protect subscribers from unwarranted increases in the rates for cable service on the basic tier, we will reexamine this treatment of retransmission consent fees.[147]

94. System Upgrades. In the Rate Order, we concluded that we should not give external treatment to costs of system improvements.[148] We stated that such expenditures are likely to be significant and, if automatically passed through, could lead to substantially increased rates. We also stated that local authorities should be permitted to carefully weigh the costs and benefits of network improvements. We then held that costs of network improvements could be recovered through cost-of-service showings to the extent they cannot be recovered through rates regulated under the price cap scheme. We stated that we would monitor the effects of treating network improvement costs this way and, if it appeared that this treatment thwarts the development of new technologies and services, would review our decision as necessary.

95. Cable operators urge the Commission to accord external treatment for costs associated with upgrades and other capital improvements.[149] They state that the Commission's benchmark/price cap mechanism does not account for upgrade costs.[150] Thus, they assert, operators will be unable to recover costs of expansion of systems, except through cost of service showings, despite the Commission's stated goal to "permit the continued growth of [cable] services."[151] Comcast argues that requiring operators to recoup such costs only through cost-of-

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[147] Rate Order, at para. 247.

[148] Rate Order, at para. 256, n. 608.

[149] See e.g., Advanced Communications Petition at 4-7; NCTA Petition at 19-21; Discovery Petition at 4-5; Viacom Petition at 4-8; Blade Petition at 6-7; Colony Petition at 4-8; Comcast Petition at 3-8. See also Corning Petition at 20.

[150] Advanced Petition at 4; Viacom Petition at 9. Discovery states that the benchmark was based only on a snapshot of rates charged by systems, and did not take into account once-a-decade capital expansions. Discovery Petition at 5.

[151] Comcast Petition at 2, citing Rate Order, at para. 9. Comcast observes that cable television has undergone tremendous growth since the 1984 Act, but argues that the current benchmark/price cap mechanism, as described in the Rate Order, will stifle continued expansion. Comcast Petition at 5-6. Corning states that future investments in system expansions are necessary to achieve increased diversity and quality of programming. Corning Petition at 20.

service showings is an untenable option, such that operators may choose not to undertake upgrade expansions at all.[152] These parties suggest that we permit upgrade costs to be treated externally, subject to evaluation by the local authorities.[153]

96. Other petitioners support the current treatment of cable system upgrade costs, as described in the Rate Order.[154] These petitioners argue that cable operators should not be permitted to recover these costs externally from the benchmark/price cap mechanism because upgrade costs are reflected in the survey data on which the benchmark formula is based. In particular, they note that systems which upgraded their plant and operations prior to September 30, 1992 were sampled in the survey and the rates resulting from such upgrades are represented in our benchmark approach. Thus, these commenters claim, permitting external treatment for such costs would result in operators' double-recovery of upgrade costs.[155] They also contend that these costs are within the control of operators because, unless required by regulators or authorities, the final decision whether

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[152] Advanced Petition at 4; Viacom Petition at 9.

[153] Comcast Petition at 10-11. See also Corning Petition at 20. Comcast proposes requiring operators to notify franchising authorities at least 60 days before any pass-throughs of costs for system expansions are charged to subscribers, and to provide the authorities with cost justification for these additional charges. Comcast then suggests various time periods during which the authority would have to review the operator's showing, and for the parties to negotiate. Comcast Petition at 10-11. NATOA agrees that, if such costs are accorded external treatment, local authorities should be permitted to review plans for system expansions. However, NATOA suggests that conflicts between operators and local authorities may arise over whether lesser system improvements qualify as an "upgrade" for purposes of external treatment of their costs. NATOA Petition at 13. Viacom, however, believes that operators must be completely free to expand programming offerings through system expansions as they see fit, without review by local authorities. Viacom opposes permitting local franchising authorities to pass on operators' upgrade plans because such review is not provided to local authorities within the 1992 Cable Act. Viacom Petition at 7-9.

[154] See e.g. NATOA Opposition at 12-13; GTE Opposition at 12-15; BellSouth Petition at 3-8.

[155] NATOA Opposition at 12.

to expand the system naturally rests with the cable operator.[156] NATOA argues that permitting external treatment for upgrade costs may not be in the public interest because only a few subscribers may receive the benefits related to a system expansion whose costs will be subsidized by all subscribers.[157] GTE argues that if the substantial costs associated with system expansions are permitted to be passed-through directly to subscribers, cable systems will have no incentive to make only prudent investments in plant and equipment.[158] BellSouth is concerned primarily that permitting operators to pass-through upgrade costs will allow them to recoup the costs of establishing new non-regulated services, such as two-way communications services, within the rates for regulated services.[159]

97. As stated in the Rate Order, upgrade costs can be significant and could substantially affect cable rates. After reviewing the petitions for reconsideration, we continue to believe that such costs should be evaluated using cost-of-service principles, and should not simply be passed through to subscribers where local franchise authorities have the opportunity for only a cursory review.[160] System upgrades will normally involve capital expenditures that will be recovered over a number of years. A determination of the appropriate recovery of such costs, including a fair rate of return and the proper allocation of costs to regulated and unregulated services, necessarily involves cost-of-service issues. Accordingly, we believe that establishment of any external treatment for upgrade expenditures should await adoption of cost-of-service standards that can then govern any external treatment of such costs. In

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[156] NATOA argues further that operators should not receive favorable treatment regarding upgrade costs just because their voluntary decision to expand the system is reduced to a binding covenant within a franchise agreement. NATOA Petition at 13. See also GTE Opposition at 14.

[157] NATOA Petition at 13.

[158] GTE Opposition at 14-15.

[159] BellSouth Opposition at 5-6.

[160] We note, however, that passing-through upgrade costs may well be appropriate where such upgrades are required under the franchise. Local authorities presumably are in a position to weigh the potential impact of any cost increases on subscribers at the time they require system changes. See e.g., Communications Act, Section 623(b)(4), 47 U.S.C. Section 543(b)(4). We thus seek comment on whether operators should be permitted to pass through as external costs upgrades required by local franchise authorities. See paras. 153-154, supra.

the Cost-of-Service Proceeding we are also examining streamlined treatment of upgrade costs. If adopted, this could provide a treatment of upgrade expenditures substantially similar to external treatment. We therefore will address in that proceeding whether and how we might establish external treatment for upgrade expenditures. Also, if the upgrade involves a change in the number of channels offered, we are continuing to examine methodologies to take into account the increased costs.[161] In the interim, operators seeking to recover such costs may do so through a cost-of-service showing.

