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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	)	

JOINT REPLY COMMENTS OF CABLE OPERATORS AND ASSOCIATIONS

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JOINT REPLY COMMENTS OF CABLE OPERATORS AND ASSOCIATIONS[1/]

On behalf of the cable television operators and state cable associations listed in footnote 1, we submit the following reply comments in further response to the Commission's Notice of Proposed Rulemaking on cost-of-service standards to be implemented as part of the Commission's overall rate regulation for cable television operators.[2/]

1/ The participating **cable operators** include: KBLCOM, Inc., Century Communications Corp., Jones Intercable, Inc., Scripps Howard Cable Company, TeleCable Corporation, Bresnan Communications Corp., Greater Media, Inc., Monmouth Cablevision Associates, Rifkin & Associates, Simmons Communications, Inc., Western Communications Alaskan Cable Network, Inc., Allen's Television Cable Service, Inc., Brownwood Television Cable Service, Inc., CableAmerica Corp., CableSouth, Inc. Cable USA, Inc., Columbus TV Cable Corp., Coosa Cable Company, Inc., Corsicana Cable TV, Gilmer Cable Television Co., Inc., Grassroots Cable Systems, Inc., Halcyon Communications, Inc., Helicon Corp., James Cable Partners, OCB Cablevision, Inc., Phoenix Leasing, Inc., Rock Associates, Satcom, Inc., Sjoberg's, Inc., Starstream Communications, Sweetwater Television Company, TCA Cable, Inc. United Video Cablevision, Inc., and Zylstra Communications Corp. The participating **state associations** include: Cable Television Assn. of Georgia, South Carolina Cable Television Assn., Tennessee Cable Television Assn., and Texas Cable TV Assn.

2/ Cost-of-service proceedings are intended to provide cable operators the opportunity to justify rates above benchmark

[Footnote continued]

In this Joint Reply, we briefly reiterate the proper elements of cost-of-service requirements,[3/] and also demonstrate the inequity in applying the restrictive approaches and interpretations urged by groups representing franchising authorities and consumer groups,[4/] as well as the local exchange carriers ("LECs").[5/] Not surprisingly, CFA expects that rates will be set

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[Footnote continued]

levels due to costs of providing regulated cable service. Notice of Proposed Rulemaking, In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 -- Rate Regulation, MM Docket No. 93-215, ¶ 5 (released July 16, 1993)("NPRM").

3/ As with our opening comments, these joint reply comments are without prejudice to the arguments Century Communications Corp. has made in its Petition for Reconsideration and its Petition for Writ of Mandamus. For the reasons set forth in those papers, Century maintains that cost-of-service regulation is unlawful under the Cable Act. In the event that cost-of-service regulation is appropriate, these reply comments set forth Century's views as to the specific deficiencies in the Commission's proposal, and how those deficiencies should be corrected.

4/ See, e.g., Comments of the National Association of Telecommunications Offices and Advisors, The National League of Cities, the United States Conference of Mayors, The National Association of Counties ("NATOA, et al."), Comments of Michigan Ad Hoc Committee for Fair Cable Rates ("Michigan Committee"), Comments of Utah League of Cities and Towns ("Utah League"), Comments of the Aerie Group, Incorporated ("Aerie"), Comments of Counsel to the Municipal Franchising Authorities ("MFA"), Comments of Austin, Texas, King County, Washington, Montgomery County, Maryland ("Austin, et al."), and Comments of the Consumer Federation of America ("CFA").

5/ Joint Comments of Bell Atlantic, the NYNEX Telephone Companies and the Pacific Companies ("BOC Joint Comments"); Comments of GTE; Comments of BellSouth Telecommunications, Inc.

so low that only cable companies facing bankruptcy could obtain cost-of-service relief.[6/] In a similar vein, franchising authorities want to exclude all acquisition costs from ratebase calculations and arbitrarily deny access to cost of service proceedings unless costs are "extraordinarily" higher.[7/] Bell Atlantic has proposed here application of full Title II regulation to cable, replicating telco regulation, although the rules applied to telcos are concededly "outmoded" and should be modified.[8/] BellSouth, on the other hand, usually one of cable's harshest critics, does "not endorse the application of unnecessary and inefficient regulation to cable operators simply because such regulation is currently applied" to telcos.[9/]

GTE harps on the "regulatory parity" theme throughout, challenging Congress' express direction that cable not be subject to Title II regulation as a common carrier. GTE cites and acknowledges Section 621(c) of the Communications Act, which provides that "any cable system shall not be subject to regulation as a common carrier or utility by reason of providing cable service". 47 U.S.C. § 541(c). GTE, however, argues that the cable

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6/ CFA Comments at 4.

