DOCKET FILE COPY ORIGINAL

RECEIVED

SEP 14 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)))	MM Docket No. 93-215
Rate Regulation	)))	

REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

Willkie Farr & Gallagher
Three Lafayette Centre
1155 21st Street, N.W.
Suite 600
Washington, D.C. 20036-3384

Its Attorneys

September 14, 1993

No. of Copies rec'd 0+4
List A B C D E

TABLE OF CONTENTS

Page

SUMMARY

TCI urges the Commission not to establish industry-wide rules governing cable cost-of-service showings, but to proceed on a case-by-case whereby cable operators are afforded the opportunity to show that their costs exceed benchmark rates. Only this type of approach is consistent with the Commission's goal of using cost-of-service showings as a "backstop" to benchmark regulation and, at the same time, ensuring that the majority of cable operators who will be regulated primarily by the benchmarks will not be saddled with the costs and inefficiencies associated with traditional rate-of-return regulation. A flexible approach is necessary to account for differences in costs given the wide diversity between and within MSOs.

In addition, because, in many cases a full-blown cost-of-service hearing will be unnecessary to cure problems that emerge from specific application of the benchmarks, the Commission should adopt TCI's streamlined "benchmark plus" approach that would focus on key cost factors.

In these reply comments, TCI also addresses specific pleadings that call for "regulatory parity" between the telephone and cable industries. The Commission should reject this concept outright. Not only has Congress spoken on this issue, but so has the Commission. The application of telco rules concerning cost accounting, cost allocation, ratebase and expense, rate-of-return, and productivity offsets to cable is misguided and

unnecessary. Furthermore, without more information and data on the state of the cable industry, the adoption of such rules cannot be sustained.

Finally, the Commission should reject the arguments made by some commenters that programming costs should neither be included in the ratebase nor allowed as a mark-up. The Commission should provide appropriate incentives to satisfy the broad societal interest in quality programming.

TCI's case-by-case approach is not meant to foreclose the Commission from adopting rules of more general applicability in the future. But such rules can only be adopted when the Commission has gained sufficient knowledge of and experience with the cable industry. Until that time, a case-by-case approach, complemented by the adoption of streamlined procedures, is the only sensible means of regulated cable rates.

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)))	MM Docket No. 93-215
Rate Regulation	))	

REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

Tele-Communications, Inc. ("TCI"), by its attorneys, files these reply comments in response to the Notice of Proposed Rulemaking in the above-captioned docket to establish standards for cost-of-service showings by cable companies.[1]

I. THE COMMISSION SHOULD NOT ATTEMPT TO ESTABLISH INFLEXIBLE RULES GOVERNING COST-OF-SERVICE SHOWINGS, BUT SHOULD PROCEED ON A CASE-BY-CASE BASIS.

The guiding principle for cost-of-service regulation is to develop a set of procedures that "form a 'backstop' for the benchmark approach to rate regulation." Notice at ¶ 7; First Order on Reconsideration at ¶ 13.[2] As a "backstop," cost-of-

---

[1] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, MM Docket No. 93-215, Notice of Proposed Rulemaking on Cost-of-Service Regulation, FCC 93-353 (released July 16, 1993).

[2] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket No. 92-266, First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, FCC 93-428 (released August 27, 1993).

service requirements will perform a fundamentally different role than they do for the telephone industry. Unlike traditional cost-of-service regulation, the rules developed in this proceeding have a limited purpose -- solely to provide a safety net for cable operators compelled to justify rates that exceed the benchmarks.

In order to carry out this function successfully, the Commission must refrain from establishing inflexible rules that, in effect, restrict a cable operator's ability to show that its unique circumstances and extraordinary costs warrant special treatment. If this safety net is actually going to provide the necessary degree of protection in those circumstances that require it, then operators must have the opportunity and necessary flexibility to adduce evidence of their own specific costs and capital structure.