98. Costs of Franchise Requirements. The Cable Act of 1992 requires that in setting basic service rates, we take into account the reasonably and properly allocable portion of, *inter alia*: 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 the costs of any public, educational, and governmental access programming required by the franchising authority. The regulatory framework for regulation of cable service adopted in the Rate Order took these costs into account in part by providing that the costs of satisfying franchise requirements, including the costs of satisfying franchise requirements for local, public, educational, and governmental access channels, would be accorded external cost treatment.[162] We stated that these costs are largely beyond the control of the cable operator, and should be passed on to subscribers without a cost-of-service showing.[163]

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[161] See paras. 133-144, *infra*.

[162] The Cable Act of 1992 requires that our rate regulations for the basic service tier include standards to identify costs that are attributable to satisfying franchise requirements to support public, educational and governmental channels, to the use of such channels or to any other services required under franchise. Communications Act § 623(b)(4), 47 U.S.C. § 543(b)(4). In the Rate Order, we determined that the costs attributable to satisfying franchise requirements shall include:

> 1) the sum of per channel costs for the number of channels used to meet franchise requirements for public, educational, and governmental channels; 2) any direct costs of providing any other services required under the franchise; and 3) a reasonable allocation of overhead.

[163] The accounting and cost allocation rules adopted in the Rate Order require that costs associated with PEG channels carried on the basic tier be directly assigned to the basic tier where possible, and that remaining costs of taxes and costs of satisfying franchise requirements be allocated between or among tiers in

99. On reconsideration, municipalities generally urge the Commission to define narrowly the scope of costs of franchise requirements that cable systems will be permitted to pass-through directly to subscribers as external costs.[164] King County contends that franchise-related costs are not beyond the control of operators in that cable systems bargain actively with authorities over long periods of time over these requirements. Michigan Communities warns the Commission that operators will attempt to turn the Commission's price cap into a "price floor" by characterizing most major franchise-related costs as external costs.[165] It is concerned that operators will attempt to force authorities to permit operators to characterize anything in a new franchise agreement as a franchise requirement entitled to pass-through treatment.[166] It states that operators will seek external cost treatment for all new standards required of operators by law, including customer service standards, technical standards, SEC requirements, local zoning laws, social security payments, and any other legal requirement tightened since the last franchise agreement.[167] NATOA urges the Commission to define the term "costs of franchise requirements" to include only direct and verifiable monetary costs specifically enumerated by a dollar amount in a franchise agreement to satisfy franchise requirements imposed by the authority.[168] In addition, NATOA believes that the Commission should not accord external treatment to franchise-related costs that operators currently provide on a voluntary basis such as customer service-related costs that many operators incur in voluntarily complying with minimum service standards adopted by NCTA.[169] NATOA also argues generally that it is unfair

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proportion to the number of channels on each tier.

164 See e.g., Michigan Communities Opposition at 14-18; NATOA Petition at 4-9; King County Petition at 3-9.

165 Michigan Communities Opposition at 14.

166 Michigan Communities Opposition at 16. Petitioner states that operators have told its member communities that any new customer standards described in a franchise agreement, even those just codifying the operator's current customer service practices, must be treated as a franchise requirement. Id.

167 Michigan Communities Opposition at 16.

168 NATOA Petition at 4. In addition, NATOA argues that, in order to prevent operators from overestimating their costs, operators should be required to spread the costs of satisfying franchise requirements over the franchise term. Id. at 4-5.

169 NATOA Petition at 5-6.

to allow operators to pass-through costs they may currently incur, such as costs incurred to comply with the Commission's recently adopted customer service standards.[170]

100. Cable operators, on the other hand, generally argue that external treatment of franchise-related costs appropriately allows them to recover the costs of items required by local authorities in exchange for franchises, and that such costs are largely under the control of local authorities.[171] NCTA contends that there is no justifiable distinction between franchise-related costs specifically enumerated by a dollar amount within a franchise agreement and those requiring in-kind expenditures. NCTA states that NATOA misunderstands current Commission rules, which permit the pass-through only of increases in external costs that exceed the GNP-PI.[172] Continental asserts that certain costs, particularly PEG access channels and institutional networks, should be treated externally from the price cap because these are clearly traditional franchise requirements.[173] Continental further objects to permitting local authorities to exclude overhead for PEG access channels and requiring operators to spread franchise-related costs over the franchise agreement term. Continental notes that it has expended tremendous funds for customer service; thus, it believes that it should be permitted to recover at least increases in these costs due to new government standards, as permitted under the Commission's current rules.[174]

101. We believe that the scope of costs that are eligible for external treatment as costs of satisfying franchise requirements should be guided by the statutory language indicating that our regulatory framework for the basic service

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[170] NATOA Petition at 5. See Implementation of Section 8 of the Cable Television Consumer Protection and Competition Act of 1992, Rate Order, MM Docket No. 92-263 (1993).

[171] See generally NCTA Opposition at 6-9; TKR Petition at 1-7; Cablevision Opposition at 3-5; Continental Petition at 9-14.

[172] NCTA Opposition at 8-9.

[173] Continental Petition at 11. In addition, Continental accuses municipalities of imposing unreasonable requirements in some instances, such as reimbursement of consulting fees, "renewal application fees," demand for multiple access channels, access studios, training and personnel, restoring St. Paul, Minnesota's Union Depot and other sites for redevelopment purposes, institutional networks, and emergency alert systems. Continental Petition at 10.

[174] Continental Opposition at 14-15.

tier should take such factors into account.[175] Thus, such costs include the costs 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 the costs of any public, educational, and governmental access programming required by the franchising authority.

102. This statutory language should be interpreted in a way that will produce equitable results for operators and subscribers. We believe that this objective will be met by providing that only increases in the costs of complying with services specifically required in the franchise documents will be eligible for external treatment. This will permit local authorities and individual systems to work cooperatively to establish the costs of meeting franchise requirements that will be accorded external treatment. If specifically required by franchising authorities, however, we believe that costs of meeting such requirements should be accorded external treatment. This will include meeting technical and customer service standard requirements that exceed the federal standards and potentially upgrade requirements.[176] The costs of simply complying with federal customer service and technical standards, however, will not be treated as external costs. We believe that this approach will be fair to operators by assuring that they can recover costs of meeting local requirements.

