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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket 93-215
	)	
Rate Regulation	)	

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

To: The Commission

REPLY COMMENTS OF PRIME CABLE, HARRON COMMUNICATIONS CORP., GEORGIA CABLE PARTNERS, ATLANTA CABLE PARTNERS, L.P., WOMETCO CABLE CORP, AND THE COALITION OF SMALL SYSTEM OPERATORS

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SUMMARY

These Reply Comments, submitted on behalf of small and medium-sized MSOs, respond to comments submitted by several consumer groups, municipal and telephone trade associations, and telcos to the Commission's Cost-Of-Service NPRM. In essence, these commenters urge the Commission to tailor a regulatory framework for the cable industry that relies primarily, if not exclusively, on price caps, with cable operators having access to cost-of-service only under extraordinary circumstances. The basis for their argument is that any regulatory scheme must ensure parity between the telephone and cable industries because they are converging. Their approach simply ignores the statutory and Constitutional basis of the cost-of-service "backstop."

Congress never intended cable to be subject to the exact same regulatory standards that govern telephone or that price caps would take the place of cost-of-service. Telephone and cable are inherently different industries that require different regulatory treatment. Because price caps will not enable cable operators to recover their investment, cable operators need access to cost-of-service proceedings so that they can show that their rates are reasonable in light of the particular operator's circumstances, even though they may be in excess of the relevant benchmarks.

To satisfy Constitutional requirements, any cost-of-service scheme must enable cable operators to recover fully the reasonable and prudent investment made in their system. Therefore, it is essential they have a mechanism to justify their rates under cost-of-service. For cable operators who have built or rebuilt their systems, cost-of-service must allow

them to include in their rate base the depreciated original cost of the system, plus all of their unrecovered expenses. As a transitional mechanism, cable operators that bought their systems after construction, but prior to regulation, must be permitted to include in their rate base the full acquisition cost of their cable systems, depreciated and amortized to the present date, at least to justify existing rates. Finally, to justify either current rates or rate increases, cable operators must be permitted to include in their rate base, at a minimum, (1) that portion of the acquisition cost that represents the full (reproduction) cost of building the cable system at the time of acquisition (less depreciation reflecting the system's age), plus (2) all of the deferred expenses the cable operator would incur in the start-up phase of operating such a system (amortized and depreciated to the present). In addition, cable operators should be permitted to include in their rate base a sufficient portion of any acquisition premium to produce revenues that reflect any cost savings to subscribers that resulted from the acquisition.

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On behalf of Prime Cable ("Prime Cable"), Harron Communications Corp. ("Harron"), Georgia Cable Partners ("Georgia Cable"), Atlanta Cable Partners, L.P. ("Atlanta Cable"), Wometco Cable Corp. ("Wometco"), and the Coalition of Small System Operators (the Coalition"), 1/ we submit the following Reply Comments in this proceeding.

1/ Prime Cable, Harron, and Georgia Cable all are cable television multiple system operators of moderate size. The Coalition of Small System Operators are small systems operators and include ACI Management, Inc.; Balkin Cable; Buford Television, Inc.; Classic Cable; Community Communications Co.; Douglas Communications Corp. II; Fanch Communications, Inc.; Frederick Cablevision, Inc.; Galaxy Cablevision; Harmon Communications Corp.; Horizon Cablevision, Inc.; Leonard Communications, Inc.; MidAmerican Cable Systems, Limited Partnership; Mid-American Cable Television Association; Midcontinent Media, Inc.; Mission Cable Company, L.P.; MW1 Cablesystems, Inc.; National Cable Television Cooperative, Inc.; Phoenix Cable, Inc.; Rigel Communications, Inc.; Schurz Communications, Inc.; Star Cable

In our Comments, we urged the Commission to fashion a cost-of-service approach supported by regulatory precedent that will enable cable operators ultimately to recover the reasonable and prudent investments they had to make in order to provide cable television services to their subscribers.

Several consumer groups (such as the Consumer Federation of America), municipal and telephone trade associations (such as the National Association of Telecommunications Officers and Advisers), and the telcos (such as GTE, Bell Atlantic, and BellSouth) (all collectively referred hereinafter as the "Telco Commenters") suggest that the Commission need not tailor special cost-of-service standards for the cable industry but, rather, need only look to the price caps. In attempting to make their case, the Telco Commenters argue that any regulatory scheme must ensure parity between the cable and telephone industries and that parity can be accomplished only if cable is subject to the same standards historically applied to the telephone industry. Then they urge the Commission to establish a regulatory framework for cable that relies primarily, if not exclusively, on price caps, with cable operators having access to cost-of-service relief only when they are on the brink of financial ruin. Their approach simply ignores the statutory and Constitutional basis of the cost-of-service "backstop."