7/ Comments of NATOA, et al. at 14; MFA Comments at 4, 22; Comments of Michigan Committee at 14; Comments of Utah League at 14; Comments of Austin, et al at 8.

8/ BOC Joint Comments at 21.

9/ BellSouth Comments at 3.

industry has "stretched this provision to apply in a way Congress could never have intended" to prohibit regulatory parity.[10/] GTE conveniently overlooks Congress' more recent direction in the legislative history of the 1992 Cable Act which provides that cost-of-service "will not replicate Title II regulation."[11/]

The proposals advanced by the franchising authorities, consumer groups and LECs, moreover, are suspect on policy grounds as well. A narrow and restrictive approach to cost-of-service rules, penalizing and punishing cable operators, rather than providing reasonable avenues for cost and rate justification, is not consistent with any legislative command or regulatory policy.

I. INTRODUCTION AND SUMMARY

In the initial comments filed by the cable operators and associations ("Joint Comments"), we made in-depth analyses of cable system operations and financial statements to provide the Commission with economic, business, and technical information pertinent to the cable industry and the impact of rate regulation on that industry. In particular, the relationship of rates to existing assets (both tangible and intangible) and expenses demonstrated that most operators utilize an extended business plan

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10/ Id.

11/ H.R. Rep. No. 628, 102d Cong., 2d Sess. 83 (1992)("House Report"). See NPRM ¶ 15, at n. 16.

which results in (1) losses in the early years of operating or acquiring a system; (2) reduced earnings until later years; (3) a gradual reduction of accumulated deficits, and only in the last few years of a business plan (generally coinciding with the franchise term); and (4) the opportunity to earn a reasonable profit. As further demonstrated, operators who sell their systems prior to completion of the business plan merely collect payment for the early losses, as well as obtain value for other tangible assets. This practice results in a price that generally exceeds the cost of the assets, because the value of those tangible assets does not reflect the total capital committed to the enterprise.

Unlike the various public utilities urged by some as comparable, the cable industry is not a cash distribution operation. Dividends are sparse, and even in situations where cash flow is positive, cumulative deficits, debt reduction, and capital investment prohibit cash distributions to the equity investors. With cable, there is substantial risk in building a system that, at the outset, has no subscribers and even after years of maturity, may only achieve a 60% penetration.[12/] Accordingly, business plans have extended out over many years

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12/ There is no credible argument that cable is not an inherently more risky than telephone. Indeed, this conclusion is borne out by simply looking at the publicly traded cable companies whose "betas" reflect a volatility far in excess of the market in general and the telcos in particular. Joint Comments at 82.

providing for gradual rate increases which, due to the economics of the business, were not limited to simply inflation. The so-called acquisition "premiums" are nothing more than compensation to the initial operator for the risk incurred and the capital committed to the start-up of the business. In addition, given the risks and additional technical obligations attendant upon renewal, the ability of cable operators to implement a business plan which allows for capital recovery in the franchise period will maintain the financial viability of the system and the operator. Renewal is not guaranteed and franchises are frequently awarded with shorter terms.

The proposals offered by the cable industry's various detractors neither address nor resolve any of the issues concerning the actual financial structure or operation of the cable industry. In these reply comments we will supply additional system-specific analysis to confirm the types of business plans, investment decisions, and re-build determinations which must be reflected in the cost-of-service regulatory regime in order to provide for a reasonable balancing of investor and subscriber interests. These distinguishing factors concerning the cable industry -- significant to the extent that no detractor has presented an industry in a similar state of maturity or operation -- disproves the claims by detractors that cable operators are "like" telephone companies and should be subjected to identical regulatory rules and policies.[13/]

13/ Most of these commenters call this theory "regulatory parity". Indeed, the LECs and other groups refer to "parity"

[Footnote continued]