TCI's position in this regard is completely consistent with the Commission's view of the purpose of cost-of-service regulation. Repeatedly, in defending determinations to employ broad and questionable averages, the Commission has stated that cost-of-service regulation will provide individual cable operators with an opportunity to demonstrate that they have costs that justify departure from benchmark rates. For instance, in response to arguments on reconsideration that too much reliance was placed on competitive rates in setting the benchmark rates, the Commission noted that "to the extent . . . the Commission must take into account each individual system's costs and profit in setting its rates, this can be accomplished through a cost-of-service showing, for which the Commission has provided." First Order on Reconsideration at ¶ 13.[3]

While TCI firmly believes that participants in the cable industry should be free to show why the benchmark rates are inapplicable to them, industry-wide requirements, such as depreciation schedules, accounting rules, and rates-of-return are either inconsistent with or disproportionate to the "backstop" function intended with cost-of-service regulation. Absent election of cost-of-service regulation, cable systems and their subscribers should not be saddled with all of the costs attendant to rate-of-return regulation. Because cost-of-service regulation will only be invoked in the unusual case, uniform applicability of cost-of-service requirements is neither necessary nor desirable. Moreover, use of FCC-specified industry averages, such as average cost-of-equity and average industry capital structures,[4] is inconsistent with a rate regulatory scheme that is designed to allow operators to show that their costs exceed the industry average.

---

[3] Elsewhere, the Commission justified measuring external cost increases since September 30, 1992 by saying that while "a general measure of inflation should on average, permit most cable operators to roughly approximate increases in costs, [i]n any event, operators whose costs have increased more than inflation may attempt to recover the costs experienced since Sept. 30, 1992 through a cost of service showing." Id. at ¶ 118. See also ¶¶ 14, 36, 97, and n. 180.

[4] See Joint Pleading filed by NYNEX, Bell Atlantic, and Pacific at 27.

While flexibility is needed to provide an adequate safety net for cable operators, simplified approaches are important as well. A full blown cost-of-service proceeding will, in many cases, be unnecessary to accomplish the objective of curing problems that emerge from specific application of the benchmark scheme. Therefore, instead of adopting a regulatory approach that is notorious for its cost, complexity, inherent inefficiency and unintended byproducts (in the form of distorted economic incentives), the Commission should attempt to rely upon streamlined alternatives that focus on "key cost factors, financial characteristics, or other combinations of factors" to justify rates above the benchmark. Notice at ¶ 72. Several commenters support this approach. For example, in the attachment to GTE's comments, Dr. Mark Schankerman agrees that the benchmarks need "to incorporate a more complete list of 'cost-determining' characteristics," including "key demographic features of the franchise area (e.g., population density) and technological characteristics of the cable system."[5] Dr. Schankerman understands that unless the benchmarks account for these and other types of costs, cable operators will need to submit cost-of-service showings, "which would destroy both efficiency incentives and administrative simplicity." Id. at 7.[6]

---

[5] GTE Attachment of Dr. Mark Schankerman at 7.

[6] The City of Austin objects to cost-based "add-ons" to the benchmark on the grounds that it "would result in cost-shifting, as companies seek to transfer expenses to those critical categories that will be examined out of categories that (continued...)

This "benchmark plus" approach would not only allow cable operators to make their required showing, but it would reduce significantly the burdens on the Commission in implementing cost-of-service regulation. Where streamlined alternatives appear insufficient, the Commission should simply proceed with the ad hoc "general principles" approach to cost-of-service showings that it has previously announced.

This case-by-case flexible approach is generally supported by the Comments of the Connecticut Department of Public Utility Control (CDPUC) and the New York State Commission on Cable Television. CDPUC strongly favors an approach that grants "wide latitude" to cable operators in providing data and information for cost-of-service showings.[7] Moreover, CDPUC asserts that an industry-wide rate-of-return "cannot possibly be responsive to the financial and business risk differences that exist among cable franchises operating in Connecticut."[8] Likewise, depreciation rules, according to CDPUC, cannot be adopted in this proceeding because "the subject is extremely complex [and] franchising authorities have not routinely evaluated depreciation in the cable industry for many

---

[6](...continued) will be effectively from review." City of Austin at 13-14. Cross-subsidy and cost-shifting arguments are largely inapposite unless cable systems are subject to rate-of-return regulation. These matters are of no concern under a benchmark scheme of regulation.