103. Taxes. The Cable Act of 1992 requires the Commission in establishing regulations governing rates for the basic service tier to take into account, inter alia, the reasonably and properly allocable portion of taxes and fees imposed by any state or local authority on transactions between cable operators and subscribers, and assessments of general applicability imposed by a governmental entity applied against cable operators or cable subscribers.[177] In the Rate Order, we determined that we met the statutory directive to take general assessments into account by providing for a general inflation

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[175] In order to assure that our regulations will generally produce tier neutral results, we determine that this language will also guide any franchise requirements for cable programming services tiers.

[176] As noted previously, we believe it may be appropriate to accord external treatment to upgrade costs required by a franchise agreement. See n. 160, supra. We are seeking further comment below on this possible approach. See paras. 153-154.

[177] See Communications Act, Section 623 (b)(2)(C)(v), 47 U.S.C. § 543 (b)(2)(C)(v). As explained in the Rate Order, we determined that we should establish the same rate regulation requirements for the basic and cable programming services tiers.

adjustment to capped rates that could be expected to recover increases in such costs.[178] We met the statutory directive to take into account taxes imposed directly on the provision of cable television service by providing for external treatment of these taxes under our benchmark/price cap requirements.[179] Thus, our rules provide that increases in state and local taxes applicable to the provision of cable television service are external costs and may be passed-through to subscribers without a cost-of-service showing.[180]

104. On reconsideration, several petitioners request that we afford external treatment to certain California taxes that are imposed on cable operators in that state. Specifically, these parties ask that the California possessory interest tax be treated as an external cost for purposes of the initial rate benchmarks and future rate increases.[181] They argue that while this levy is not an industry-specific tax, it is nevertheless assessed in a unique manner against cable operators that warrants external cost treatment under Section 76.922 (d)(2)(i)(A) of our rules.[182] In this regard, they describe the tax as being

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[178] Rate Order, at para. 254.

[179] Rate Order, at para. 254.

[180] See 47 C.F.R. § 76.922 (d)(2)(i)(A). The opportunity to base rates on a cost-of-service showing also takes these costs into account independent of our price cap and external cost provisions. We note also that in the cost-of-service Notice, we proposed to allow, in determining a cable operator's annual expenses, "taxes incurred in the provision of regulated cable services." See Notice of Proposed Rulemaking, in MM Docket No. 93-215, FCC 93-353, released July 16, 1993.

[181] See California Cable Television Association (CCTA) Petition at 3-5; Colony Communications Petition at 12-13; Intermedia Partners Petition at 3-5; Continental Cablevision Petition at 10-12; Booth American Petition at 20. Petitioners also seek to have these taxes itemized on subscriber bills. We will address this itemization issue in the next reconsideration order.

[182] CCTA also requests external cost treatment for possessory interest and utility user taxes with respect to the initial benchmark rates. We note that the Rate Order only provided for external cost recovery of increases in taxes on a going forward basis. This is because the existing level of taxes is already accounted for in the benchmark, which is based on rates charged by systems in an unregulated marketplace. If these taxes place a disproportionate burden on California cable systems with respect to the initial benchmark rates, operators can make the appropriate

different from a generally applicable property tax that would be accounted for in the GNP-PI adjustment.[103] Furthermore, they explain that it is a significant tax outside the control of cable operators.[104] One petitioner also requests similar external treatment for the California utility user tax.[105] The utility user tax is described as a local tax on customers of California utilities and cable television service.[106]

105. Our rule concerning external treatment of taxes is formulated to encompass only taxes imposed by state or local authorities on transactions between cable operators and cable subscribers; taxes of general applicability applied against cable operators and subscribers are to be recovered through the inflation adjustment to capped rates. This approach is narrowly tailored to protect consumers while assuring that cable operators may recover special taxes applicable to the provision of cable television service.

106. Based on the record before us we are unable to conclude that the California possessory interest tax is, in every instance, the type of tax that is entitled to be passed through to subscribers separately and specifically, rather than accounted for and recovered as part of the GNP-PI inflation adjustment. However, we do not disagree with petitioners that such taxes may be entitled to external treatment on a going forward basis where

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cost-of-service showing to obtain individual consideration of these taxes.

[103] CCTA assumes that Section 76.9229 (d)(2)(i) was meant to subsume within the category of allowable external costs both types of taxes referenced by the 1992 Cable Act, that is, both those imposed on "transactions between cable operators and cable subscribers" and those of general applicability but "applied against cable operators or cable subscribers." CCTA Petition at 3-4.

[104] See, e.g., CCTA Petition at 5-8.

[105] See CCTA Petition at 3.

[106] CCTA indicates that this local tax is calculated as a percentage of a subscriber's monthly bill charges, which ranges from three to eleven percent, depending on the jurisdiction. CCTA states that this tax is applied to cable television customers in almost 50 California franchises, but admits that it is also applied to users of gas, electric, water and telephone services. CCTA claims, however, that it is a tax "imposed on" or "applicable to" the "provision of cable television service," since like franchise fees, it is based on customer revenues for the receipt of service. See CCTA Petition at 5.

they are in fact, as CCTA suggests, "in essence and effect" taxes on "transactions between cable operators and cable subscribers." Whether or not they are entitled to this treatment is dependent on the manner of assessment.

107. As CCTA indicates, the proper assessment technique has been the subject of ongoing litigation in California and it appears that different jurisdictions within the state have chosen to apply the tax in different ways so that in some situations the levy may be applied in a common fashion to cable and other businesses whereas in other situations cable may be subject to a relatively unique assessment process. As CCTA's own data indicate, for some systems the levy is nominal in amount and in others it is much more significant. Where the assessment is very directly related to subscriber revenues, such as where the tax is based on a value of intangible assets formula effectively calculated from the operator's income for the provision of cable service, then such a tax should, we believe, be treatable as a cost subject to "external treatment" on a going forward basis. Where this is not done and the assessment process is not different for cable and other business, we would expect this tax to be one of the costs to be accounted for under the inflation adjustment process. This result is, we believe, consistent with the statutory provisions mandating that our regulations take into account taxes imposed on system operators. Such taxes are clearly beyond the control of the system operator and this process should both avoid unnecessary cost of service showings and create a measure of accountability for the costs imposed.[187]

108. Limitations on External Treatment of Costs of Affiliated Programming. In the Rate Order, we indicated that the pass-through of increases to the program services of affiliated programmers is limited to the lesser of the annual incremental percentage increase in such costs or the GNP-PI. We defined affiliated programmers in the same manner as they are defined for purposes of the program access rules.[188] We indicated that we

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[187] Utility taxes in California and in other states do not appear to create this unique problem. We would, however, be prepared upon an appropriate demonstration to accord them external treatment as well where their application to cable can be demonstrated to be consistent with the underlying policy of the rules. We are not, however, prepared in this proceeding to rule on the California or other utility taxes specifically.