The "parity" argument has only surface appeal as it follows from the often mentioned "convergence" of telco and cable.[14/] Although telco and cable are indeed converging, differences in the two industries and between the typical LEC and cable operator are nonetheless substantial.[15/] These differences -- both economic and technical -- will remain for some time, although recent court decisions may hasten the elimination of barriers between the two industries.[16/]

If the Commission were to accept the "regulatory parity" argument as proposed, the results would be ridiculous. For example, telco and cable provide the same "service" much the same way that busses, trains, and planes provide the same service and compete for the same passengers. All three of those entities can transport an individual from Washington, D.C. to New York City. However, for "regulatory parity", no one would seriously suggest

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[Footnote continued]

throughout their comments. See, e.g., BOC Joint Comments at 4-26; GTE Comments at 9-12; Comments of AERIE at 9-13.

14/ "Convergence" has become the telecommunications mantra of the 1990s, much like "plastics" was the manufacturing mantra of the 1960s.

15/ The multitude of differences in maturity, penetration, lines of business and others are all discussed in more detail in the Joint Commenters' initial comments at pages 53-62, and 79-84.

16/ Chesapeake & Potomac Tel. Co. of Va. v. United States, 1993 U.S. Dist. LEXIS 11822 (E.D.Va. 1993).

that busses be outfitted with pressurized cabins or that airplanes have brake lights. Accordingly, adherence to a reflexive "regulatory parity" policy would produce absurd results given the undeniable differences in the telco and cable industries.

Many of the opposing commenters also argue that cost-of-service showings should be limited or prices will go up.[17/] This rather foolish proposition would eliminate the entire rationale for having cost of service rules in the first place -- to allow for adequate recovery of costs, including reasonable capital costs. If costs justify higher rates, that is the consequence of cable economics. Cable operators have real bills to pay and real obligations to investors and creditors. There is no basis for disallowing costs merely because consumer groups or franchising authorities would be dissatisfied with the results.

Finally, a number of the opponents challenge the inclusion of any acquisition premium in the ratebase, and suggest original cost as the only approach to valuing the ratebase.[18/] As we demonstrated in our initial comments, recovery of acquisition costs is rightfully allowed. The costs do not reflect

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17/ MFA Comments at 3; Comments of Aerie at 4; Austin, et al. at 1. See Utah League at 6-7; Michigan Committee at 6-7.

18/ See e.g., NATOA Comments at 14; CFA Comments at 3; MFA Comments at 19; Michigan Committee at 13; Utah League at 13.

monopoly rents, but rather, as intangible assets, reflect (1) established subscriber base; (2) franchise operating rights; (3) subscriber growth; and (4) other economies. In the absence of any specific economic study or substantive analysis by the various opponents of inclusion of acquisition costs in the ratebase, the Commission cannot merely accept unsupported argument for their exclusion. Similarly, as we demonstrated in our opening comments, the original cost for tangible assets is mostly unknown and has no relationship to the actual amount of capital committed to the operation and construction of the system. Accordingly, a ratebase limited to tangible assets would not generate reasonable rates and could not be sustainable under ratemaking precedent.

In our opening comments, we also suggested a number of methods for streamlining cost-of-service showings allowing for adjustments to the benchmarks to reflect, for example, particular capital improvements as well as subscriber growth.[19/] While some detractors have argued against any streamlined approach, lest the process become too "easy",[20/] the sole purpose for cost-of-service showings, as well as the need to streamline the entire process, merit outright rejection of this rhetoric. A number of other details concerning items such as productivity

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19/ Joint Comments at 96-104.

20/ See, e.g., Comments of Aerie at 2; Comments of Michigan Committee at 22; Comments of Utah League at 22.

offsets, operating expenses, and the like, also are dealt with inconsistently by the opposers, but with one theme -- drive the cable operators' rates to new lows and provide relief only to avoid bankruptcy.[21/]

While bashing cable may seem politically correct, it is entirely incorrect as a matter of law and regulatory policy. The consumer groups' proposals thus reflect, as Chairman Quello previously noted, CFA's "pathological disregard for the real world implications of its suggestions."[22/] The Commission should ignore the clamor to impale cable operators on confiscatory rates.

II. Regulatory "Dis"parity

As might have been expected, the telcos, as well as a number of consumer groups, have argued strenuously to impose the

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21/ CFA Comments at 4.

