

of some kind."²³⁴ Indeed, there is nothing in the record to support the contentions that overbuilt competitive systems of any particular age are engaged in "price wars," and are charging rates that do not allow them to recover costs or otherwise provide for viable operation. Thus, petitioners' speculation concerning the costs and profits of municipal and overbuild systems is not sufficient to warrant their exclusion from the effective competition sample data -- even if the Commission had the discretion to do so. As thoroughly explained in the preceding paragraphs, we do not believe we are free to change the definition of systems subject to effective competition merely because petitioners might devise a definition they think is more appropriate. Since Congress defined municipal systems and overbuilds as subject to effective competition, we will not exclude them from our benchmark analysis.

V. THIRD NOTICE OF PROPOSED RULEMAKING

132. In this Notice, we seek comment on: (1) the appropriate methodology for use of the benchmark to adjust capped rates when channels are added or deleted from a regulated tier; (2) whether we should permit cable operators who have completed rebuilds immediately prior to regulation, and whose rates are below benchmark level, to raise their rates to the benchmark; (3) whether we should permit cable operators to elect either the benchmark or cost-of-service approach for different tiers of regulated service after the initial period of rate regulation; and (4) whether we should permit external cost treatment for costs of upgrades required by local franchise authorities, and, if so, whether local or federal standards should govern rate adjustments based on costs of such required upgrades.

A. Adjustment to Capped Rates Because of Addition or Deletion of Channels.

133. The Rate Order provided that cable operators may pass-through, after the initial regulated rate is determined, any increases in programming costs incurred for regulated services that exceed inflation.²³⁵ The Rate Order, however, did not specify the methodology for using the benchmark approach to determine rates when channels are added or deleted from service offerings.

²³⁴ There is no indication that Congress intended "profit" to necessarily mean net positive cash flow at all times, as opposed to some other positive return such as increased value of the business, future anticipated profits, or some other valuable consideration.

²³⁵ Report and Order, at paras. 241, 257, n.609.

134. Several cable operators and programmers request further guidance on how an operator seeking to add channels will be able to reflect associated programming costs in rates.²³⁶ They argue that the current benchmark formulation does not allow cable operators to charge an amount sufficient to cover costs for programming to fill new channels, creating disincentives for the addition of new facilities and services that could benefit subscribers.²³⁷ Programmers argue that these disincentives encourage the offering of programming on an a la carte basis.²³⁸ They point out that the benchmark rate applicable to all channels decreases as the cable operator adds channels, and that as the number of channels increase, the break-even cost of any new programming substantially decreases.²³⁹ They argue that a declining per channel benchmark rate as channels are added discourages the development and carriage of higher-quality and higher-cost programming.²⁴⁰ These parties thus urge the Commission to clarify that channels added by a cable operator after the implementation of rate regulation would not alter the capped rate for existing channels.²⁴¹ They further urge that cable operators be permitted to adjust the price of the regulated tier to which the channels are added by an amount reflecting the cost of the new programming plus a reasonable rate of return.²⁴²

135. Under the regulatory framework adopted in the Rate Order, cable operators may elect between the benchmark and cost-of-service approaches for setting initial regulated rates. Cable operators may use either of these approaches for setting new

²³⁶ See e.g. Booth American Co., et. al. Petition, at 14; E Entertainment Television, Inc. Petition, at 6.

²³⁷ See e.g., NCTA Comments, at 16-17; Mountain Cablevision, Inc. Petition, at 2; and Booth American, et. al., Petition, at 15. For a more in-depth discussion on how this effects upgrades, see paras. 133-144, infra.

²³⁸ See E Entertainment Television, Inc. Petition, at 2; Discovery Communications, Inc. Petition, at 2 and 7-8.

²³⁹ See e.g., Liberty Media Corp. Petition, at 20-21; Affiliated Regional Communications, Ltd. Petition, at 16.

²⁴⁰ See e.g., Liberty Media Corp. Petition, at 21; Disney Channel Petition, at 14.

²⁴¹ See e.g., Liberty Media Corp. Petition, at 21. Commenters have not offered any suggestions as to how deletions of channels should be handled.

²⁴² See e.g. Liberty Media Petition, at 21; Affiliated Regional Communications, Ltd. Petition, at 16.

regulated tier rates when channels are added to, or deleted from, either the basic or cable programming services tiers.²⁴³ In the Cost-of-Service Proceeding we are considering requirements that will govern rates for cable service based on costs, including when channels are added or deleted from regulated tiers. In the Rate Order, as indicated, we did not provide specific guidance on how to adjust rates when channels are added or deleted for those operators seeking to use the benchmark approach for rate setting instead of cost-of-service showings. We are therefore offering for comment several approaches to use of the benchmark to determine adjustments to capped rates when channels are added or deleted.²⁴⁴

²⁴³ The Cable Act of 1992 expresses Congress' desire that our rate regulations "reduce the administrative burdens on subscribers, cable operators, franchising authorities, and the Commission." Communications Act, Section 623(b)(2)(A), 47 U.S.C. Section 543(b)(2)(A).