[7] CDPUC Comments at 1.

[8] Id. at 3.

years . . . ."[9] Similarly, the New York State Commission on Cable Television states that "it is precisely because of the complexity and burdens of cost-of-service regulation that [the Commission should] pursue with the utmost diligence various of the 'streamlining alternatives' described in paragraphs 70-75 in the NPRM."[10]

TCI's recommended approach for case-by-case treatment of cost-of-service showings is not meant to foreclose the Commission from adopting, some day in the future, rules of more general applicability. But such rules can only be accomplished when the Commission has gained sufficient knowledge of and experience with the cable industry. Until that time, a case-by-case approach is the only option.

II. THE TELCO COST-OF-SERVICE RULES CANNOT AND SHOULD NOT BE THE MODEL FOR THE CABLE INDUSTRY.

The joint pleading filed by NYNEX, Bell Atlantic and Pacific ("Joint Parties") is perhaps the most extreme contribution to this record. It argues strenuously for "regulatory parity" between the cable and telephone industries.[11]

---

[9] Id. at 2.

[10] New York State Commission on Cable Television Comments at 2.

[11] The Joint Parties' submission must constitute one of the oddest public policy recommendations ever visited upon the Commission. The Joint Parties acknowledge explicitly that the ideas tendered are bad policy.

> We believe that many of the rules that currently apply to telephone companies are

(continued...)

This premise is not one of the stated goals in the Notice, nor should it be. Moreover, Congress expressly rejected the concept of regulatory parity: "Any cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service." 47 U.S.C. § 541(c). Consistent with this view and the Commission's objective in this proceeding, the cost-of-service rules applicable to the telcos should not be applied here.

The purpose of cost-of-service regulation for the cable industry is very different from that of traditional cost-plus regulation for the telephone industry. From the beginning of telephone rate regulation, cost-of-service has been the primary form of regulation. It has been in place for decades. By its very definition, rates were developed based on costs, and uniform applicability was required because all telcos were subject to the rules; no alternative regulatory schemes existed.

By contrast, the primary method of regulation of cable is a benchmark approach, which is not based on costs. Cost-of-service regulation is intended only to provide a safety net for

---

[11] (...continued)

> outmoded and should be streamlined or eliminated. Nonetheless, so long as the Commission believes that it must pervasively regulate telephone companies, these considerations, reinforced by the Congressional policy underlying the 1992 Cable Act, support the adoption of rules for cable that closely resemble the rules for telephone companies.

Joint Parties at 2. This disclosure is a warning label the Commission should heed.

those cable operators that need to justify rates that are above benchmark levels. The benchmark addresses an industry average, but those departing from this average due to extreme diversity -- age of systems, penetration, extent of rebuilds, etc. -- need an alternative to the benchmarks to justify rates above the benchmark because of higher costs. Even the Joint Parties recognize this "backstop" function: "[T]he cost-of-service regulations serve exclusively as a backup safety valve for those operators who choose to invoke it for their own benefit." Joint Parties at 9. This difference alone justifies departure from the telco model of cost-plus regulation, even if the Commission does not agree with the Joint Parties that cost-of-service regulation is "outmoded and should be streamlined or eliminated." Joint Parties at 2.[12]

TCI is not alone in this view. It is shared widely by the leading scholars in the field, including Professor Kahn, who only recently has served as an expert for one of the Joint Parties in a highly publicized constitutional case.[13] In 1981, Professor Kahn authored a report with Dr. Irwin M. Stelzer that concluded that because of the dynamic nature of cable television, "the application of traditional regulatory concepts and

---

[12] There simply is no need to impose cost-of-service obligations on all cable systems seeking higher-than-benchmark rates because the benchmark system exists; there is no parallel to the benchmarks for telephone companies.

[13] Reply Affidavit of Alfred E. Kahn (May 24, 1993) submitted on behalf of plaintiffs in Chesapeake & Potomac Tel. Co. of Virginia v. United States, Civil No. 92-1751-A (4th Cir. Aug. 24, 1993).

techniques is most likely to obstruct the full development of that potential."[14] Kahn and Stelzer provide several reasons why the rates and services offered by cable operators should not be subject to traditional public utility regulation.