22/ Order in MM Docket No. 92-266, FCC 93-372 (separate statement of Chairman Quello) at 1, July 27, 1993. In that order, the Commission rightly refused to cave into the unreasonable demands of CFA to accelerate the implementation of rate regulation and allow subscribers to withhold unilaterally 15% of their cable bills. Id. As the Commission stated CFA's "petition appeared to be more of an effort to grab headlines and to engage in self-aggrandizement than a serious plan for rate regulation. . . . [The FCC] has a statutory obligation to regulate the communications industry for the benefit of all the public, and is not obliged to accede to the demands of groups who, despite their pretensions, have not been appointed the bargaining agents for all consumers." Id.

telco regulatory regime on cable operators, with a complete Title II-type regulation replete with depreciation prescriptions, tariffs, strict accounting rules and ratebase restrictions.[23/] Their argument ignores Congress' express direction not to subject cable operators to Title II regulation.[24/] Moreover, the entire premise for Title II regulation -- the absence of competition -- does not exist with respect to cable. Cable is clearly subject to substantial competition now, and it is expected that this competition will be fully "effective" shortly. Cable has no equivalent of a protected monopoly for any of its services.[25/] No equivalent "overbuild" of the LEC monopoly intraLATA distribution network has yet been completed, let alone operated to date. The essential elements of utility regulation to which the telcos hope cable becomes subject, therefore do not apply. "Government [has] forced upon the utility an obligation to provide service, but that obligation, as we have seen, is quid pro quo for a protected area of service. . . ."[26/] Without this protected area of

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23/ See, e.g., BOC Joint Comments at 4-26; Comments of GTE at 9-12; Comments of CFA at 6-8.

24/ NPRM ¶ 15 at n. 16; House Report at 83.

25/ Availability of multiple franchises has always been a part of the cable industry, as recognized by the Commission's consideration of "overbuilds" in calculating benchmark rates. Indeed, as pointed out in some petitions for reconsideration and petitions for writs of mandamus, the Commission's inclusion of overbuild systems with below cost rates due to short-term price wars has resulted in benchmarks that do not reflect true competitive rates and are confiscatory.

26/ Jersey Central Power & Light Co. v. F.E.R.C., 810 F.2d 1168, 1190 (D.C.Cir. 1987)(Starr, J. concurring).

service, the strict obligations inherent in the regulatory compact (non-discriminatory service and limitations on operation and rates) are not counterbalanced by a statutory or regulatory monopoly. Indeed, the Commission noted that cable television consists of a unique cluster of services and that local broadcasters, video cassette rentals, and others provide cable with varying degrees of competition.[27/]

Moreover, the Commission refused to find the existence of cable market power based on post-deregulation increases in basic cable rates.[28/] In any event, to the extent there has been an increase in horizontal concentration and vertical integration of the cable industry, it has not been a detriment to subscribers through mere increases in cable rates. To the contrary, the Commission in fact agreed with federal agencies, cable interests and others that

> horizontal concentration and vertical integration produced a significant benefit for cable subscribers. Higher concentration levels in the cable industry have enabled companies to take advantage of valuable economies of scale, and foster investment in more and better program sources, which lead to more investment in programming, more

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27/ Report in Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, MM Docket No. 89-600 (released July 31, 1990) at ¶ 69.

28/ Id. at 70. Opponents have argued that the increases in rates reflected "monopoly rents" yet provide no evidence beyond the increases in rates themselves. See, e.g., Comments of NATOA, et al. at 13; CFA Comments at 3.

original programming, and a wealth of new viewing options for consumers.[29]

Telco and cable financial structures are also quite different. Many cable systems have either accumulated deficits or no net profits. On the telco side, however, profitability is at an all-time high. A recent NARUC study examined total electric utility and telephone company shareholder returns compared with those of non-regulated corporations. NARUC's first study covered the period of 1972 through 1986, and the most recent study expanded the analysis through 1991. For those nineteen years, "utility equities have been a more profitable investment vehicle than those of non-regulated corporations."[30] NARUC's most recent updated study actually found regional holding companies earning even more substantial rates of return. For example, Bell Atlantic is earning 19.53%, while at the same time arguing that cable should be limited to 8.9% overall rate of return.[31]

29/ Id. at ¶ 82.