²⁴⁴ A number of parties have raised the issue of whether the external cost adjustment of the benchmark for increases in programing costs should include a mark-up or profit margin on the programing increases. They argue that if programing costs increase faster than inflation, while the remainder of the benchmark rate increases only with inflation, programing costs will over time increase as a percentage of the maximum permitted rate per channel, eroding the cable operator's margin. Several issues are raised by this request. The first issue is whether a markup or profit on additional programing expense is consistent with our policy goal of establishing rates no higher than would prevail under competition. Second, how should we determine the appropriate mark-up? Freezing the margin over programing expense would require benchmark rates to grow at the same rate as programing expenses. Historically, there has been a downward trend in margin over programing expense, as programing expense has grown faster than inflation, while the rate per channel at which cable service is offered has declined. This trend of a declining margin over programing expense does not necessarily imply declining profitability, since at the same time technological improvements have been reducing the per channel operating cost of cable service. The mark-up of programing expense increases should not be inconsistent with this historic trend. A third issue is what cost increases should be marked up. What distinguishes programing expenses from other expenses of cable operators? Should retransmission consent fees (and the fees for channels associated with retransmission consent agreements) be marked up? Arguably the profit associated with broadcast retransmissions is already present in benchmark rates. Should affiliated programing expense increases be marked up? Would this be providing a profit on a profit? Fourth, what would be the impact on programers of allowing a profit margin on increases in programing expense? Would a mark-up on

136. We tentatively conclude that any methodology we adopt should achieve the goals of protecting consumers from unreasonable rates while assuring the continued growth of the cable industry and the additional services that it can provide to subscribers. Thus, the methodology that we select should provide sufficient incentives for cable operators to invest in continued growth of cable television service while not permitting operators to raise rates to unreasonable levels. We solicit comment on these goals and on the extent to which the alternative methodologies described below, or other methodologies, will permit achievement of these objectives.²⁴⁵

programming costs make advertising-supported programming less attractive to operators than fee-supported programming? Would programmers attempting to gain audience by offering operators low fees be disadvantaged by a mark-up of programming expense? Would a mark-up on programming expense increases have a material effect on negotiations between cable operators and broadcasters? Fifth, how should we treat advertising and other provisions of programming contracts that affect the level of programming expense? Should total advertising revenues be deducted from programming expense? Should the program promotional expenses of a cable operator be marked up? Should operators receiving different volume discounts on a program have the same or different mark-ups? A sixth issue is whether reductions, as well as increases, in programming expense should be marked up. We note that a programming shift between tiers may cause programming expense to increase in one tier and fall in another, but create no net change in programming expense.

In our Cost-of-Service NPRM we sought comment on whether we should permit a mark-up on programming costs for the development of cost-based rates. We believe that the issue of a mark-up on programming costs accorded external treatment should be resolved with similar issues raised in the Cost of Service NPRM. Accordingly, we will retain jurisdiction over this issue as raised on reconsideration and will resolve it with cost of service issues.

²⁴⁵ On reconsideration, several parties have suggested modifications to the benchmark to correct alleged defects or that would alter the benchmark level or structure. We will address these suggestions in the Second Reconsideration. Any revised benchmark that we could adopt could affect the methodology that we select for use of the benchmark to adjust rates when channels are added or deleted from regulated tiers. We thus are providing notice that any benchmark methodology that we select will reflect any modifications to the benchmark that we might adopt in the Second Reconsideration. Parties are requested to comment on the appropriate methodology for use of the benchmark to adjust rates when channels are added or deleted in light on the suggestions for modification to the benchmark raised on reconsideration.

137. One proposed methodology for use of the benchmark to adjust capped rates when channels are added or deleted provided that the charge should consist of the sum of: 1) the current permitted charge for the existing channels on the tier; and 2) a charge for the new channels consisting of the benchmark rate for the total number of channels on the tier multiplied by the number of new channels. We tentatively conclude that we should reject this approach, despite its apparent ease of calculation. First, we note that this approach would permit tier pricing above economies of scale observed in the industry survey and reflected in the benchmark. Additionally, there is no apparent analytical or empirical basis for using the benchmark per channel rate for only the new channels on a tier and pricing the old channels on the basis of the pre-upgraded rate.²⁴ Furthermore, we are not certain that this methodology would work for determining the new permitted rate associated with channel deletions. In addition, this approach could result in significantly higher rates than other options. We solicit comment on our tentative conclusion not to adopt this approach.

138. A second approach would be to require that the new permitted rate for a regulated tier with added or deleted channels would be the benchmark per channel rate based on the new number of channels on the system multiplied by the number of channels on the tier. This approach could require that systems with rates above the benchmark reduce them to the benchmark level when channels are added, including for existing channels. At the same time, it would permit systems with rates below the benchmark to come up to the benchmark level when channels are added. This approach could also be applied to adjust rates when channels are deleted. We tentatively conclude that we should not adopt this approach because it would create substantial disincentives for cable operators with rates above the benchmark to add channels. Conversely, it could create undue incentives for systems with below benchmark rates to add channels, permitting substantially increased rates. We solicit comment on this tentative conclusion.

139. A third approach would be to require that the new permitted per channel rate be the existing permitted per channel rate adjusted for programming expense, as described below, and adjusted to reflect the same proportionate per channel rate increase or decrease observed in the benchmark curve. Under this option, the new permitted per channel rate would not directly reflect the benchmark rate but only the benchmark's proportionate increase or decrease in per channel rates. For example, if the benchmark rate per channel decreases 3% based on the number of

²⁴ The benchmark rate is the rate observed in the survey for all regulated channels on the system, not just new ones.

channels the cable operator is adding to a regulated tier, then the cable operator's new per channel rate will also reflect a 3% decrease from current levels, separate from any adjustments for programming expense or other external costs.²⁴⁷ Thus, this methodology would permit capped rates to maintain their relative position above or below the benchmark, prior to adjustments for external costs.²⁴⁸

140. We believe that there may be several benefits to this approach. Maintaining the relative position of current rates to benchmark rates is consistent with the overall treatment of above and below benchmark systems envisioned in the Rate Order.²⁴⁹ Thus, in the Rate Order we did not require all systems with above benchmark rates to lower rates to the benchmark, or permit those with rates below the benchmark to come up to the benchmark. Under this methodology, these distinctions would be preserved. At the same time, the new per channel rate would reflect the same proportionate per channel rate decreases observed in benchmark rates. This would benefit subscribers by requiring that rates reflect the same efficiencies and economies of scale observed in benchmark rates. Accordingly, we tentatively conclude that we should adopt this third approach.