> (1) Cable is not an essentially standard service, like water, electricity or gas, but a wide and varied range of services. . . . (2) The market and technology are extremely dynamic, and the service definitions and stipulations in any given year are subject to becoming outdated within a very short period of time. What may economically be provided will vary not only from one market to the other, but from one year to the next. (3) For many of the services, there are . . . noncable substitutes -- over-the-air radio and television broadcasting; movies and live entertainment; . . . [and] telephone companies, who already have a wire into almost every home. Most of these services can hardly be characterized as necessities, justifying the imposition of the heavy hand of utility regulation.

Id. at 8.

The telephone industry, unlike the cable industry, can be characterized as stable and mature throughout much of its history. But, as Kahn and Stelzer point out, where:

> market opportunities are in considerable measure unpredictable and subject to change and where we want to encourage risk-taking innovation, holding returns to some rate that a regulatory commission is likely to regard as 'reasonable' is highly likely to discourage the provision of desirable services, and especially to stifle innovation.

---

[14] Telecommunications in New York State: Redefining the Role of Government, New York State, Executive Chamber, Office of Development of Planning, April 1981, Appendix B, at 2.

Id. at 9. Most importantly, in cases where cable rate regulation is applied, Kahn and Stelzer:

> would strenuously resist any attempt to convert it to the traditional public utility mode, basing allowable rates on an acceptable return on invested capital, with all its inescapably accompanying paraphernalia of uniform systems of accounts, valuation of rate base, allocations of investment and operating costs between 'basic' and other services, and estimation of cost of capital.

Id. at 9-10.

Moreover, regulatory parity is not a view that is fully endorsed by other telephone companies. While BellSouth, for example, argues for "competitive parity" between the cable and telephone industries, it correctly acknowledges the purpose for which cost-of-service regulation is intended, that is, as a safety net that affords cable operators an opportunity to recover the cost of providing regulated cable services. BellSouth at iii. BellSouth also understands the pitfalls associated with traditional cost-of-service regulation.

> The Commission should resist the temptation simply to engraft into cable regulation the traditional cost-of-service regulation applied to telecommunications companies. Instead, the Commission should use this proceeding to take a fresh look at the traditional regulatory process and to prune away aspects of that process that do not produce benefits that exceed their costs. The Commission should look for ways to streamline cost-of-service regulation for cable operators . . . .

BellSouth at iii. BellSouth is also correct that application of unnecessary and inefficient regulation should not be applied to cable operators. BellSouth at 3.

A. The Commission Should Not Adopt Cost Accounting and Cost Allocation Rules.

The adoption of cost accounting and cost allocation rules for cable services is contrary to the Commission's objective to utilize cost-of-service regulation as a safety net. To subject all carriers to burdensome cost accounting and financial reporting requirements when only a relatively few cable systems are expected to submit cost-of-service showings is overly burdensome and, more importantly, unnecessary to achieve the Commission's objectives in this proceeding.

For the telephone industry, cost accounting rules and a prescribed USOA were necessary features of a uniformly-applicable regulatory regime based on costs. But, because the primary method of regulation for the cable industry is a benchmark scheme that is not based on costs, cost-of-service rules only come into play when a cable operator elects a cost-of-service showing. Since only in the unusual circumstance will cable operators make this election, TCI urges the Commission to permit a case-by-case showing in accordance with Generally Accepted Accounting Principles.[15]

---

[15] Because the Commission's rules already prohibit cable operators from cross-subsidizing other ventures with revenues from regulated services, cost allocation rules, beyond what is required by GAAP, are not necessary. See 47 C.F.R. § 76.924(b) and (g). BellSouth also supports the use of GAAP accounting procedures, stating that only "the minimum requirements that are necessary to make cost-of-service regulation meaningful and effective" should be imposed. BellSouth at iv, 4.

Moreover, it will be impossible for the Commission to develop accurate cost accounting and cost allocation rules in (continued...)