[188] See Rate Order, at para. 252 n. 601. Specifically, we determined that an affiliated programmer is a programmer with an ownership interest of 5 percent or more in a cable operator including general partnership interests, limited partnership interests, direct ownership interests and stock interests in a corporation where such stockholders are officers or directors who

took this approach with respect to affiliated programming out of concern about the abuses that might occur if we were to permit vertically integrated cable operators to engage in unlimited pass-throughs of programming costs to their subscribers.[189]

109. Subsequently, in the Cost-of-Service NPRM, we offered for comment a proposal to replace the cap on affiliated programming increases with affiliate transaction safeguards that would prevent cable MSOs from imposing unreasonable programming costs on regulated cable subscribers.[190] As a possible safeguard, we proposed to prescribe the methodology for determining the value of such costs that could be recovered in regulated cable service rates. In particular, we asked whether we should require cable operators to record affiliate transactions at prevailing company prices offered in the marketplace to third parties, whenever the supplying affiliate has established such prices, or at fair market value.[191]

110. Cable operators and programmers contend that the cap of affiliated programming increases will adversely effect the cable programming marketplace. They argue that cable systems will not want to absorb affiliated program increases and will therefore either drop such services or will offer them a la carte. In either case, they claim that subscriber programming choice will suffer.[192] Affected affiliated programmers, they

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directly or indirectly own 5 percent or more of the outstanding stock, whether voting or nonvoting. See also First Rate Order, in MM Docket No. 93-265, 8 FCC Rcd 3359, 3370 (1993).

[189] Rate Order, at para. 252.

[190] See Notice of Proposed Rulemaking in MM Docket No. 93-215, FCC 93-353, released July 16, 1993, 58 F.R. 40761 (July 30, 1993) ("Cost-of-Service NPRM"). The proposed affiliate transaction rules would encompass all affiliate transactions between the regulated and nonregulated portions of cable systems, as well as transactions that occur between regulated and nonregulated portions of the same cable company (e.g., intracompany transfers). Id. at para. 67 and n. 67.

[191] Id. at paras. 67-69. We note that initial comments were due August 25, 1993 and reply comments are due September 14, 1993 in response to the cost-of-service Notice.

[192] See, e.g., Affiliated Regional Communications, Inc. petition at 12-13 (hereinafter "ARC Petition"); Black Entertainment Television petition at 3-4 National Cable Satellite Corporation petition at 2-4 (hereinafter "NCSC Petition"); Cablevision Systems Corporation petition at 18-20 Turner Broadcasting System, Inc. petition at 3-5.

point out, would include entities that provide regional sports programming, minority entertainment programming and non-profit, public affairs programming (i.e., C-SPAN).[193] They also believe the restriction will hurt the ability of affiliated programmers to compete with nonaffiliated program services and will discourage investment in the development of new, high quality program services.[194] They further assert that many innovative program services exist today because cable MSOs were willing to invest in their services at critical stages of development.[195]

111. Petitioners also challenge the need for such a restriction and argue there is no evidence in the record to support adoption of such a rule.[196] They regard the Commission's cost-shifting concerns as theoretical. In practice, under the new regulatory regime, they believe cable MSOs will be more concerned with increasing subscribership than with obtaining any marginal benefit from unreasonable cost-shifting.[197] Some

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[193] See ARC Petition at 11-12 (regional sports network); BET Petition at 9-11 (minority entertainment programming); NCSC Petition at 2-4 (non-profit, public affairs programming). If a cap on affiliated programming is retained, both BET and NCSC request that the Commission exempt program services with their particular characteristics (i.e., minority and non-profit, non-stock program services) from the restriction. Id.

[194] See, e.g.,Cablevision Systems Petition at 18-20; BET Petition at 10-11; ARC Petition at 13, 16-17. Continental Cablevision argues that the rule effectively caps an affiliated program channel in its start-up years at a rate slightly below inflation, at a time when advertising dollars are most difficult to obtain. See Continental Cablevision, Inc. petition at 9-10.

[195] See, e.g., E Entertainment Television petition at 5.

[196] In this regard, a number of parties argue that the Commission instituted its affiliated programming restriction without adequate notice and comment as required by the Administrative Procedures Act, 5 U.S.C. § 553, since the rate regulation Notice did not specifically include such a proposal regarding pass-through treatment of affiliated program services. See BET Petition at 4-8; Cablevision Systems Petition at 21-22; Continental Petition at 9.

[197] Cablevision Systems argues that cable MSO operators will resist inflated programming prices from an affiliated programmer if, as a result, they will lose subscribers. They further claim that the benefits that could accrue to a vertically integrated cable MSO from engaging in discriminatory cost-shifting are quite attenuated, since ownership in program services is frequently shared by third parties. Cablevision Systems Petition at 17-18 and

petitioners also assert that the Commission's program access rules, and other rate evasion measures provided for under the 1992 Cable Act, adequately protect against any objectionable cost-shifting behavior without the need for a limit on the recovery of affiliated programming costs.[198]

112. Petitioners propose several different approaches to the treatment of affiliated programming costs. For example, Turner Broadcasting suggests that we only apply our affiliated programming pass-through restriction in cases where there is evidence of discriminatory pricing to affiliated systems and when a program service is primarily distributed to affiliated cable systems.[199] On the other hand, Discovery Communications requests that we allow complete external recovery of all programming cost increases above GNP-PI, regardless of affiliation.[200] Other petitioners suggest that we adopt some sort of transactional safeguards similar to the proposal in the Cost-of-Service NPRM. TCI, Colony Communications and Liberty Media suggest that we allow cable operators to use prevailing company prices, if offered in the marketplace to third parties, to determine programming costs that may be passed-through.[201] Another proposal by Viacom International would permit cable operators to pass-through as affiliated programming costs at least the average increase in nonaffiliated programming expense experienced by

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n. 35.

[198] For example, BET asserts that the FCC's program access rules do not permit programming cost differentials based solely on whether a cable operator is owned by an affiliated MSO. BET Petition at 8-9. See also Booth American Company Petition, at 22; Cablevision Systems Petition at 19-20; E Petition at 4 and n.4

We also note that at least one petitioner criticizes our use of the program access attribution standard for determining whether a program service is affiliated to a cable system. Specifically, Liberty Media Corporation asserts that an operator with only a 5 percent nonvoting or limited partnership interest in a programmer cannot control the programmer's operational decisions when 100 percent of its voting stock is held by third parties. Liberty Media Corporation Petition, at 15-16.