141. In the Rate Order, we stated that we would permit cable operators to pass through to subscribers increases in programming costs on a going forward basis.²⁵⁰ We believe that this determination should apply not only to increases in programming costs for channels offered as of the initial date of regulation but to programming associated with additional channels. This will preserve incentives for cable operators to

²⁴⁷ Adjustments for external costs, including programming expense, will affect the total final permitted rate.

²⁴⁸ The question has also been raised as to the correct way to set rates if the operator adds channels merely by "flipping a switch." Here, the operator would be adding channels by activating unused capacity without presumably incurring any significant costs. The benchmark determines rates based on the number of activated channels, subscribers, and number of satellite delivered signals. Because it is based on observed rates of competitive systems with these characteristics, it may be used to determine the permitted rate per channel when new channels are even added when operators do so without incurring significant incremental costs. Accordingly, we propose that operators would be able to apply the described methodology when they add channels by simply activating unused capacity.

²⁴⁹ See Report and Order, at paras. 177-240 and 382-397.

²⁵⁰ Report and Order, at para. 251.

provide additional programming services to subscribers. Accordingly, we further tentatively conclude that under the methodology for application of the benchmark to determine rates when channels are added or deleted, we should provide that cable operators may recover the actual increased cost of programming incurred when regulated channels are added to a regulated tier, and that rates must reflect any decreases in programming costs, measured on a per channel per subscriber basis.

142. Benchmark rates per channel presumptively include programming costs because it is reasonable to assume that the rates on which the benchmark is based were set at a level that enabled cable operators to fully recover costs, including those incurred for programming. Therefore, if we permit cable operators to pass-through programming costs when channels are added, and also permit recovery of the full capped rate per channel, the operator would receive a double recovery of programming expense -- the actual amount associated with the channel additions and the amount already included in the capped per channel rate. Accordingly, we tentatively conclude that we should include in our methodology a programming offset for channel additions and deletions that will preclude this double recovery.²⁵¹

143. To illustrate, under the above tentative conclusions, in order to use the benchmark to determine new permitted rates when channels are added or deleted from a regulated tier, cable operators would first identify the level of programming costs for the tier on the initial date of regulation on a per subscriber per channel basis and subtract it from the current permitted per channel rate. The operator would then determine the percentage difference between the benchmark per channel rate for the existing number of channels and the benchmark per channel rate for the new number of channels. This percentage change would then be applied to the previously determined current permitted per channel rate minus programming expenses. The operator would then add its actual programming expense (for both the old and the new channels) determined on a per channel per subscriber basis to this "base" to obtain the new permitted per channel rate.²⁵² We

²⁵¹ This approach would not accurately reflect programming costs for all cable operators because the benchmark is based on average industry rates and it would require that actual programming costs be deducted from the benchmark. However, this inaccuracy is balanced by the fact, on a going forward basis, that cable operators would be able to recover the actual level of programming expense incurred.

²⁵² For example, if the current permitted per channel rate is 45 cents and the programming expense on the initial date of regulation is 10 cents measured on a per channel per subscriber

solicit comment on the above described methodology and on whether it would protect consumers while permitting the continued growth and success of the cable industry. Specifically, we seek comment on whether this methodology would provide incentives to cable operators to add programming services, as well as whether the methodology would create disincentives with respect to certain types of programming services.

144. Commenters should provide more than generalized allegations to assist the Commission in determining which method for adjusting benchmark rates will provide sufficient incentives for cable operators to invest in continued growth of cable service.²⁵³ In evaluating the above alternatives for use of the benchmark to adjust capped rates when channels are added or deleted, cable operators and other commenters should provide factual information, including cost data that will provide a firm basis for choosing the best methodology. Commenters should also address the extent to which penetration, subscribership and revenues increase when systems add channels and how such gains should be reflected in rates and our benchmark methodology.

B. Upgrades Initiated Shortly Before Rate Regulation

basis, the benchmark rate per channel decreases 2 percent between the current and new channels, and the new level of programming expense with the new number of channels is 12 cents measured on a per channel per subscriber basis, the new permitted per channel rate would be 46.1 cents per channel. This general methodology would also apply to channel deletions. If the total number of channels is reduced, however, the final permitted rate would reflect the percentage increase observed in the benchmark rate. It may also be more likely that the final level of programming expense would decrease.

²⁵³ In this respect, the current record should be supplemented. For example, Disney states without supporting factual information, that cable operators will examine their marginal per channel benchmark in determining whether it is economically feasible to add a new program service. Disney Petition at 14-15. In support of its general contention that the benchmark is not compensatory on a going forward basis, Liberty Media merely points out the efficiency factor reflected in the benchmark and observed in our industry survey. Liberty Media Petition at 204. These contentions do not provide sufficient data to warrant a general conclusion that benchmark rates are insufficient to recover expenses of additional channels. Cost information submitted tended to show that the benchmark rate can be compensatory, including a 20 percent return for rebuild costs, before any programming expense. Supplemental Comments of Medium-Sized Operators, Ernst & Young Study at 12, and Attachment 2.