Congress never intended that cable operators and telcos would be subject to the exact same regulatory standards or that price caps would take the place of cost-of-service. The telephone and cable

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Associates; Triax Communications Co.; USA Cablesystems, Inc.; and Vantage Cable Associates.

industries are inherently different and, as recognized by the Commission, price caps will not enable cable operators in all cases to recover their investment. Reliance solely on the price caps would lock cable operators into a rate that slowly would erode their profits and eventually drive them out of business. Cable operators need access to cost-of-service proceedings so that they can show that, although their rates may be in excess of the relevant benchmarks or price caps, they are reasonable in light of the particular operator's circumstances. To comply with Congress' mandate and to satisfy Constitutional requirements, any cost-of-service standards must enable cable operators to recover fully the investment they make in their system.

I. The Commission Should Not And Must Not Apply To The Cable Industry The Same Regulatory Scheme That Historically Has Been Applied To The Telephone Industry.

A. Congress Never Intended Cable To Be Subject To The Exact Same Regulations Governing Telephone.

Many of the Telco Commenters 2/ focus on the convergence of the cable and telephone industries to support their position that cable and telephone must be governed by the identical regulatory standards. These Commenters try to convince the Commission that because telcos may compete with cable in the future, it is only fair that they be governed by the

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2/ Not all of the telcos think that cable should be governed by the same regulations governing common carriers. For example, BellSouth has acknowledged that it "does not endorse the application of unnecessary and inefficient regulation to cable operators simply because such regulation is currently applied to local exchange carriers." See Comments of BellSouth

same set of rules. Despite their efforts, it is inescapable that Congress never intended that cable would be governed by traditional common carrier regulation. 3/ Cost-of-service standards must be tailored to meet the cable industry's economic and financial requirements. Applying to the cable industry standards that are a mere carbon copy of standards developed for the telephone industry would be inconsistent with the legislative admonition against replicating utility regulations.

Congress made this point when it expressly stated that the rules governing cable companies must not mirror those governing common carriers and the Commission must avoid turning cable cost-of-service analysis into the enormously complex regulation traditionally applied to common carriers. 4/ The Commission has recognized Congress' directive in acknowledging that "cost-of-service requirement for cable rates will not replicate Title II regulation." NPRM at ¶ 15, n.16. The rote application to cable of the complex procedural and substantive rules the Commission has developed over decades of rate regulation of common carriers not only would contravene Congress' mandate, but would also be a disservice to

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3/ Congress did not afford the Commission the option of fashioning a regulatory scheme for cable operators based solely on price caps. Rather, Congress directed the Commission to establish rates for cable operators based on cost factors. See Section 623(c) of the Communications Act of 1934, as amended by the Cable Television Consumer Protection and Competition Act of 1992.

4/ The House Committee on Energy and Commerce expressed this sentiment when it stated that it was "not the Committee's intention to replicate Title II regulation [and that] the FCC should create a formula that is simple to implement, administer, and enforce, and should avoid creating a cable equivalent of a common carrier 'cost allocation manual.'" H.R. Rep. No. 102-628, 102d Cong., 2d Sess., at 83 (1992).

the already burdened Commission staff, local franchising authorities, cable operators, and cable subscribers. The more burdensome the standards governing cable, the more complex, lengthy, and costly any cost-of-service showings will become.

This is not to suggest that the Commission should not consider precedents involving common carriers and other regulatory authorities in fashioning cost-of-service standards. The Commission simply should not fashion standards for cable that mirror Title II regulations. But because neither the Commission not the courts have addressed what components should comprise the rate base of cable companies entering rate regulation, it is important to consider other regulatory precedent including precedents involving common carriers. Along these lines, the Commission should heed its own precedent and recall that it has allowed telecommunications entities to include in their rate bases (1) deferred start-up expenses, 5/ (2) construction costs budgeted for the ensuing twelve months, 6/ (3) deferred interest paid on funds borrowed during the start-up phase of a telecommunications system, 7/ (4) deferred depreciation, 8/ and (5) full

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5/ Communications Satellite Corp., 56 F.C.C.2d 1101 (1975), remanded on other grounds, Communications Satellite Corp. v. FCC, 611 F.2d 883 (D.C. Cir. 1977).