B. The Commission Should Not Adopt Rigid Ratebase and Expense Rules

The Joint Parties claim that the ratebase and expense treatment customarily applied to telephone companies should apply to the cable industry based on the plainly incorrect hypothesis that regulatory parity between the cable and telephone industries is a legitimate public policy established by the 1992 Cable Act. However, the Joint Parties fail to account for a crucial difference between the local telephone industry and the cable industry that undermines their advocacy of comparable ratebase and other regulatory elements.

The telco rules governing regulated ratebase and expenses have evolved over decades, with ample time for the telephone companies to adjust to changing regulatory requirements that generally affected their returns only at the margins. The fact that for many decades the supply of telephony in this country was fully integrated and coordinated in almost every aspect -- operationally, financially, and technically -- made it appropriate to use broad averages and rules of industry-wide application. Thus, the history of the telephone business itself justified the use of these regulatory "shortcuts."

By contrast, rate regulation of the cable industry is starting at a very different point, characterized by a widely

---

[15](...continued)
this one proceeding. TCI has explained in detail how long it took the Commission to establish such requirements for the telephone companies. See TCI's Comments at 51-56.

diverse and unconcentrated collection of entities. Even among MSOs, and in fact within TCI, cable systems differ widely operationally and technically. Even where there are superficial similarities, an MSO's systems often will accomplish similar functions in very different ways. Over the last two decades, cable systems have grown and developed in fundamentally different ways through a wide variety of engineering, management, and financial practices. Unlike the telephone companies, the thousands of cable systems are widely disparate in such matters as systems design, equipment, technological development and deployment, etc. The regulatory regime adopted in this proceeding should reflect the fact that historical differences exist between the cable and telephone industries.

Moreover, the use of broad averages and industry-wide requirements may be appropriate when that is the primary method of regulation. But, where the purpose of cost-of-service regulation is to provide a safety net, acceptance of the Joint Parties' recommendations could well have the effect of removing the safety net altogether, leaving the cable industry to contend with an abrupt imposition of rate regulation that in some cases could produce very drastic consequences.

Disallowing "excess acquisition" costs and accumulated losses, for example, is not appropriate as a hard-and-fast general rule for an industry such as cable where such acquisitions were reasonable, prudent, and customary when they were incurred. The cable industry's harshest critics have claimed that certain cable acquisitions in the 1980's were overpriced. But this possibility cannot result in a blanket disallowance of such costs or substitute for a thorough investigation of whether these costs should legitimately be included in the ratebase. The comments provide numerous and valuable reasons on why acquisitions are made, including the ability of cable operators to generate efficiencies that benefit the operators and subscribers alike. And, even the City of Austin realizes that summarily disallowing excess acquisition costs is not appropriate. City of Austin at 3.[16]

Based on this record, it is erroneous to conclude that all "excess" acquisition costs are capitalized monopoly profits. Given that the telephone companies have been operating under cost-based regulation for over many decades, the Commission has had ample opportunity to examine their operations, and could properly determine that "excess" acquisition costs presumptively are due to expected monopoly rents. Without more information on cable industry practices, one cannot make the same assumption here. Thus, the Commission is in no position to disallow these costs without more data on the record. The benefits associated with these acquisition prices are, and should be, fairly

---

[16] GTE similarly argues that acquisition costs in excess of such costs be excluded "to the extent [these costs] are associated with monopoly rents." GTE Comments at 21. Presumably, costs not associated with monopoly rents would be included in the ratebase.

reflected in the acquisition price. Accordingly, these costs should be included in the ratebase.[17]

Similarly, accumulated losses and intangible capital should not be denied ratebase treatment by general fiat. First, the record is replete with evidence that start-up losses are common throughout the cable industry and are only recouped after the system matures. This is the case not only with cable but with every high fixed cost industry. Second, intangible capital in the form of subscriber lists, franchising rights, goodwill, etc., provide substantial benefits to subscribers. Depriving investors a return on intangible capital or their investment for these losses is not only unfair but it would discourage potential investors from making future investments. Only through individualized cost-of-service showings will the Commission be able to determine whether these costs could be properly excluded from the ratebase.[18]

---

[17] The argument advanced by the New Jersey Board of Regulatory Commissioners that excess acquisitions costs "can not be realistically reviewed by objective standards because they _may_ represent expectations of monopoly rates," misses the point. New Jersey Board of Regulatory Commissioners at 7 (emphasis added). That these costs _may_ reflect monopoly rents does not mean that they in fact do. This mere possibility, however, is not enough to adopt an industry-wide rule that all such costs should be disallowed.