145. Some cable operators with rates below benchmark levels may have initiated or completed system upgrades shortly before rate regulation. It is possible that the initiation of rate regulation could prevent systems with rates below benchmark levels from raising rates to recover such upgrade costs. While cable operators could seek to recover such costs through a cost-of-service showing, we solicit comment and suggestions on alternatives to a full cost-of-service showing that could permit recovery of such upgrade costs. In particular, we solicit comment on whether the streamlined cost-of-service showing proposed in the Cost-of-Service NPRM should be applied in this context. Alternatively, we solicit comment on whether we should simply permit cable operators that have undertaken upgrades shortly before regulation to raise rates to the benchmark level without any cost showing. This would avoid the burdens of cost-of-service determinations while assuring that rates will not rise to above benchmark levels. We solicit comment on appropriate criteria for identifying upgrades that would be eligible for either of these alternatives.²⁵⁴

C. Operator Discretion to Select Benchmarking or Cost-of-Service for Different Regulated Tiers

146. The Rate Order did not explicitly state whether cable operator is permitted to choose the cost-of-service approach for one tier and benchmark approach for the other tier, or whether parallel treatment for both tiers is required in setting initial rates. In the Rate Order we established a regulatory framework governing rates for cable service that is tier neutral.²⁵⁵ The current rule governing the setting of initial rates, Section 76.922(b), may be read to allow the cable operators to elect one showing on one tier and another showing on another tier. A number of interested parties seek guidance on whether systems have discretion to select different rate-setting approaches for different program service tiers.

147. Several cable operators and cable interests state that requiring a uniform selection is undesirable because: 1) it would prevent cable operators from offering a discounted or

²⁵⁴ We also request comment on the method of pricing that cable operators generally follow after a rebuild. For example, do cable operators raise rates in a manner that allows them to recoup costs immediately after a rebuild, or, is it a gradual process? What has typically happened to rates, on a per channel and overall basis, when operators have expanded their channel capacity? How much do the various types of rebuilds cost and how have operators in the past recovered those costs? Commenters should provide detailed answers to these issues, with supporting documentation.

²⁵⁵ See Rate Order, at para. 177.

"lifeline" basic tier service, which they ostensibly would do if they could seek a cost-of-service showing only on the cable programming services tier; 2) it would encourage a greater number of cost-of-service filings for the basic tier, as cable operators that would have been satisfied with a benchmark analysis for their basic tier rates will be required to make a cost-of-service showing on basic in order to make that showing on another tier; 3) it would require cable operators to duplicate the same case before different regulatory bodies; 4) Congress intended different schemes for the different tiers; and 5) since cost structures differ among tiers, a cable operator should be allowed to choose the appropriate regulatory scheme. On the other hand, NATOA contends that cable operators should be required to make parallel showings for both tiers, when both proceedings occur within a reasonable time of each other. NATOA argues that such a requirement would prevent cable operators from "gaming," i.e., deciding whether it would be advantageous to submit a cost-of-service showing on one tier and a benchmark analysis on another. NATOA believes that allowing different showings would undermine the Commission's intention that the same "reasonable" rate determination be made on both tiers. Another petitioner argues that if the Commission adopts a parallel approach to the setting of initial regulated rates, the Commission should conduct a single cost-of-service proceeding, rather than authorize the franchising authorities to hear such cases. According to this commenter, parallel showings will not promote uniform rates on both tiers, because the per-channel, per-subscriber benchmark rate may differ between the tiers, depending upon the initial date of regulation.

148. Based on the record before us at this time, we tentatively conclude that cable operators should be required to elect either the benchmark or the cost-of-service approach for all regulated tiers. Thus, if a system becomes subject to regulation at the local level and seeks to justify its basic service rates using the benchmark system, the reasonableness of its cable programming services rates will also be judged under the benchmark should a complaint be filed about those rates with the Commission. Similarly, if an operator has more than one tier of cable programming services and receives a complaint regarding the rates for all of those tiers, it must justify the reasonableness of each rate using a consistent approach.

149. We believe at this point that requiring operators to use the same rate-setting approach when supporting the reasonableness of various regulated rates during the initial stages of rate regulation best protects our decision to develop a benchmark system based on tier neutrality and also eliminates any incentive to "game" the regulatory process. As noted in the preceding section, we have implemented a benchmark approach based on tier-neutrality in order to simplify the initial rate-setting process, remove a regulatory incentive to retier or move

individual channels from one tier to another, and reduce administrative burdens. If an operator was permitted to elect the benchmark approach for one service tier and cost-of-service for another, however, it would have an incentive to retier its services and place all of its low cost and cost free programming on the tier to which the benchmark will be applied while moving its most expensive programming to the tier for which a cost-of-service showing will be made. In so doing, the operator could be allowed to charge a per channel rate for the low cost tier based on the benchmark (which is an averaged rate) that actually far exceeds its costs for that tier (and, thus, the rate it would be able to charge under a cost-of-service showing). At the same time, the operator may be able to charge a higher-than-benchmark rate for the other service tier through a cost-of-service showing, based on its higher costs for that tier. This result would seriously undermine the rate averaging and tier-neutrality concepts built into the benchmark approach by allowing operators to apply the average per channel rates derived from the benchmark formula only to certain tiers. As importantly, cable operators selectively applying the benchmark system in this fashion would be able to charge higher overall rates than would be allowed if either the benchmark or the cost-of-service approach had been applied consistently across all regulated program tiers.¹⁵⁶

150. Out of an abundance of caution, to avoid such adverse consequences during the initial stages of regulation, we tentatively conclude that operators should be required to use the same rate-setting approach to justify the reasonableness of all regulated service rates.¹⁵⁷ We recognize petitioners' concerns

¹⁵⁶ This is because, if the operator had chosen a consistent cost-of-service approach, it would not have been able to charge the benchmark rate for the low cost tier, but rather would have had to charge a lower rate based on its actual costs. Similarly, if the operator had chosen a consistent benchmark approach, it would not have been able to charge an above-benchmark rate for the high cost tier, but rather would have had to charge the benchmark rate.