6/ Id.

7/ Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, 4 FCC Rcd 1697 (1989) ("1989 Rate Base Decision").

8/ Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, 7 FCC Rcd 296 (1991) ("1991 Rate Base Decision").

acquisition costs with respect to acquisition premiums paid to acquire previously unregulated carriers. 9/.

B. Telephone And Cable Are Inherently Different.

1. Telephone Has Been Subject To Regulation For Decades, Whereas Cable Has Not.

Cable and telephone need to be governed by different regulatory standards because telephone and cable are inherently different industries. 10/ One of the essential differences between telephone and cable is that telephone has been subject to rate regulation for decades. During this period, the Commission has developed complex procedural and substantive rules governing not only telephone acquisitions, investments, and operations but also the rates that can be charged telephone customers. And during this period, telco investors and operators made their decisions in a fully regulated environment, knowing full well that the industry had been, and would remain, regulated. Investors were well aware that telephone was subject to rate regulation and that any return on their investment was affected directly by the strict regulatory policy governing telcos.

9/ Id.

10/ We mention here only three factors that distinguish the telephone and cable industries. There are, of course, many more distinguishing factors that necessitate different regulatory schemes. For example, cable television is not an essential service and, accordingly, the demand for cable is far more price elastic. Absent strict rate regulation, telcos could raise their basic residential rates substantially with little danger they would lose their customers. Cable customers are far more sensitive to price increases and, due to the availability of substitute products (direct broadcast services and home movie rentals to name but a few), are likely to cancel their service if the prices rise dramatically.

The cable industry never has been subject to the same type of rate regulation. As Congress correctly noted, there is "no history of establishing rates for cable service that is analogous, for example, to the process used in the telephone industry." S. Rep. No. 92, 102d Cong., 1st Sess. 18, 73 (1991). And as the Commission recognized in its NPRM, there is a fundamental difference between entities subject to regulation and entities "as they adapt to a rate regulated environment." NPRM at ¶ 22, n. 21. Even prior to 1984, any rate regulation was exercised by local or state authorities. After 1984, investors in cable systems made their investment decisions in the deregulated marketplace specifically sanctioned by Congress.

At least since 1984, investors in cable made their investment decisions on the basis of the unregulated status of the cable industry. For example, in 1988 an investor invested monies in a given cable system, and the operator planned and expanded the system, based on the reasonable expectation they would recover fully their investment in a deregulated marketplace. Indeed, in 1988 no cable operator acquiring cable systems at prevailing market prices could reasonably have expected that it would not only become subject to rate regulation, but that any portion of its acquisition costs would be disallowed. Disallowing recovery of the full acquisition price would be just the sort of arbitrary governmental deprivation of reasonable expectations that creates an unconstitutional taking. It would be entirely inappropriate to treat investments made in an unregulated environment the same as those made in a regulated environment. Although there are, of course, risks inherent in any business venture, the investor must be able to rely on the fact that the government by regulatory fiat cannot take away its ability to recover its past investment.

2. The Telephone Industry Is A Declining Cost Industry While The Cable Industry Is An Increasing Cost Industry.

Another feature that distinguishes telephone and cable is that the telephone industry is a far larger, much older, and a less efficient industry than cable. Telephone (which has operated as a monopoly in a regulated environment for decades) is a declining cost industry, whereas cable (which has competed in an unregulated environment) is an increasing cost industry. A regulatory scheme tailored to the telephone industry simply would not fit the cable industry.

For decades, carriers were regulated under a "cost-plus" system of regulation, in which the rates telcos could charge for services were based upon its costs plus a return on invested capital. Although carriers subject to such regulation were limited to earning a particular percentage return on their investment during a fixed period, a carrier seeking to increase its dollar earnings often could do so merely by increasing its aggregate investment. Under a "cost-plus" system, telcos' profits (i.e., dollar earnings) would increase whenever their investment increased. This created a powerful incentive for carriers to "pad" their rate base, regardless whether additional investment was necessary or efficient. 11/ Also, because carriers' operating expenses generally were

