulatory approach for cable rate regulation endorse the use of a benchmarking alternative over traditional cost-based regulation. Commenters assert that the Cable Act's legislative history reveals that Congress has rejected common carrier type cost-based rate of return regulation.<sup>469</sup> Many parties additionally contend that even if cost-of-service rate regulation were implemented, the statutory objective of reasonable rates for basic tier services could not be fulfilled because of inherent drawbacks with the cost-based regulatory approach.<sup>470</sup>

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<sup>467</sup> Id. at 519, para.33.

<sup>468</sup> Id.

<sup>469</sup> See, e.g., AdelphiaII Comments at 45-49; BellSouth Comments at 3; NATOA Comments at 41; NCTA Comments at 14; Newhouse Comments at 10; Rapids Comments at 23-25; Time Warner Comments at 17-20.

<sup>470</sup> See, e.g., AdelphiaII Comments at 45-59; Armstrong Comments at 16-17; Carib Comments at 5; CATA Comments at 14; CIC Comments at 11-12; Cole Comments at 24-26; Comcast Comments at 22-29; Continental Comments at 26; Cox Comments at 8-11; Intermedia Reply Comments at 1-2; NCTA Comments at 11-13; NECTA Reply Comments at 3; Oxnard Comments at 4; Rapids Comments at 23-25; SmallSystems Comments at 6; TCI Reply Comments at 10-12; Time Warner Comments at 15-19. The following municipalities favor a benchmarking regulatory approach and argue that it is consistent with Congress' goal for the FCC to enact a rate regulation formula that is "uncomplicated to implement, administer and enforce." See Bayonne Reply Comments at 8; Chandler Comments at 3; Cincinnati Comments at 4; Dade Reply Comments at 7; Fort Lauderdale Comments at 3; Garden City Comments at 3; Hastings Comments at 3; Hays Comments at 4; Indian River Comments at 4; Junction City Comments at 3; Lake Forest Comments at 3; Liberal Comments at 4; Lincoln Park Comments at 3-4; Louisville Comments at 3; MACC Comments at 3; Madison Comments at 3; Mankato Comments at 3; Marshall Comments at 3; Mentor Comments at 3; Mesa Comments at 4; Mount Prospect Comments

183. Commenters identified several disadvantages unique to cost-of-service rate regulation that they claim would outweigh any potential benefits derived from such an approach. Commenters state that cost-of-service regulation: a) is administratively costly to all parties involved<sup>471</sup>; b) provides no incentives for efficiency<sup>472</sup>; c) discourages risk taking and innovation<sup>473</sup>; d) encourages padding rate base to earn larger overall return<sup>474</sup>; and e) increases incentives to cross-subsidize non-regulated costs with regulated costs.<sup>475</sup> CIC and Time Warner aver that traditional telephone company cost-of-service regulation is unsuitable for cable operators and should not be adapted to cable because the industries are significantly different.<sup>476</sup> NCTA states that a cost-based regulatory approach would create delays and uncertainties that would hinder the availability of financing for cable operators and disrupt payment of their existing loan obligations.<sup>477</sup> In addition, NCTA questions whether local franchising authorities have the financial ability, expertise, and competence to apply cost-of-service regulation.<sup>478</sup> Finally, several parties argue that although benchmarking should be the primary method of establishing reasonable basic tier rates, cost-of-service regulation should remain available as a secondary

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at 4; Multnomah Comments at 7-8; Niles Comments at 3; Oakland Comments at 3; Ottawa Comments at 2; Palm Desert Comments at 3; Phillipsburg Comments at 3; Prince George Comments at 4; Ramsey Comments at 3; Salina Comments at 3; San Antonio Reply Comments at 4.

<sup>471</sup> See, e.g., AdelphiaII Comments at 45-49; Cole Comments at 24-28; Comcast Comments at 22-29; Continental Comments at 26; Intermedia Reply Comments at 1-2; Mesa Comments at 4; NCTA Comments at 13.

<sup>472</sup> See, e.g., Cole Comments at 24-28; Continental Comments at 26; NCTA Comments at 13; Time Warner Comments at 15-19.

<sup>473</sup> See, e.g., AdelphiaII Comments at 22-24; Comcast Comments at 22-29.

<sup>474</sup> See, e.g., AdelphiaII Comments at 45-49; NCTA Comments at 13; Time Warner Comments at 15-19.

<sup>475</sup> See AdelphiaII Comments at 45-49.

<sup>476</sup> See CIC Reply Comments at 17; Time Warner Comments at 14.

<sup>477</sup> See NCTA Comments at 13.