¹⁵⁷ A selective approach also would allow cable operators to engage in forum-shopping based on an assessment of which jurisdiction would be likely to grant most favorable treatment in a cost-of-service hearing, thus potentially leading to higher rates for subscribers.

We are not persuaded by petitioners' claims that requiring a parallel approach will result in more cost-of-service showings, since it is entirely possible that systems will choose to file fewer cost-of-service showings if they know that they must pursue the same approach for all regulated service tiers. We also are not convinced that an operator would refuse to offer an inexpensive basic tier, as some claim, simply because it was required to submit

that, if they then elect the cost-of-service approach, they will be required to make cost-of-service showings before two different regulatory entities. This possibility, of course, is a function of the Cable Act itself, which gives local franchising authorities primary authority over basic service rates and the FCC exclusive authority over rates for cable programming services. Nonetheless, we are mindful of the difficulties that could result from this situation. Accordingly, we seek comment below on procedures we might implement to coordinate the local and federal regulatory processes as much as possible. In addition, we invite comment on whether our tentative conclusion to require a consistent rate-setting approach is necessary to avoid gaming of the regulatory process and to protect our initial benchmark approach.

151. We also solicit comment on whether we should establish longer term limitations on cable operators discretion to choose between these different alternatives to rate setting, and what those limitations should be. For example, we could require on a permanent basis that cable operators use the same approach for tiers that are concurrently subject to regulation. However, even if we require that the same rate setting approach be used for all regulated tiers, we also believe that cable operators should be permitted reasonable opportunities to switch from benchmarking to cost-of-service, and *vice versa*. Thus, we could require that operators use the same approach for both tiers within a calendar year but permit them to convert to the other approach after using one approach for that period of time. We solicit comment on whether this alternative is feasible or other alternatives should be adopted. We solicit comment on whether we should not adopt any limitations on operator discretion to elect different approaches for rate setting for different tiers after the initial phase of rate regulation.

152. We also solicit comment on what procedural requirements we should adopt to provide for coordination between local franchising authorities and the Commission if we adopt limitations on operators' ability to select different approaches for different tiers. For example, if a cable operator elects cost-of-service, would there be a need for coordination between the two jurisdictions? What requirements should we adopt, if any, for coordination of cost proceedings at the local and federal level? If a cost proceeding is initiated in one

a cost-of-service showing for basic service if it chose to do so for cable programming services. Indeed, to the extent petitioners' argument assumes that it may be less expensive to provide basic service than other regulated services, a uniform cost-of-service approach would enable the operator to charge a lower rate for basic (and a higher rate for cable programming services) based on such costs -- the very result petitioners desire.

jurisdiction, and at a later date a different tier becomes subject to regulation, should we provide that the proceedings may proceed independently, or should we take other steps for coordinated or concurrent decision making? Should we require that the determination of one jurisdiction will govern, or be given considerable weight in, setting rates for the tier subject to the oversight of the other jurisdiction? This could reduce administrative burdens on cable operators by, for example, requiring only one cost-of-service showing. It would also promote tier neutrality by assuring that per channel rates based on the same costs or benchmark data will result in the same per channel rates prior to adjustments for external costs.²⁵⁸ We solicit comment on whether such provisions would be consistent with the local and federal regulation of cable service rates envisioned in the Cable Act of 1992. We note that absent adoption of provisions of this sort, the Commission may rely on established procedures for review by the Commission of local decisions to assure that rate determinations for different tiers are consistent with our rules.

D. Cost of Upgrades Required by Local Franchising Authorities.

153. Finally, we solicit comment on whether we should permit external cost treatment for costs of upgrades required by local franchise authorities.²⁵⁹ This would be consistent with our general approach of permitting external cost treatment of

²⁵⁸ We solicit comment on whether our rate regulations will in any event produce the same per channel rates for different tiers if showings are based on the same costs or the same benchmark data.

²⁵⁹ There is no basis at this time for modifying the benchmark to include an upgrade variable to govern situations where cable operators upgrade systems that either do, or do not, involve changes in the number of channels offered. The current benchmark determines rates based on only three variables: number of channels, number of subscribers, and number of satellite delivered signals. Without modification to include an upgrade variable, the current benchmark cannot directly determine rates for upgrades any more than for other changes that do not affect the three variables already included in the benchmark, such as, for example, an upgrade of vehicles or increased wages. In addition, the cost of upgrades will vary for each operator depending on the extent and quality of the upgrade making it very difficult to fashion a variable to the benchmark to govern rates when channels are not added or deleted. However, we will continue to explore the feasibility of modifying the benchmark to include an upgrade variable. Finally, cable operators making upgrades that do not affect benchmark variables may either maintain current capped rates or make a cost-of-service showing. The Cost-of-Service Proceeding is considering streamlined procedures for upgrades.

costs of franchise requirements. On the other hand, upgrade costs could be significant and external treatment for such costs could mean in many cases that a significant component of capped rates will be based on costs. This could undermine the benefits that we believe can be achieved by using benchmarks and price caps as the primary method for regulating cable service rates instead of cost-of-service. We solicit comment on these considerations.