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11/ The Commission has noted that its "own experience with administering a rate of return system convinced [it] that carriers in fact attribute unnecessary costs to their operations in an effort to generate more revenue." The Commission further noted that "[u]nfortunately, a regulatory system that simply corrects for a tendency to pad investments or expenses is not a system that can also drive [carriers] to become more efficient and productive." See In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786, 6795 (1990).

recovered from ratepayers on a dollar for dollar basis and did not affect shareholders' profits, they had little incentive to conserve on such expenses or operate efficiently. The Commission determined that carriers were not as productive as they could be and that incentive regulation, implemented through price caps, would benefit consumers, increase efficiency, promote innovation and competition, and further the public interest more effectively than rate of return regulation, and at a lower cost to society. See In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, 4 FCC Rcd 2873 (1989)("AT&T Price Cap Order"). 12/ In 1989 the Commission implemented a "price-cap" scheme governing AT&T's rates, AT&T Price Cap Order, 4 FCC Rcd 2873, and in 1990 adopted a similar price-cap scheme for local exchange carriers. See In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786 (1990). As a result of implementation of the price caps, carriers now have the incentive to become more efficient and decrease their costs.

Cable operators, unlike the telcos, never had the incentive to "pad" their costs. As a general rule, cable operators have been unable to recover their operating expenses from subscribers on a dollar for dollar

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12/ The Commission noted that the attractiveness of incentive regulation for carriers "lies in its ability to replicate more accurately than rate of return the dynamic, consumer-oriented process that characterizes a competitive market." The Commission further noted that "such regulation operates by placing limits on the rates carriers may charge for services." The Commission also noted that "[i]n the face of such constraints, a carrier's primary means of increasing earnings are to enhance its efficiency and innovate in the provision of service." The Commission concluded that "because cost padding and cross-subsidization do not justify higher prices under this system -- but instead lower profits -- the incentives to engage in such activity are limited." See AT&T Price Cap Order, 4 FCC Rcd 2873.

basis and have had a strong incentive to operate efficiently. Indeed, in its NPRM the Commission specifically noted that there may be embedded inefficiencies in the telephone industry that do not exist in the cable industry: "the regional Bell companies supported only 244 access lines with each full time employee, while Continental Cablevision's largest regional operation serves over 512 subscribers with each of its full time employees." NPRM at ¶ 86, n.100. Because cable operators operating in an unregulated market previously had no incentive to be inefficient, as a result of rate regulation their costs will not decrease. If anything, their costs will continue to increase as they continue to spend capital to expand their systems.

3. The Capital Structures Of The Industries Are Different.

As the National Cable Television Association ("NCTA"), the Community Antenna Television Association, Inc. ("CATA"), and Cablevision Systems Corporation ("Cablevision") all noted in their respective Comments, the capital structures of the telephone and cable industries, and their access to the financial markets, are dramatically different. Unlike telephone companies, which historically have had equal amounts of debt and equity (i.e., a debt/equity ratio of 1.0), cable companies tend to be highly leveraged with far more debt than equity (i.e., a debt/equity ratio higher than 1.0). This is due in part to cable companies' need to deploy large amounts of capital to expand capacity, build infrastructure, service new customers, and offer new program services. In addition to having a higher percentage of debt, the cost of that debt to cable companies tends to be much higher than it is to telephone

companies. In short, the risks associated with investing in cable systems are considerably higher than those associated with telephone companies.

As a result, cable companies have not had the same access to the public bond markets as telcos have had. To raise monies cable companies historically have had to obtain financing through private sources (generally private banks and insurance companies) at rates substantially higher than those in the public bond markets. However, according to major lenders to the cable television industry, the prospect of rate regulation has made it increasingly difficult for cable operators to obtain even private financing. New bank financing has become essentially unavailable to most cable operators. See Letter from 18 Lending Institutions attached to Comments of Cablevision. Notwithstanding their high debt service, a freeze on their rates, and ever-decreasing access to new financing, cable operators' existing debt service will not disappear simply due to the onset of rate regulation. A regulatory scheme designed specifically for the telephone companies, which have relatively lower debt service, would not recognize cable companies' special financial and economic status. Any regulatory scheme designed for the cable industry must take into account the fact that cable operators tend to be highly leveraged with a high debt service.

C. Even If Telcos And Cable Eventually Converge And Compete, It Is Essential That Cable Operators Recover Their Investment So They Can Compete On A Level Playing Field.