30/ National Association of Regulatory Utility Commissioners, Electric and Telephone Utility Stockholder Returns: 1972-1990, (Aug. 2, 1991). Not only did the study find that the average Bell stockholder almost quadrupled the value of his investment since divestiture, the study also found that shareholders had returns substantially greater than those earned by investors who purchased AT&T stock at the same time and held it over the entire study period. The study concluded that the "often repeated argument of utility sympathizers regarding the 'inadequacy' of earnings and the inability of utilities to attract investment capital are unfounded and without merit."

31/ Compare Hamilton, Study Shows High Returns for Utilities, Wash. Post, Sept. 10, 1993 at B-1, B-8 with BOC Joint Com-

[Footnote continued]

The telephone and cable industries also are at different levels of maturity. The telephone industry is currently at a 95% penetration, while cable is at 60%. The telephone industry reached 60% penetration approximately 45 years ago, at a time when it was without the least bit of competition and had been regulated for some 40 years. Cable, on the other hand, is new to the regulatory process imposed by the 1992 Cable Act, and cannot be expected to digest in one year -- or even five years -- the ancient obligations long attendant upon common carriers and other regulated industries.[32/]

[Footnote continued]

ments at 29, n.73. The BOC four year old rate of return -- 11.25% -- provides for 12.25% before sharing, and after sharing, up to 14.25%. Assuming a 50% equity ratio and a cost of debt of 8%, this translates to a 20.5% return on equity. Because the cost of both debt and equity for telcos has dropped in the last four years, the overall rate of return for telcos under current market conditions should be set at approximately 9%. If regulatory parity is truly the BOCs' goal, cable should be allowed to earn the 19.53% that Bell Atlantic is earning, until the BOC rate of return is reduced.

32/ The Commission has recognized from the beginning that entities willing to risk capital, and develop technologies (and grow) in the early stages, should be accorded substantial leeway. The Commission has concluded they should be encouraged, rather than discouraged, from continuing to provide service under such conditions. See In the Matter of Establishment of Procedures to Provide a Preference to Applicants Proposing an Allocation for New Services, 6 F.C.C. Rcd. 3488, 3490 (1991).

For this reason, Joint Commenters have suggested that a transition phase be allowed initially and then phased out as the industry matures, copes with regulation, and completes the "convergence". The Commission here is not performing routine telephone ratemaking proceedings; instead it is subjecting the whole industry to rate regulation for the first time. This unique situation requires unique measures, some of which were in existence when telephone regulation was in its fledgling state, all of which are necessary to equitably balance the interests of subscribers and investors.

Second, because it is anticipated that cable will be unregulated again in the near future as "effective competition" develops, a flash-cut to full-fledged Title II regulation now also would be punitive in that it would deprive cable operators of the funds they need right now to position themselves to survive that competition -- whether by system expansion, conversion to digital, deployment of fiber, or other measures. Accordingly, a transition period is needed whether competition develops tomorrow or in ten years. That same transition will minimize the negative impact of rate regulation on the ability of cable firms to prepare for competition.

Finally, the notion that the telcos and cable operators are employing identical technologies should be laid to rest. This assertion is used to justify identical regulation of

depreciation and investment decisions with respect to capital deployment and equipment purchases. However, one fundamental difference renders this comparison inapposite. The LEC integrated voice and video network requires switches to deliver video, making the LEC video switch the essential bottleneck through which video programming must pass.[33/] For true communications specialization, the centralization of network control and switching must end to allow the user to customize the network with the use of customer premise equipment, so that each user can determine his or her own needs. This is the approach for cable and will result in far greater technological capability and subscriber interfaces.[34/]

Decentralization mirrors the movement in the computer field where very powerful mainframes with a number of "dumb"

33/ The direct costs of the telco integrated approach have been publicly estimated at $400 - $500 billion (compared with the $20 billion to fiberize existing cable TV plant, which already passes 90% of the television households).