<sup>478</sup> See NCTA Comments at 14.

procedure as a safety net for the justification of rates above the benchmark.<sup>479</sup>

184. On the other hand, many municipalities argue that the Cable Act directs the Commission to impose a scheme of basic cable service rate regulation "patently analogous" to telephone common carrier rate regulation.<sup>480</sup> CFA contends that the lack of effective competition in the cable industry necessitates that the Commission implement cost-of-service regulation.<sup>481</sup> Parties favoring such an approach argue that a standardized benchmarking system, unlike cost-of-service regulation, would result in higher basic rates since it fails to take into account the vast differences in cable operating systems.<sup>482</sup> Montana states that based on its experience the benefits of lower rates and improved customer services associated with cost-of-service regulation would outweigh the cost of such regulation.<sup>483</sup>

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<sup>479</sup> See AdelpiaII Comments at 50-51; Carib Comments at 5; Cole Comments at 24-25; Continental Comments at 35-36; Fairfax Reply Comments at 7; NCTA Comments at 14; Newhouse Comments at 10; Northland Comments at 6; NJ Comments at 7; NYNEX Comments at 4; Prime Comments at 4; SSO Reply Comments at 7-8; USTA Comments at 10-13. Hawaii asserts that the state should have the option of resorting to cost-of-service ratemaking on an individual system basis where either the national or local benchmark produces an unreasonable rate. Hawaii Reply Comments at 1-6.

<sup>480</sup> See, e.g., Baltimore Comments at 8-9; Bowling Green Comments at 9, 14; Carson Comments at 9, 14; Conneaut Comments at 9, 14; Drexel Comments at 9, 14; Key West Comments at 9, 14; McKinney Comments at 9, 14; NewBern Comments at 9, 14; Paducah Comments at 9, 14; Parsippany Comments at 9, 14; Port St. Lucie Comments at 9, 14; St. Petersburg Comments at 11, 15; Salisbury Comments at 9, 14; Williamston Comments at 9, 14. NYNEX and Pactel favor cost-based basic tier rates for cable subscribers and propose that price caps be implemented for subsequent price adjustments. See NYNEX Comments at 4; Pactel Comments at 2.

<sup>481</sup> See CFA Comments at 85-87.

<sup>482</sup> See, e.g., Dennison at 2; Minn. Comments at 10-12; Montana Comments at 2; Randolph Comments at 1-2; Rocky Comments at 3. Although Fall River does not specifically endorse either regulatory approach, it contends that a national benchmark would increase current rates because it would fail to recognize unique differences among cable systems. See Fall River Comments at 2. Media General asserts that it could support a cost-based approach unless the Commission adopts a benchmark that can distinguish between various cable operators. See Media General Comments at 3-4.

<sup>483</sup> Montana Comments at 2.

### iii. Discussion.

185. As we stated in the Notice, under a benchmark approach to rate regulation the Commission would establish a rate, or a simple formula to derive a rate, that would be used to measure the reasonableness of a cable system's per channel prices. Benchmarks permit a ready means of identifying systems with presumptively unreasonable rates, while at the same time defining a zone of reasonableness that can accommodate a range of existing rate levels below the benchmark. As we stated in the Notice, a benchmark could be based on selected industry characteristics. We stated that a benchmark could protect consumers from excessive rates, and, by eliminating the need for detailed cost-based regulation, would keep the costs of administration and compliance low. Thus, a benchmark approach to regulation of basic tier rates holds substantial advantages.

186. Under cost-of-service regulation, by contrast, a cable system's rates would be reviewed using the established standards of cost-of-service regulation traditionally applied to public utilities. As we observed in the Notice, while there are some advantages to cost-of-service regulation, there are significant disadvantages. Cable operators would have little incentive to be efficient, to improve service, or otherwise to make regulated service more attractive to consumers. Cost-of-service regulation also imposes heavy burdens upon regulators and regulatees because of the significant administrative and compliance costs associated with this regulatory model.

187. Based on these considerations, we conclude that we should use a benchmark approach for regulating rates for the basic service tier. The benchmark formula we have developed is based on our analysis of the rates of systems subject to effective competition. Use of this benchmark formula will provide a simple way to ascertain on an individual system basis the extent to which rates exceed the competitive rate level. As such, it achieves our goal of identifying a relatively simple way of determining the reasonableness of cable rates. By comparing the rate derived by applying the benchmark formula to a cable system's current or September 30, 1992 rates, as we explain more extensively below, we determine an initial reasonable regulated rate for each cable system. Thereafter, a price cap mechanism applied to those rates will govern future rate changes. Our rules will, however, additionally permit cable operators to use cost-of-service principles to justify rates that exceed the permitted rates calculated under our benchmark and price cap approach.

188. We believe that among the regulatory alternatives that we could realistically adopt at this time, this model for regulating basic service tier rates will best meet the statutory mandate that we reduce administrative burdens on subscribers,