[199] See Turner Petition at 2. Turner also seeks pass-through treatment of costs that constitute bona fide loan payments or return of capital to investors of program services. Turner Petition at 6.

[200] See Discovery Communications, Inc. Petition, at 3.

[201] See TCI Petition, at 23-24 Colony Communications, Inc., Petition, at 11-12; Liberty Media Petition at 17-18.

systems of comparable size without a GNP-PI cap.[202] Telephone companies and municipalities support our treatment of affiliated programming and generally oppose any further expansion of our external cost categories.[203]

113. Where rate regulated industries have the ability and incentive to recover costs of unregulated activities from regulated service subscribers, we traditionally have established safeguards to prevent such improper cost shifting.[204] Accordingly, we conclude that we should maintain in place some type of safeguard.

114. However, we are persuaded by petitioners that a cap on affiliated programming charges could limit operators' ability to recover otherwise fair increases in the costs of programming

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[202] Viacom International, Inc. Petition, at 12.

[203] See Bell Atlantic Petition, at 3-4; GTE Service Corporation Petition, at 15 See also King County Petition, at 3-6 (alleging cable operator's have substantial bargaining power to control programming costs); NATOA, Opposition at 10-14 (arguing against additional external cost categories that would undermine the benchmark scheme).

[204] Amendment of Section 64.702 of the Commission's Rules and Regulations, CC Docket No. 85-229, Phase I, Report and Order, 104 FCC 2d 958 (1986) (Phase I Order), reconsideration, 2 FCC Rcd 3035 (1987) (Phase I Reconsideration Order), further reconsideration, 3 FCC Rcd 1135 (1988) (Phase I Further Reconsideration), second further reconsideration, 4 FCC Rcd 5927 (1989) (Phase I Second Further Reconsideration), Phase I Order and Phase I Reconsideration Order vacated sub nom. Illinois Bell Telephone Co. v. FCC, California v. FCC, 905 F.2d 1217 (9th Cir. 1990), Phase II Order, CC Docket No. 85-229, Phase II, 2 FCC Rcd 3072 (1987), recon., 3 FCC Rcd 1150 (1988) (Phase II Reconsideration Order), further recon., 4 FCC Rcd 5927 (1989) (Phase II Further Reconsideration Order), Phase II Order vacated sub nom. California V. FCC. 905 F.2d 1217 (9th Cir. 1990) ; Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, CC Docket No. 90-623, 6 FCC Rcd 7571 (1991) (BOC Safeguards Order), pets. for recon. pending, pets. for review pending, California v. FCC, No. 92-70083 (9th Cir. filed February 14, 1992); Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities & Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Transactions Between Telephone Companies and Their Affiliates, CC Docket No. 86-111, 2 FCC Rcd 1298 (1987) (Joint Cost Order), recon., 2 FCC Rcd 6283 (1987), further recon., 3 FCC Rcd 6701 (1988), aff'd sub nom., Southwestern Bell Corporation v. FCC, 896 F.2d 1378 (D.C. Cir. 1990).

that exceed inflation.[205] As we indicated in the Rate Order, we attach great importance at this stage of rate regulation to the continued growth of programming. On balance, we thus believe that we should adopt an initial regulatory approach that is somewhat more liberal in permitting external treatment of affiliated programming costs. Specifically, we will replace the cap on affiliated programming costs with affiliate transaction requirements of the type proposed by some petitioners and additionally proposed in the Cost-of-Service NPRM.[206] Cable operators may pass-through the costs of affiliated programming that exceed inflation as long as the price charged to the affiliated system reflects either prevailing company prices offered in the marketplace to third parties (where the affiliated program supplier has established such prices) or the fair market value of the programming.[207] We are amending Section

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[205] C-SPAN has raised the additional point that, while it may be considered to be vertically integrated, it operates as a not-for-profit and necessarily reinvests all revenues received from system operators directly in its own programming operation. This provides an additional ground for reconsidering the affiliated programming limitation with respect to C-SPAN and similarly structured entities.

[206] Some petitioners suggest that the Commission's cost-shifting concerns are unwarranted since the program access rules generally preclude dramatic price differentials between programming sold to both affiliated and nonaffiliated cable systems. However, the program access rules apply only to satellite delivered programming. In addition, the programming access restrictions are not specifically tailored to rate regulation requirements. Accordingly, we will not rely on the program access restrictions as safeguards against unreasonable affiliated programming pass-throughs, or model our affiliated programming safeguards on them.

[207] Cost-of-Service NPRM, at paras. 67-69. TCI seeks clarification of an inconsistency in the Rate Order and the federal register summary. Specifically, the Rate Order states that "programming costs attributable to the program services affiliated with such systems will be capped at the lesser of the annual incremental percentage increase in such costs or GNP-PI." Rate Order, at para. 252. However, the federal register summary states that "programming costs for programming obtained from affiliated entities [is limited] to the percentage change in the admissions component of the Consumer Price Index between the effective date of the price increase and the date the previous price took effect." 58 Fed. Reg. 29736, 29743 (1993). Use of the CPI in the federal register summary was erroneous. However, TCI's concern is now moot since we are today deciding to treat affiliated and nonaffiliated programming the same with respect to measurement of the increased costs we will allow to pass-through. Specifically, we will require

76.922(d)(2)(vi) to reflect this change.[208] We will further examine this issue based on the record obtained in the Cost-of-Service Proceeding and we may refine these requirements in that proceeding, if necessary.[209]

115. We will not modify the attribution standard for identifying affiliated programming services as was suggested by

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adjustments to per channel charges on account of increases in costs of programming obtained from affiliated or nonaffiliated programmers to the extent such increases are greater or less than the GNP-PI for the relevant period. Per channel charges may not be increased if programming costs increase at a rate less than inflation. Permitted per channel charges also shall be decreased to the extent such affiliated or nonaffiliated programming costs decrease from previous levels. See 47 C.F.R. 76.922 (d)(2).

NATOA urges clarification of a similar matter with respect to the inflationary measure of affiliated programming cost increases. In particular, NATOA claims the language of our rule (Section 76.922 (d)(2)(vi)) suggests that a cable operator is permitted to impose as an "external cost" any increase in affiliated programming costs up to the percentage rate increase on overall cable service permitted by the GNP-PI. NATOA states that such treatment is better than that afforded nonaffiliated programming, since a cable operator can only recover increases in nonaffiliated programming to the extent they "exceed inflation." NATOA Petition at 41. In light of our discussion above, we believe NATOA's concerns are also now moot.