34/ The argument that cable and telcos should be regulated in the same manner because they are each placing increasing reliance on fiber is nonsense. First, the networks into which fiber is deployed are fundamentally different, as set forth above, with cable using a "tree and branch" structure, and telco using a "star" structure. Perhaps ten years from now, after both industries have gone through another major round of network reconfiguration, the networks will look more similar, but for now they are dissimilar. Moreover, the vast majority of telco fiber is inter-office fiber, that is, fiber between and among telco switches. Cable does not even have switches. The comparison is also invalid when the absolute level of fiberization is considered. Telcos have deployed vastly more fiber than cable companies.

terminals have been replaced by individual smart terminals joined by a more invisible local area network. This evolution decentralizes the system and allows for individual users desiring various levels of service to invest in, and own, the necessary equipment for accessing and sending messages, video, text, or other capabilities, and allowing others who only need simple voice or data services to avoid investing in that capability.[35/] In the cable industry, the use of decoders and converters at the subscriber's premises provides this decentralized approach to maximize consumer choices. Accordingly, technology and business considerations demonstrate that telco and cable do not fit into the same regulatory regime.

The FCC also has implicitly rejected the approach urged by the telcos. Even if we concede that the eventual goal should be "regulatory parity", that goal only can be reached over time. This is the manner in which the Commission handled regulation of "other common carriers" (such as MCI, Sprint, and the other non-AT&T long distance companies) as compared to AT&T. These OCCs were in exactly the same business as AT&T, they competed directly with AT&T for the same customers, used essentially

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35/ The cost for this type of network would likely be far less than the centralized network proposed by the telcos. The computing capability and prices of personal computers have diverged rapidly. PCs now can approach supercomputer speeds, but the chips required to run these machines are priced at less than $100.00.

identical technologies and business plans, and ultimately obtained a percentage of the long distance market. The FCC, however, did not regulate AT&T and the OCCs in exactly the same way, requiring the dominant carrier (AT&T) to be subject to a number of restrictions in much the same way LECs should be more strictly regulated to prevent distortions in competition while others gain a foothold in the telephony market.[36/]

Thus, when the Commission wanted to stimulate competition with the entrenched AT&T long distance monolith, it did so, in part, by allowing new entrants fewer regulatory burdens than AT&T. The telcos' argument (which misses the mark in any event because at issue here is regulation of cable's video entertainment offerings, not its telephony offerings) seems to be that the Commission should over-regulate cable companies in connection with their video offerings so that they won't be able to unfairly compete with the multi-billion dollar entrenched LECs in telephony.

36/ For example, for the dominant carrier to provide CPE, AT&T must comply with a number of reporting requirements, as well as be subject to structural and non-structural safeguards, not required of the OCCs. Competition in the Interexchange Marketplace, 6 F.C.C. Rcd. 5880, 5908 (1991). In addition, ONA requirements were imposed on AT&T despite the introduction of competition, due to the "substantial likelihood that, absent safeguards, the integrated enhanced service offerings of AT&T could still result in distortions to competition." Policy and Rules Concerning Rates for Competitive Common Carrier Service, 2 F.C.C. Rcd. 3035, 3051 (1987)(reconsideration).

First, it is farcical for firms with market shares in excess of 90% for virtually all major telephony offerings to claim that a new entrant into the industry, with a fraction of telco revenues, and an even tinier fraction of telco assets and borrowing power, has an "unfair advantage".[37/] Second, while putting competitors on equal footing may make sense in the future, it simply is not germane now.

Unthinking application of telco regulatory requirements to cable, without considering whether, on an individual basis, such requirements are necessary or whether they even "fit", will create the "regulatory disparities" the telcos claim they wish to avoid, by imposing on cable companies needless burdens and expenses that the telcos already are incurring. In these circumstances, the incremental cost of these regulations to the telcos is zero, while the incremental cost of the regulation to cable is great. This shows that the telcos, and consumer groups, in fact are attempting to impose significant, new, unnecessary costs on cable at this key moment when telco-cable competition is just beginning to heat up.

These arguments, in short, are not about fairness. They are about consumer advocates trying to use the regulatory process to artificially drive rates below any reasonable floor,

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37/ See BOC Joint Comments at 7.

and about telcos trying to game the regulatory process to obtain competitive advantages at a crucial time, all in the name of parity and purported consistency. However, as Emerson noted, "a foolish consistency is the hobgoblin of little minds".[38/]

III. Purposes of Cost-Of-Service Showings

It has been argued in this proceeding that the threshold requirement of impending financial doom or bankruptcy is an absolute prerequisite to commencing any cost-of-service showing.[39/] As set forth in our opening comments, constitutional considerations for ratemaking require unrestricted access to cost-of-service proceedings. Any artificial restrictions to prevent cost recovery would themselves be constitutionally suspect.[40/] Moreover, the effort to make the process too onerous would be tantamount to denying a meaningful opportunity to obtain rate relief and cause serious problems under the due process clause.[41/]

38/ R.W. Emerson, Self-Reliance, (1841).