154. We also solicit comment on two alternatives for determining the adjustments to rates based on franchise required upgrade costs if we permit external treatment of them. First, we could require that any such costs be governed by the cost-of-service standards that we adopt in the Cost-of-Service Proceeding.¹⁰⁰ This would have the advantage of providing for uniform treatment of such costs for all cable systems. This would also permit the Commission to assure that such standards and resulting rates reflect a federal balancing of goals for regulation of cable service rates. Second, we could permit local franchise authorities to determine the way in which rates would be adjusted to reflect upgrade costs, including over what period of time such costs would be recovered, the operator's profit on upgrade costs, and other issues involved in cost-of-service standards. This option would establish more local control and responsibility for adjustments to rates on account of upgrades. Either of these alternatives could be applied to only the basic tier or to other regulated tiers as well. We solicit comment on these alternatives.

VI. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS

155. Pursuant to Section 603 of the Regulatory Flexibility Act, the Commission has prepared the following initial regulatory flexibility analysis (IRFA) of the expected impact of these proposed policies and rules on small entities. Written public comments are requested on the IRFA. These comments must be filed in accordance with the same filing deadlines as comments on the rest of the Notice, but they must have a separate and distinct heading designating them as responses to the regulatory flexibility analysis. The Secretary shall cause a copy of the Notice, including the initial regulatory flexibility analysis, to be sent to the Chief Counsel for Advocacy of the Small Business Administration in accordance with Section 603(a) of the Regulatory Flexibility Act, Pub. L. No. 96-354, 94 Stat. 1164, 5 U.S.C. Section 601 et seq. (1981).

¹⁰⁰ Prior to adoption of requirements in that proceeding, general cost-of-service principles will be applied on a case-by-case basis.

156. Reason for action. The Cable Television Consumer Protection and Competition Act of 1992 requires the Commission to prescribe rules and regulations for determining reasonable rates for basic tier cable service and to establish criteria for identifying unreasonable rates for cable programming services. The Commission has adopted rate regulations that require a comparison to the rates of cable systems subject to effective competition, as defined in the Cable Act of 1992. This Notice proposes to establish regulations governing the setting of rates for regulated cable service based on programming costs.

157. Objectives. To propose rules to implement Section 623 of the Cable Television Consumer Protection and Competition Act of 1992. We also desire to adopt rules that will be easily interpreted and readily applicable and, whenever possible, minimize the regulatory burden on affected parties.

158. Legal Basis. Action as proposed for this rulemaking is contained in Sections 4(i), 4(j), 303(r) and 623 of the Communications Act of 1934, as amended.

159. Description, potential impact and number of small entities affected. Until we receive more data, we are unable to estimate the number of small cable systems that would be affected by any of the proposals discussed in the Notice. We have, however, attempted to reduce the administrative burdens and cost of compliance for cable systems that have 1,000 or fewer subscribers as required by Section 623(i) of the Cable Act of 1992.

160. Reporting, record keeping and other compliance requirements. The proposals under consideration in this Notice do include new reporting and record keeping requirements for cable systems. These reporting requirements include the possibility of filings by cable operators of financial data annually at the Commission.

161. Federal rules which overlap, duplicate or conflict with this rule. None.

162. Any significant alternatives minimizing impact on small entities and consistent with stated objectives. Wherever possible, the Notice proposes general rules, or alternative rules for small systems, to reduce the administrative burdens and cost of compliance for cable systems that have 1,000 or fewer subscribers as required by Section 3(i) of the Cable Act of 1992.

VII. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

163. A final Regulatory Flexibility Act statement was published in the Rate Order at paragraphs 564-574. That analysis remains the same.

VIII. PAPERWORK REDUCTION ACT

164. The proposal contained herein has been analyzed with respect to the Paperwork Reduction Act of 1980 and found to impose no new or modified information collection requirement on the public. Implementation of any new or modified requirement will be subject to approval by the Office of Management and Budget as prescribed by the Act.

IX. PROCEDURAL PROVISIONS

165. For purposes of this non-restricted informal rulemaking proceeding, members of the public are advised that ex parte contacts are permitted from the time of issuance of a notice of proposed rulemaking until the time a draft Order proposing a substantive disposition of the proceeding is placed on the Commission's Open Meeting Agenda. In general, an ex parte presentation is any written or oral communication (other than formal written comments or pleadings and oral arguments) between a person outside this addresses the merits of the proceeding. Any person who submits a written ex parte presentation addressing matters not fully covered in any written summary must be served on this Commission's Secretary for inclusion in the public file, with a copy to the Commission official receiving the oral presentation. Each ex parte presentation discussed above must state on its face that the Secretary has been served, and must also state by docket number the proceeding to which it relates. See generally Section 1.1231 of the Commission's Rules. 47 C.F.R. §1.1231.

166. Pursuant to applicable procedures set forth in Sections 1.415 and 1.419 of the Commission's Rules, 47 C.F.R. Sections 1.415 and 1.419, interested parties may file comments on or before **September 30, 1993** and reply comments on or before **October 7, 1993**. To file formally in this proceeding, you must file an original plus four copies of all comments, reply comments, and supporting comments. If you want each Commissioner to receive a personal copy of your comments and reply comments, you must file an original plus nine copies. You should send comments and reply comments to Office of the Secretary, Federal Communications Commission, 1919 M Street, N.W. Washington, D.C. 20554. Comments and reply comments will be available for public inspection during regular business hours in the FCC Reference Center, Room 239, Federal Communications Commission, 1919 M Street N.W., Washington D.C. 20554.