Numerous Telco Commenters, including GTE, Bell Atlantic, and NATOA, suggest that applying to cable the same regulatory scheme currently applied to telcos not only is necessary to avoid artificially favoring

one industry over the other, but also will spur competition within the cable industry. These Telco Commenters (most of which are telephone companies that presently do not own cable systems) suggest that the rate bases of these cable operators should be limited to the undepreciated original cost of their systems, and should not include most of their acquisition costs. Clearly these and other financially strong telcos will benefit if existing cable operators are financially weakened. The cable operators then will have fewer resources to compete in any head to head competition. Though it may be a boon to the telcos, very little benefit will be derived by the public if existing cable operators do not remain financially viable.

II. If Cable Operators Are Limited To The Benchmarks and Price Caps, They Won't Recover Fully Their Investments.

A. The Cost-of-Service Prong Plays An Integral Role In The Regulatory Scheme, Distinct From The Price Caps.

GTE, BellAtlantic, NATOA and other Telco Commenters suggest that the primary, if not sole, backstop for the benchmarks should be the price caps. These Commenters suggest that price caps and cost-of-service share the same essential function and that by relying on the price caps (subject to a productivity index), cable operators can recover their investment. Apparently, these Commenters fail to understand that price caps and cost-of-service serve very different functions in the Commission's overall regulatory scheme. The price cap mechanism simply allows cable operators to keep up with the national rate of inflation, whereas cost-of-service allows operators to justify a boost in their rates based on factors

other than a national inflation rate -- including local prices and technical or engineering requirements of the cable system.

The price caps allow cable operators to keep up with the national rate of inflation by permitting them to increase their per-channel rates for regulated basic service tiers by the Gross National Producer Price Index. Assuming that the only cost increases a cable operator experiences from one year to the next correspond to a rise in the national rate of inflation, the price cap mechanism will enable the cable operator to realize the same "real" revenue from one year to the next without having to initiate a cost-of-service showing. However, in reality many cable operators will incur other legitimate costs (such as costs associated with rebuilds) that the price caps would not allow them to pass through to their subscribers. Because cable operators cannot pass these costs directly through to their subscribers, they must be permitted to use cost-of-service to recover these otherwise legitimate costs.

The Telco Commenters also refuse to admit that not all cable operators face the same costs and that certain cable systems must be permitted to charge rates higher than those prescribed in the benchmarks 13/ in light of the systems' particular circumstances. Because cable systems face a range of costs, there is obviously a range of rates

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13/ The benchmarks are themselves seriously flawed for numerous reasons. The benchmarks are based on rates of a few selected systems nearly 12 months ago. The benchmarks do not account for the reality that cable operators' costs have increased, in some cases dramatically, since September 30, 1992. Moreover, the benchmarks are based on a statistical sample so small and so illogical that they constitute an arbitrary and capricious exercise of the Commission's regulatory authority. See, e.g., Petition for Reconsideration filed by the Coalition of Small Systems Operators in this Docket on June 21,1993.

that are reasonable and competitive. Cable systems with costs that are above average will charge rates that are above average whether or not the such systems are subject to effective competition. To the extent the Commission's benchmarks are based on average rates, cable systems with above average costs are likely to charge rates that exceed the benchmarks even though those rates are wholly justified. In fact, 20 of the 45 small systems the Commission deemed competitive for the purposes of establishing benchmarks are charging rates above the benchmark rates. See Petition For Stay of Coalition, Prime Cable of Alaska, L.P., and Community Antenna Television Association, Inc., filed July 28, 1993, at pp. 15-18. And 60 percent of the competitive systems with more than 1,000 subscribers in the Commission's data base charge rates above the benchmarks. See Petition for Reconsideration of Harron Communications Corp., filed June 21, 1993. Given that the whole purpose of cost-of-service showings is to allow systems that do not fit within the average on which the benchmarks are based an opportunity to justify prices based on their atypical circumstances, the Commission cannot employ any sort of broad averaging. For this reason, cost-of-service is a vital tool for systems to show that rates in excess of their relevant benchmarks are, nevertheless, justified in light of their particular circumstances.

Numerous Telco Commenters, such as NATOA, also suggest -- absent any legal authority whatsoever -- that cable operators should be forced to meet significant thresholds prior to even making cost-of-service showings. These Commenters also suggest that cost-of-service should not be available unless the cable operator is on the verge of bankruptcy, the cable operator has a history of low earnings, or investors in the cable system are in danger of recovering not all but, rather, no return on their

investment. To require cable operators to satisfy such thresholds would deny cable operators their Constitutional right to recover sufficient revenues to "assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital" as well as "compensate its investors for the risks assumed." Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1943). Congress never once indicated, nor has the Commission even intimated, that cable operators should have to satisfy any such thresholds in availing themselves of cost-of-service.