39/ See, e.g., Comments of CFA at 4; Comments of NATOA, et al. at 3. MFA believes cost-of-service showings should only be permitted in limited, exceptional circumstances. MFA Comments at 4.

40/ Joint Comments at 11-13.

41/ Jersey Central, 810 F.2d at 1168.

The proposition that cable rates should be suppressed to favor consumers at the expense of cable investors impermissibly tilts the required balance for setting rates. For example, it has been argued that the ultimate result of cost-of-service showings will be higher rates.[42/] However, the effort to maintain cable operators at the benchmarks, regardless of costs, is unsound both as a matter of regulatory policy and constitutional fundamentals. As set forth in detail in our initial comments, the benchmarks were set not on costs, but on the supposed pricing of cable services in certain overbuild markets. Indeed, the inability of those particular rates to recover costs has been demonstrated by the failure of the very markets utilized to generate those benchmarks.[43/] Forcing cable operators to accept rates that are not financially viable would constitute confiscation.

42/ MFA Comments at 3.

43/ See Comments of Continental Cablevision, Inc. in MM Docket No. 92-266, 7 (June 17, 1993)($15 million operating loss in South Central Los Angeles); Larry Young, Paragould Cable to Drive Taxes Higher Once Again, Arkansas Democrat Gazette (July 31, 1993)("for the second year in a row, Paragould residents will have to pay higher taxes to continue subsidizing City Cable, the city-owned cable system."); Vincent Pasdeloup Double Hit in Paragould: Municipal Cable Subscribers Support Service Through Rates and Tax, CableWorld (April 19, 1993). In addition, the municipally owned system in Zephyrhillis, Florida collapsed in 1992.

IV. Acquisition Costs and Intangibles

As set forth in Joint Commenters' initial filing, "excess acquisition costs" or "acquisition premiums" are essentially misnomers; to the extent they represent amounts above the value of tangible assets, they are nonetheless a valuable intangible resource reflecting the amount of capital committed to the construction and operation of the cable system, and a discrete source of value.[44/] Joint Commenters have emphasized the need to include these intangible elements as an element of the rate base subject to an earned rate of return as they reflect capital committed to the operation of the cable television systems. Similarly, amounts in excess of the tangible assets of a particular system are reasonable as estimates of the cost of reproducing the cable system and its subscriber base. These costs would be far greater in almost all instances than just the cost of deploying wires, headend and satellite dishes. For that reason, the purchase of an on-going system thus is worth far more than its tangible assets, and this value was in no sense "paid for" by any subscriber.[45/] Indeed, the financial models used to evaluate

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44/ These include (1) subscriber base; (2) franchise operating rights; (3) subscriber growth; and (4) going concern value. Joint Comments at 31 - 40. Intangible assets also represent start-up losses and foregone earnings in the early stages of system development. Id.

45/ Cable operators traditionally have operated at a significant loss during the early stages of their systems operation.

[Footnote continued]

system acquisitions as well as rebuilds all demonstrate this concept.

A. The Economics of Cable Operations and Rebuilds

Where franchises are renewed with rebuild requirements, the benchmark approach as currently configured does not allow for the recovery of the necessary capital which must be committed by the terms of the franchise renewal. As set forth in Exhibit A, an analysis was developed estimating costs and revenues for a recently acquired system of 250,000 subscribers over a 15-year operating period. With the benchmark rates initializing in 1994 and escalating at 4% per year, it is assumed that operating expenses will also increase with this rate of inflation and with programming costs escalating each year at 5%. Without any rebuild requirements, a financial model shows that at the end of the 15-year period, the operator would have earned less than 3% return on investment.[46/]

Where a franchising authority then requires the operator to invest in system upgrades, the situation is even more

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[Footnote continued]

Nonetheless, the telcos and consumer groups refer to cable operators' "captive subscribers" as having paid for the development of these systems. Cable does not have any "captive subscribers". If it did, cable would not experience the 30% churn levels that exist in the industry.

46/ Exhibit A at A-2.