X. ORDERING CLAUSES

167. Accordingly, IT IS ORDERED that, pursuant to Sections 4(i), 4(j), 303(r), 612(c) and 623 of the Communications Act of 1934, 47 U.S.C. §§ 154 (i), 154 (j), 303(r), 532 (c), 542(c), and

543, NOTICE IS HEREBY GIVEN of proposed amendments to Part 76, in accordance with the proposals, discussions, and statement of issues in this Notice of Proposed Rulemaking, and that COMMENT IS SOUGHT regarding such proposals, discussion, and statement of issues.

168. IT IS FURTHER ORDERED that, the Secretary shall send a copy of this Notice of Proposed Rulemaking and Order to the Chief Counsel for Advocacy of the Small Business Administration in accordance with paragraph 603(a) of the Regulatory Flexibility Act. Pub. L. No. 96-354, 94 Stat. 1164, 5 U.S.C. §§ 601 et seq. (1981).

169. IT IS FURTHER ORDERED that Part 76 of the Commission's rules, 47 C.F.R. Part 76, IS AMENDED, as indicated below.

170. IT IS FURTHER ORDERED that the Petitions for Reconsideration ARE GRANTED in part, DENIED in part, and to the extent that Petitions raise issues unresolved in this Rate Reconsideration, they will be disposed of in future orders.

FEDERAL COMMUNICATIONS COMMISSION


William F. Caton
Acting Secretary

APPENDIX A

Title 47, Part 76 of the Code of Federal Regulations is amended as follows:

PART 76 -- CABLE TELEVISION SERVICE

1. The authority citation for Part 76 continues to read as follows:

Authority: Sec. 2, 3, 4, 301, 303, 307, 308, 309, 48 Stat., as amended, 1064, 1065, 1066, 1081, 1082, 1083, 1084, 1085, 1101; 47 U.S.C. Secs. 152, 153, 154, 301, 303, 307, 308, 309; 532; 533; 535; 542; 543; 552; 554, as amended, 106 Stat. 1460.

2. Section 76.911 is amended by revising paragraph (c) (3) to read as follows:

§ 76.911 Petition for reconsideration of certification.

* * * * *

(c) * * *

(3) In any case in which a stay of rate regulation has been granted, if the petition for reconsideration is denied, the cable operator may be required to refund any rates or portion of rates above the permitted tier charge or permitted equipment charge which were collected from the date the operator implements a prospective rate reduction back in time to September 1, 1993, or one year, whichever is shorter.

* * * * *

3. Section 76.922 is amended by adding a sentence to the beginning of paragraph (b) (1) and by revising paragraph (d) (2) (vi) to read as follows:

§ 76.922 Rates for the basic service tier and cable programming services tier.

* * * * *

(d) * * *

(2) * * *

(vi) adjustments to permitted per channel charges on account of increases in costs of programming obtained from affiliated programmers 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.

* * * * *

4. Section 76.931 is revised to read as follows:

76.931 Notification of basic tier availability.

A cable operator shall provide written notification to subscribers of the availability of basic tier service by November 30, 1993, or three billing cycles from September 1, 1993, and to new subscribers at the time of installation. This notification shall include the following information:

- (a) that basic tier service is available;
- (b) the cost per month for basic tier service;
- (c) a list of all services included in the basic service tier.

5. Section 76.942(c)(1) is amended by removing the reference to June 21, 1993, and by adding September 1, 1993, in its place.

6. Section 76.951(b)(4)(i) is amended by removing the reference to June 21, 1993, and by adding September 1, 1993, in its place.

7. Section 76.953 is amended by revising paragraph (a) to read as follows:

76.953 Limitation on filing a complaint.

(a) Complaint regarding a rate in effect on September 1, 1993. Notwithstanding paragraph (b) of this section, a complaint regarding a rate for cable programming service or associated equipment in effect on September 1, 1993, must be filed by February 28, 1994.

* * * * *

APPENDIX B

Petitions for Reconsideration

MM Docket No. 92-266

Affiliated Regional Communications, Ltd.
Alaska Cablevision, Inc.
Alsea River Cable TV
Arizona Cable Television Association, et.al.
Atlanta Interfaith Broadcasters, Inc.
Bank of New York
Baraff, Koerner, Olender & Hochberg, P.C.
Bell Atlantic
Black Entertainment Television, Inc.
Blade Communications, Inc.
Booth American Company, et.al.
C-SPAN
Cable Services
Cablevision Systems Corporation
California Cable Television Association
Center for Media Education, et.al.
Century Communications Corp.
Coalition of Small System Operators
Colony Communications, Inc., et.al.
Comcast Cable Communications, Inc.
Community Antenna Television Association, Inc.
Community Broadcasters Association
Continental Cablevision, Inc.
Corning Incorporated; Scientific Atlanta, Inc.
Crown Media, Inc.
Discovery Communications, Inc.
The Disney Channel
E! Entertainment Television, Inc.
Encore Media Corporation
Fairmont Cable
Harron Communications Corp.
Higgins Lake Cable, Inc.
Inland Bay Cable TV Associates
InterMedia Partners
King County, Wash., et. al.
Liberty Media Corp.
Longview Cable Television
Michigan C-TEC Communities
Mountain Cablevision, Inc.
Multichannel Communication Sciences, Inc.
Municipal Franchising Authorities
National Association of Telecommunications Officers and Advisors,
et. al.
National Cable Television Association, Inc.
Newhouse Broadcasting Corporation
Northland Communications Corp.
Paradise Television Network, Inc.
Searle, Stanley M.
SuperStar Connection

Sur Corporation
Tele-Communications, Inc.
Time Warner Entertainment Company, L.P.
TKR Cable Company/TKR Cable of Kentucky
Turner Broadcasting System, Inc.
Valuevision International, Inc.
Viacom International, Inc.
Video Data Systems
Video Jukebox Network, Inc.
Wometco Cable Corp.