208 See Appendix A.

209 We also retain jurisdiction of this issue on reconsideration in this docket. We may later address this issue on subsequent reconsideration decisions in this docket. With respect to the APA argument raised by some petitioners (i.e., that we did not provide an opportunity to comment on our affiliated program pass-through proposal), we find these concerns moot. In the Notice, we specifically sought comment on the appropriate ratemaking treatment of "price changes caused by factors outside the operators control" including "increases in...programming costs." Notice, 8 FCC Rcd at 83. This satisfied the APA requirement that an agency give notice of "either the terms or substance of the proposed rule or a description of the subjects and issues involved." 5 U.S.C. 553 (b)(3). Addressing the sub-issue of affiliate relationships regarding programming costs is well within the scope of the Notice. See para. 16-17, supra. Moreover, the particulars of this revised approach will be refined in the cost-of-service proceeding, where parties will have a further opportunity to comment on the matter.

Liberty Media.[210] We find that use of the 5 percent attribution standard that was adopted in the program access proceeding is appropriate for determining when our affiliate transaction requirements described above should come into play.[211] This measure of affiliation will capture most instances in which ownership relationships between programmers and cable systems could create incentives to pass through excessive costs to cable subscribers. Also, this relatively inclusive attribution standard is warranted in light of our decision to allow the pass-through of reasonable affiliated programming cost increases above the rate of inflation. As with our affiliated programming limitations generally, we may further examine this ownership affiliation standard in the Cost-of-Service Proceeding.

2. Starting Date for External Cost Treatment

116. In the Rate Order, we determined that for all categories of external costs, other than franchise fees and retransmission consent fees,[212] changes in external costs shall be measured from the date on which the system becomes subject to regulation, or 180 days from the effective date of our

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[210] See Liberty Media Petition, at 15, n.6.

[211] In addition to the program access proceeding, the Commission has decided in other contexts that a 5 percent equity interest is an appropriate threshold for determining the point at which ownership in a publicly traded entity may create the potential for influence or control. See, e.g., Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Notice of Inquiry, 2 FCC Rcd 5092 (1987), Further Notice of Inquiry and Notice of Proposed Rulemaking, 3 FCC Rcd 5849 (1988), Further Notice of Proposed Rulemaking, First Report and Order, and Second Further Notice of Inquiry, 7 FCC Rcd 300 (1991), recon., 7 FCC Rcd 5069, appeal pending sub. nom., National Cable Television Assoc., Inc. v. FCC, No. 91-1649 (D.C. Cir. filed Dec. 26, 1991), Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, 7 FCC Rcd 5781 (1992), pets. for recon. pending, appeal pending sub. nom., Mankato Citizens Telephone Co. v. FCC, No. 92-1404, (D.C. Cir. filed Sept. 9, 1992).

[212] Rate Order, at para. 255. The benchmark rate level derived from the Commission's survey data has been adjusted to remove franchise fees. Thus, the total amount of franchise fees will be accorded external treatment at the time the system becomes subject to regulation, rather than only the amount of additional franchise fees incurred after that date. Rate Order, at para. 256.

regulations, whichever occurs first.[213] Any changes in external costs occurring prior to that date, including those since September 30, 1992, will not be accorded external treatment. For those systems whose base rate is determined by reference to September 30, 1992 rates, the Commission determined that the permitted rate will be calculated by adjusting rates as of that date forward only for inflation until the date of regulation or 180 days from the effective date of regulation, whichever occurs first. We recognized that precluding external treatment for cost increases over this initial period may unnecessarily encourage cost-of-service showings by those operators who have experienced high external costs during the interim. However, we stated that this approach will save operators the burden of identifying external costs since September 30, 1992.[214] We determined that this approach, instead of permitting addition of external costs from September 30, 1992, would best balance administrative practicality against permitting operators the opportunity automatically to recover external costs.[215]

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[213] The initial date of regulation of the basic tier is the date of local notice that the cable system is subject to regulation. The initial date of regulation of the cable programming services tier will be the date on which a valid complaint is filed with the Commission concerning any cable programming services tier. Rate Order, at para. 255 n. 607; 47 C.F.R. Section 76.922(d)(iv). In the Rate Order, we recognized the likelihood that the initial dates of regulation for the two tiers of cable service may differ, resulting in different initial permitted rates due to different adjustments for inflation and external costs. We stated, however, that these initial dates of regulation should not differ significantly because we anticipate receiving certification forms and complaints concerning the same cable system largely simultaneously. Thus, the initial permitted per-channel rates for the tiers of service should not differ substantially. We stated that differing starting dates for external treatments of cost increases would not undermine our policy of tier neutrality. Rate Order, at para. 255, n. 607.

[214] Id. at 255.

[215] In the Rate Order, para. 255, we observed that only allowing an inflation adjustment from September 30, 1992 until the initial date of regulation may unnecessarily encourage cost-of-service showings by cable operators who experienced high levels of costs in the interim. Our starting date requirements for external costs strike a reasonable cut-off for the inflation adjustment since September 30, 1992 for those operators who do not become subject to regulation until substantially into the future by providing that they may recover actual external cost increases after 180 days from September 1, 1993.

117. Several cable operators object to the starting date for external treatment of costs established in the Rate Order.[216] These commenters argue generally that this approach creates a "gap" period of between one year and 18 months, during which increases in external costs above inflation incurred may never be recovered.[217] Thus, these parties contend that initial benchmark-determined rates may not be compensatory.[218] Discovery argues that the starting date for external cost treatment established in the Rate Order may not serve the public interest goal of expanding cable service because many operators may hesitate to incur certain external cost increases prior to the initial date of regulation, such as programming costs associated with additional channels.[219] These commenters generally favor eliminating the "gap" by establishing a single date on which external treatment of appropriate cost increases may begin, e.g., October 1, 1992,[220] or the effective date of our rules.[221]

118. Under our starting date for external cost treatment, cable operators whose rates are determined by reference to September 30, 1992 rates will be permitted to adjust those rates forward by inflation to the initial date of regulation, or 180

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[216] Discovery Petition at 6-7, and Reply at 9; Colony Petition at 13; Viacom Petition at 14; Blade Petition at 8; Booth Petition at 19; NCTA Opposition at 10; USA Opposition at 6-9.