[18] The City of Austin would also disallow cable system upgrades unless the operator can demonstrate that the rebuild substantially benefitted subscribers of regulated services. City of Austin at 10-11. The comments filed by the New York State Commission on Cable Television correctly address this issue:

> We note, initially, that the concept of 'excess capacity' as it applies to cable

(continued...)

C. There is No Basis on This Record for Establishing an Industry-Wide Rate-of-Return.

Although the Joint Parties throughout most of their pleading advocate "regulatory parity" between the industries, they notably abandon that concept on the issue of the appropriate rate-of-return for cable. Instead of arguing for regulatory parity and a rate-of-return that is equal to their own, the Joint Parties estimate a rate of return of 8.83%. In the telco context, establishing a rate-of-return for the telcos takes several months, includes a voluminous record, and produces a lengthy Report and Order. Professor Vander Weide, on behalf of the Joint Parties, tackles this arduous task in a 23 page study. Plainly, the 23 pages are so assumption-laden that the 8.83% figure should be rejected out of hand. But Professor Vander Weide's study is valuable. It shows conclusively, if unintentionally, that a single cable industry-wide cost of capital could not possibly be specified if the goal is to permit a firm to demonstrate why the benchmark price is inadequate. To

---

[18](...continued)

> television systems may be difficult to apply. Where a franchise requires a cable operator to rebuild or upgrade a system to a specified minimum capacity, we do not believe that the concept of 'excess capacity' is relevant. Given the capital intensive nature of plant construction for cable television systems and the emphasis of federal and state policy on diversity of programming available, but temporarily unused, channel distribution capacity is decidedly in the public interest and should not be excluded in the rate base.

New York State Commission on Cable Television at 7.

adopt Professor Vander Weide's conclusion or his methodology would be to read cost-of-service showings out of the regulatory scheme.[19]

As TCI advocated in its initial comments, the Commission should determine rates-of-return on a case-by-case basis. A unitary rate-of-return will not adequately reflect the actual cost elements for all cable operators. It is important -- indeed, indispensable in light of the role the Commission assigns to cost-of-service regulation -- that cable operators electing to make a cost-of-service showing have the opportunity to support their own specific costs and capital structure. Any "shortcuts" to this approach would contravene the safety net purpose of cost-of-service regulation.

D. There is No Basis For Concluding That the Telco Productivity Offset or Sharing Mechanism Should be Applied to Cable.

Despite the numerous studies that were conducted and the extensive debate that ensued regarding the appropriate productivity offset for the telephone industry,[20] the Joint

---

[19] BellSouth calls the Commission's attempt to resolve both methodology and prescription issues in this one proceeding "exceedingly ambitious," noting that the Commission has conducted three separate methodology proceedings since 1984 and is still contemplating procedures to perform rate-of-return prescriptions for telephone companies. BellSouth at 18.

[20] See, e.g., Testimony of L. Christensen filed in United States v. AT&T, Civ. Action No. 74-1698 (filed D.D.C. 1974) (measured total factor productivity for the Bell System for the years 1947-78); AT&T, Bell System Productivity Study 1947-78 (Nov. 1979); M.I. Nadiri & M. Schankerman, The Structure of Production, Technological Change, and the Rate of Growth of Total Regulated Industries (T. Cowing & R. Stevensen eds. 1981); M. (continued...)

Parties as well as GTE argue that the cable industry should be subject to the same productivity offset as the telephone companies.[21] There are no facts, let alone any quantitative evidence, provided in this record to support this contention.[22] More importantly, no data have been provided which support the view that the cable industry's productivity growth deviates substantially from that of the economy as a whole.