Comments/Oppositions to Petitions For Reconsideration

Ad Hoc Rural Consortium
Advanced Communications, Inc.
Affiliated Regional Communications, Ltd.
Arizona Cable Television Association
Bell Atlantic
Bellsouth Telecommunications
Bend Cable Communications, Inc., et. al.
Cable TV of Jersey City, Inc.
Cablevision Industries Corporation, et. al.
Cablevision Systems Corporation
Center For Media Education, et. al.
Consumer Electronics Group of the Electronic Industries
Association
Consumer Federation of America
C-TEC Cable Systems
Continental Cablevision, Inc.
General Instrument Corporation
GTE Service Corporation
Home Recording Right Coalition
Home Shopping Network, Inc.
King County, et. al.
Liberty Cable Company, Inc.
Medium-Sized Operators Group
Michigan Communities
National Association of Telecommunications Officers and Advisors,
et. al.
National Association of Towns and Townships
National Cable Television Association, Inc.
National Telephone Cooperative Association
Prevue Networks, Inc.
Time Warner Entertainment Company, Inc.
United States Telephone Association
USA Networks
Valuevision International, Inc.
Viacom International, Inc.
Videomaker Magazine

Replies to Oppositions To Petitions For Reconsideration

Cablevision Industries Corp., et. al.
Cablevision Systems Corporation
Center for Media Education, et. al.
City of Saint Paul
Coalition of Small System Operators
Continental Cablevision, Inc.
Corning Incorporated; Scientific-Atlanta, Inc.
Discovery Communications, Inc.
Engle Broadcasting
King County, Wash., et. al.
Liberty Media Corporation
Medium-Sized Operators Group
Michigan C-TEC Corporation
National Association of Telecommunications Officers and Advisors,
et. al.
National Cable Television Association, Inc.
Paradise Television Network, Inc.
Puerto Rico Cable Television Association
State of Hawaii
Sur Corporation
Televista Communicationss, Inc.
Time Warner Entertainment Company, L.P.
United Video, Inc.
Valuevision International, Inc.
Viacom International, Inc.

Federal Communications Commission Record

**Separate Statement
of
Chairman James H. Quello**

**In the Matter of Implementation of Sections
of the Cable Television Consumer Protection
and Competition Act of 1992, MM Docket
No. 92-266.**

Today's *Order* represents the Commission's first attempt to reexamine the many difficult and complex issues presented by cable television rate regulation. It is evident, however, that what we are doing is incomplete. We expressly reserve a number of important issues for the next phase of reconsideration and seek comment on several new questions.

I would have preferred to resolve these matters all at once. Such an approach would have been more conducive to reasoned decisionmaking. But with the effective date for rate regulation close upon us, it became evident that the Commission would not be able to answer in advance all the issues arising from this major restructuring of the cable industry.

Given this hard fact, we were faced with a choice: should we put off reconsideration altogether until we could resolve all the issues (including the cost of service proceeding), or should we try to answer as many questions as possible before the effective date? The Commission chose the latter course. Although I am not completely satisfied with this bifurcated approach, I believe it was the best choice under the circumstances.

On the other hand, I am more than completely satisfied with the Commission staff's ability to grapple with these difficult issues and produce this document. At a time of year when most of official Washington is on vacation and work flow typically slows to a crawl, these dedicated public servants continued to work the around-the-clock schedule they have shouldered since passage of the Cable Act. Their hard work makes me proud to be Chairman of this agency.

August 27, 1993

SEPARATE STATEMENT

OF

COMMISSIONER ANDREW C. BARRETT

RE: Implementation of the Cable Television Consumer Protection and Competition Act of 1992 -- Rate Regulation (First Reconsideration)

This Order on Reconsideration (Order) regarding cable rate regulation takes several actions to affirm the Commission's general approach of establishing (1) a benchmark mechanism to set initial rates for regulated tiers of service, and (2) a price cap for determining permissible rate increases. The Commission also clarifies a number of questions raised in response to the Rate Order,¹ especially regarding certain matters that require decisions prior to the September 1, 1993 effective date for the rate regulations. Finally, we seek additional comment on issues that we will resolve in the Second Reconsideration along with our decision regarding specific suggested refinements to the benchmark mechanism.

I write separately to express my concern that the Commission must remain able to implement cable rate regulations in an orderly and effective manner, especially with respect to providing certainty to consumers and the regulated cable industry on how rate regulation rules will be enforced. In this regard, I emphasize that many questions regarding the specific application of the benchmark mechanism must be resolved at a later date, such that certain conclusions in this Order are necessarily tentative in order to retain the ability to carefully resolve benchmark questions. Indeed, I believe we must have the opportunity to balance consumer, economic, and industry factors in order to avoid unintended consequences from rate regulation, including: (1) reduced levels of cable service; (2) reduced economic activity among programmers, equipment suppliers, and other service vendors; (3) the complete demise of smaller businesses, including cable operators, due to rate regulations; and (4) withdrawal of funding resources for small to mid-size cable businesses.²

With respect to phased reconsideration to meet the September 1, 1993 effective date for the rate regulations, I previously stated that the extraordinary demands created solely by the rulemakings on

¹ Rate Order and Further Notice of Proposed Rulemaking in MM Docket No. 92-266, FCC 93-177, released May 3, 1993, 58 Fed. Reg. 29736.

² See Order in MM Docket No. 92-266, FCC 93-372, released July 27, 1993; 58 Fed. Reg. 41042 (Concurring in Part and Dissenting Statement of Commissioner Andrew C. Barrett).