[217] In light of the Commission's Order advancing the effective date of these rules from October 1, 1993 to September 1, 1993, Order, FCC 93-372 (released July 27, 1993), the earliest possible date of regulation of the basic tier will be October 1, 1993, and of the cable programming services tier will be September 1, 1993. The latest possible date for external treatment of appropriate cost increases on any tier thus will be March 1, 1994.

[218] Discovery Reply at 9. As Booth notes, this can also affect future rates because the initial rate represents the base rate for future adjustments for inflation. Booth Petition at 19.

[219] Discovery Petition at 6-7.

[220] Viacom Petition at 14.

[221] USA Opposition at 6-9; Discovery Reply at 9; Blade Petition at 8. NATOA also urges the Commission to adopt a single date on which regulation of all tiers of cable service will begin, namely, the earlier of the dates on which regulation of any tier would begin under our current rules. However, NATOA is primarily concerned with ensuring that future rate increases on any tier would be subject to the price cap formula, and does not address this suggestion in the context of external costs. See generally NATOA Petition at 36-38.

days from the effective date of our regulations, whichever occurs first, and thereafter may recover increases in external costs. Increasing rates by a general measure of inflation should, on average, permit most cable operators to roughly approximate increases in costs since September 30, 1992. In any event, operators whose costs have increased more than inflation may attempt to recover the costs experienced since September 30, 1992 through a cost-of-service showing. Requiring or permitting external cost treatment through the benchmark process since September 30, 1992 may provide a more accurate measure of external costs for most cable operators but would entail considerably more administrative burden on operators and regulators. In particular, such an approach would entail detailed identification of costs back to that time. In addition, because regulation will be taking place on a tier basis, it would be necessary to track changes in external costs on a tier basis and account for service restructuring and retiering that may have occurred since that time. It would also be necessary to apply our cost accounting and cost allocation requirements back to September 30, 1992. We believe that the administrative difficulties involved in establishing September 30, 1992 as the starting date for external cost treatment outweighs any greater accuracy involved. Accordingly, we will retain the starting date for external costs established in the Rate Order.

3. Frequency of rate adjustments based on increases or decreases in external costs.

119. In the Rate Order, we provided for an annual inflation adjustment to capped rates.[222] We also have indicated in response to formally submitted questions that cable operators should file rates increases no more than once per year.[223]

120. Cable operators argue that permitting rate adjustments based on legitimate changes in external costs only once per year unfairly burdens operators by forcing them to absorb these costs until the next opportunity to file for a rate increase.[224] Cablevision, for example, argues that this "lag" time can be more than a year in some instances.[225] These operators thus argue that cable systems should be permitted to file for rate increases based on changes in external costs as

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[222] Rate Order, at para. 233-240.

[223] Cable Television Rate Regulation Questions and Answers, Public Notice, at 8 (released May 13, 1993).

[224] Continental Petition at 9; Colony Petition at 10; Cablevision Reply at 4.

[225] Cablevision Reply at 4.

such costs arise. These commenters express particular concern over recovering as soon as possible the programming costs associated with adding a new channel.[226] NATOA, on the other hand, expresses general satisfaction with our current rules permitting such rate filings only annually.[227]

121. Limiting capped rates to annual adjustments for increases in external costs clearly would involve lesser administrative burdens on operators and regulators than more frequent filings.[228] On the other hand, annual filings would require cable operators to forego recovery of external costs for up to one year, which could create undue hardships should a system experience a significant increase in costs mid-year. In addition, we note that in an unregulated environment cable operators have generally instituted rate increases only on an annual basis. And, cable operators have incentives to reduce consumer concern over rate increases by not instituting frequent rate increases. For these reasons, we conclude that we need not limit rate increases on account of increases in external costs to an annual basis, although we believe that in the vast majority of such cases increases will occur only once a year.[229]

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[226] Colony Petition at 10; Cablevision Reply at 4. Disney states that our current rules adversely affect its efforts to offer the Disney Channel on a tiered, rather than a la carte basis. Disney contends that cable systems previously committed to adding the Disney Channel to cable programming services tiers are now hesitant because of they are required to absorb the Disney Channel's relatively high programming costs for many months until this additional cost can be recouped through increased cable service rates. Disney thus argues that permitting operators to file for rate increases as new programming is added holds benefits for the subscriber. Disney Petition at 6-7.

[227] NATOA Petition at 11 n.11.

[228] In the Cost-of-Service Proceeding we are also considering how often cable operators will be allowed to file a cost-of-service showing. Cost-of-Service NPRM, at para. 17. We also note that the Medium-Sized Operators have suggested that the Commission, in cost-of-service proceedings, apply external treatment to the costs of rebuilds. Supplemental Comments of the Medium-Sized Operators, Ernst & Young Study, at 13. As discussed above at para. 97, we will address the utility of this approach in the Cost-of-Service Proceeding.

[229] This determination only applies to rate increases on account of changes in external costs. It does not apply to the inflation adjustment to capped rates which shall continue to be limited to an annual filing. For a discussion of filing limitations of on common carriers subject to price cap regulation see Policy and

122. Under our external cost requirements, however, increases in external costs are permitted to be reflected in rates only to the extent they exceed inflation. Increases in external costs thus must be compared to the inflation index. The GNP-PI inflation index is released quarterly and is later updated. We provide that operators may file rate increases no more frequently than quarterly on account of increases in external costs. We also require that where rate increases are made based on a comparison to the initial quarterly inflation index, adjustments must be made in subsequent rate filings to reflect the final index. Our FCC Form 394 and instructions, to be released in the near future, will prescribe the precise manner of making these adjustments. We also will monitor the flexibility we give today to cable operators to make relatively frequent rate increases, and stress that we can impose more stringent limitations at a later date if necessary to protect consumers.

123. We also recognize that cable operators may experience decreases in external costs on a going-forward basis. Prompt reflection of such decreases in rates would benefit consumers. At the same time, a requirement for immediate rate filings to reflect decreases in external costs could significantly increase burdens on operators and regulators. Accordingly, we will not require such rate filings. Instead, we require that any filing to reflect increases in external costs or the annual inflation adjustment must also reflect any decreases in such costs that have occurred over the same period. In addition, we require that operators file revised rates to reflect decreases in external costs no later than one year from when such decreases occur. These requirements will assure that consumers will generally receive the benefits of decreases in external costs within a reasonable time frame without imposing significant burdens on operators.