Absent such hard data, it is simply not possible for the Commission to determine that a productivity offset is appropriate for the cable industry based on this record. And, even if the Commission concluded that a productivity offset should be applied, it would take a great deal of time and analysis to determine the appropriate offset. More analysis on

---

[20](...continued) Denny, M. Fuss & L. Waverman, The Measurement of Total Factor Productivity in Regulated Industries, with an Application to Canadian Telecommunications, Productivity Measurement in Regulated Industries (T. Cowing & R. Stevensen eds. 1981); American Productivity and Quality Center, Multiple Input Productivity Indices; Bureau of Labor Statistics, CPI Sub-Index for Telephone Service 1935-85; J. Kendrick, Improving Company Productivity 87, 102 (1984); Bellcore, The Impact of Federal Price Cap Regulation on Interstate Toll Customers (Mar. 17, 1988); J. Frentrup & M. Uretsky, A Study of Local Exchange Carrier Post-Divestiture Switched Access Productivity, 5 FCC Rcd 2176 (Appx. C) (1990); T. Spavins & J. Lande, Total Telephone Productivity in the Pre- and Post-Divestiture Periods, 5 FCC Rcd 2176 (Appx. D) (1990).

[21] GTE Attachment of Dr. Mark Schankerman at 20; Joint Parties at 11-13.

[22] Dr. Schankerman proposes that the price cap should be based on Total Factor Productivity (TPF) and input prices for "competitive unregulated cable systems." GTE Attachment of Dr. Mark Schankerman at 19. This approach ignores the problems raised by the small and idiosyncratic nature of the competitive systems.

this question is required than just simply saying that "[c]able's productivity offset should replicate the adjustment currently applicable to most telcos." Joint Parties at 12.

The prescribed productivity offsets for AT&T and the LECs, for example took four notices, two orders, and one reconsideration over a span of four years.[23] Moreover, a productivity offset and, in addition, a sharing mechanism was ordered because of a strong suspicion that telco inefficiencies attributable to rate-of-return regulation had accumulated over the decades. Cable companies have never been subject to these regulatory distortions and incentives to inefficiency. Thus, a productivity adjustment is not merely unachievable on this record, but there is no basis in a telephone company analogy for regarding it as necessary.[24]

III. PROGRAMMING COSTS SHOULD BE EXPENSED WITH A MARK-UP.

A few commenters, such as the Joint Parties, City of Austin, and CFA argue that programming costs should neither be included in the rate base nor allowed a mark-up. The City of Austin claims that allowing a mark-up on programming would create

---

[23] See Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Notice of Proposed Rulemaking, 2 FCC Rcd 5208 (1987); Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195 (1988); Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989); Supplemental Notice of Proposed Rulemaking, 5 FCC Rcd 2176 (1990); Second Report and Order, 5 FCC Rcd 6786 (1990); Order on Reconsideration, 6 FCC Rcd 2637 (1991).

[24] As a general matter, scale economies are already included in the benchmarks so it would be "double counting" to take them into account in a productivity offset.

perverse incentives to add programming regardless of customer demand. City of Austin at 7. Programming expenses are unlike other ratebase expenses, such as physical plant. Whereas it is possible under cost-of-service regulation to make inefficient capital improvements, cable operators have no incentive to offer undesirable programming services. The relationship between cable operators and their programmers is by necessity close, and the success or failure of the programming service and the cable system that carries it are interdependent. As a result, programming services that do not meet customer expectations will adversely affect the cable operator's ability to sustain high penetration rates.

Similarly, CFA's argument for disallowing a mark-up on programming expense should be rejected. While CFA is correct that in an unregulated market, a programmer that exceeds the market price would lose business, this is not to say, as CFA does, that the market price excludes "economic profits." See CFA at 5-6. On the contrary, in an unregulated environment, prices for services usually include a profit margin or mark-up, and TCI requests that programming expense be treated no differently. Even more important, it is desirable to provide incentives to provide quality programming given the broad societal interest involved. Moreover, there is no merit to CFA's argument that a cable operator "can avoid . . . market discipline by bundling or otherwise giving preference to self-provided programming. Id. The program access rules prevent such events from occurring.[25]

---

[25] Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity in Video Program Distribution and Carriage, MM Docket No. 92-265, First Report and Order, FCC 93-178 (released April 30, 1993).