IV. SECOND REPORT AND ORDER

124. While the Rate Order established a benchmark methodology based on the rates of systems subject to effective competition, the Further Notice sought comment on whether cable systems with less than 30 percent penetration should be included in the "competitive" sample. When data from all systems in the competitive sample were used, the competitive differential was calculated at approximately 10 percent. However, when data from systems with less than 30 percent penetration were excluded from the analysis, a competitive rate differential of roughly 28

Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 3022, at para. 307 (1989).

percent was calculated. This result occurs because many of the low penetration systems have rates which were significantly above the rates of other systems in the "competitive" sample.

125. The Further Notice queried whether such low penetration systems could be lawfully excluded from benchmark calculations, given the 1992 Cable Act's definition of such systems as being subject to effective competition. Comment was also sought on whether, as a policy matter, systems in low penetration areas should be excluded or given less weight in calculating the competitive rate differential in order to produce a "better" measure of that differential. In addition, comment was sought on how to redefine the benchmark formula and how to phase-in any further rate reductions if exclusion of such systems were found to be lawful and appropriate. Finally, comment was sought on the impact on consumers and the industry, and the proper application of, any new competitive rate differential.

126. Most commenters contend that the Commission, having chosen to use a benchmark that is designed to approximate the rates that systems subject to effective competition charge for cable service, must use the statutory definition of systems subject to effective competition. Other commenters, however, argue that the Commission is bound by this definition only when determining which systems are exempt from rate regulation.

127. The question at issue, then, is whether the Commission may adopt a definition of systems subject to "effective competition" for purposes of establishing its benchmark rate formula that differs from the definition of that term set forth in the statute. As various commenters noted, this issue is quite similar to the question decided in American Civil Liberties Union v. FCC, 823 F.2d 1554 (D.C. Cir. 1987) ("ACLU"), cert. denied, 485 U.S. 959 (1988). In ACLU, the court held that, notwithstanding the legislative history that seemed to support the Commission's authority to redefine "basic cable service," the statutory definition was itself clear and unambiguous and could not be overridden by legislative history. Id. at 1567, 68. As numerous commenters point out, the 1992 Cable Act also defines "effective competition" in a manner that is clear on its face. Moreover, the commenters have pointed to no legislative history that suggests that the Commission has discretion to redefine that term.

128. We thus conclude that the statutory definition controls when determining reasonable or unreasonable rates pursuant to Section 623 of the Act based on our benchmark

approach.[230] In particular, we believe that, to be most consistent with the clear statutory language, cable systems with less than 30 percent penetration should continue to be included in the sample of systems subject to effective competition which is used to calculate the benchmark rates.[231]

129. Despite the clear statutory language, various commenters argue that rates for low penetration systems, should be excluded from the benchmark formula calculation, because such rates are allegedly disproportionately high. Even if the Act's "effective competition" definition were not binding on the Commission, however, the commenters have not presented convincing arguments as to why low penetration systems should be excluded from the sample. While many commenters speculate about various reasons why systems with less than 30 percent penetration might have higher rates than other competitive systems,[232] there is no factual support for their contentions or upon which the Commission could conclude that exclusion of rates for such systems from the benchmark would produce a "better" measure of the competitive rate differential. In addition, some commenters suggest that defining low penetration systems as subject to effective competition would parallel the antitrust theory that companies with less than 30 percent of the market share do not have monopoly power. This theory holds that without monopoly power, a firm lacks the power to raise prices significantly above cost for any significant period of time. Thus, to the extent that a cable company with less than 30 percent penetration is unable to exert substantial market power, its rates should approximate the rates charged by competitive systems, which also are unable to raise prices substantially above costs. This theory also is consistent both with Congress' concern that cable

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[230] "It is an elementary precept of statutory construction that the definition of a term in the definitional section of a statute controls the construction of the term wherever it appears throughout the statute." Florida Department of Banking and Finance v. Board of Governors of the Federal Reserve System, 800 F.2d 1534 (11th Cir. 1987); see also, Board of Governors v. Dimension Financial Corp., 474 U.S. 361 (1986).

[231] See Talley v. Mathews, 550 F.2d 911, 919 (4th Cir. 1977) (agency is not free to rewrite acts of Congress merely because it disagrees with the terms of the statute); Farmers Union Central Exchange, Inc. v. FERC, 734 F.2d 1486, 1500 (D.C. Cir. 1984) (agency decision-making must not only be reasonable but must also be consistent with congressional mandate).

[232] Some commenters speculate, for example, that low penetration may result from new construction which has not yet been fully marketed, from unusually high costs resulting in high prices, and from simple poor management.

systems, in general, were accumulating monopoly power which led to monopoly profits and with its simultaneous decision to include systems with less than 30 percent penetration when defining which systems face effective competition. See Sections 2(a) and 3(a) of the 1992 Cable Act.

130. Moreover, it would not serve the public interest to exclude low penetration systems from the benchmark calculation, as suggested by some commenters, merely because such exclusion would result in larger rate reductions which those commenters seek. Benchmark rates which are 10 percent below prevailing rates in the cable industry will substantially comply with the congressional mandate to ensure that subscribers pay reasonable rates for cable service.[233] Future surveys will gather information on competitive rates as well as system costs, and if greater rate reductions appear appropriate on the basis of such additional information, the Commission will be in a better position to decide the issue at that time. Now, however, based on the instant record, we believe that a more cautious approach in setting cable rates is the better course.

131. Finally, some petitioners and commenters argue that the universe of systems subject to effective competition used in calculating the benchmark rates should not include municipal systems, systems competing with municipal systems or systems involved in head-to-head competition that have been operating for less than five years -- even though each of these systems faces effective competition as defined in the Act. These parties contend that municipal systems do not charge "competitive" rates because they are subsidized by taxpayers, share costs with other municipal services, and do not make a profit. NCTA purported to support these contentions with studies showing that a few municipal systems were subsidized and/or not making a profit. However, these municipal systems responded that the information and assumptions used in the studies were not accurate and that NCTA's conclusions were unfounded. Some parties proffered a study concluding that overbuild systems in operation for less than five years charge lower rates than other overbuild systems. However, even if true, this does not mean that these systems are not viable enterprises in the long term, *i.e.*, making a "profit"

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[233] Some comments reveal a misunderstanding of how the benchmark rates will work. These petitioners contend that they, or others like them, will have to lower their rates 15 to 30 percent to come down to the appropriate benchmark rates. However, the <u>Rate Order</u> made it clear that no system will have to lower its rates by more than 10 percent from its rate level on September 30, 1992. Only systems with extraordinary price increases since that date would face potential reductions of the magnitude suggested by petitioners.