B. If Rates Were Limited To Price Caps, Many Operators Would Be Forced To Take Drastic Actions To Retain Their Systems.

The price cap mechanism will not permit all cable operators to remain financially viable and, in many cases, will place them into default of their financing arrangements. As both Cablevison and NCTA have pointed out in their Comments, in an effort to avoid default many cable operators will be forced to reduce valuable services to their subscribers including technological improvements in their systems. Rate regulation, which already has restricted the cable industry's access to the capital markets, also will reduce most cable operators' cash flow. Many cable operators have financing agreements that require them to maintain certain minimal levels of cash flow. If cable operators are unable to maintain required cash flow levels , they will be forced to renegotiate their existing financial arrangements and seek amendments of their financial covenants. While some operators may be able to renegotiate their financial arrangement, others will not. To satisfy their creditors, some cable operators may have to direct funds from capital expenditures, raise additional equity, or amend

their debt amortization schedules to meet existing debt repayment obligations. The remaining cable operators who are unable to satisfy their creditors and maintain minimum cash flow levels will be forced to default on their loans and may be forced eventually into bankruptcy. See, e.g., Declarations of Michael J. Pohl on behalf of Douglas Communications Corp. II, and Vince King on behalf of ACI Management, Inc. attached as Exhibits J and K respectively to the Petition For Stay. 14/

III. Original Cost Methodology Is Fair, Provided Operators Are Also Permitted To Recover Their Other Unrecovered Costs.

Because price caps often will not afford cable operators the opportunity to recover their investment, it is essential that they have a mechanism to justify their rates under cost-of-service. For cable operators who built or rebuilt their systems, cost-of-service must allow them to include in their rate base the depreciated original cost of the system, plus all of their unrecovered expenses. Given the Commission's historical reliance on an original cost standard, in our Comments we agreed that the fundamental building block for rate base purposes for cable operators who built or rebuilt their systems could be the "original cost" of their systems. See United States v. FCC, 707 F.2d 610 (D.C. Cir. 1983); 1989 Rate Base Decision, 4 FCC Rcd 1697 (1989). 15/ While Telco Commenters such as

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14/ While a few strong cable operators will have financing options available to carry them through this crisis, the majority of cable operators (which are less financially stable) may find all forms of capital elusive. The real cost of capital investment and operating expenses borne by cable operators and the existing obligations due their creditors simply will not disappear.

15/ Numerous commenters (including Comcast Cable Communications, Inc., National Cable Television Association, and Arthur Andersen) suggest

GTE, BellAtlantic, BellSouth, and NATOA, agree that "original cost" is the appropriate building block, they argue (without any legal support) that cable operators should not be permitted to include any other costs in their rate base. Apparently, these Telco Commenters forget that the "law of industry regulation does not prohibit inclusion of noncost elements in the rate base if they are based on appropriate grounds." Southern Louisiana Area Rate Cases v. FPC, 428 F.2d 407, 426 (5th Cir. 1970), cert denied, 400 U.S. 950 (1970).

The Commission must take an approach to the issue of rate base valuation that ensures cable operators have the opportunity to recover all of the legitimate costs they incurred in the construction, development, and expansion of their systems. Based on extensive regulatory precedent, we urge the Commission to allow cable operators to include in their rate base additional components to enable them to recover fully their reasonable and prudent investment. Numerous commenters (such as Comcast, Cablevision, CATA, NCTA, Cablevision Industries Corp. and even BellSouth) similarly have recognized that cable operators are entitled as a matter of law to recover cost components over and above the original cost of their systems. The Telco Commenters that urge the

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that cable operators be permitted to include in their rate base the "trended original cost" or "reproduction cost" of their system. While we have agreed that an original cost methodology is appropriate given the Commission's historical reliance upon it, we would have no objection to using trended original cost or reproduction cost, provided that cable operators would still be entitled to recover their other unrecovered costs. Indeed, we have proposed reproduction cost (plus unrecovered start-up costs) as the minimum measure of the value of a cable system for purposes of determining what portion of acquisition costs to rely on for purposes of justifying rate increases.

Commission to disallow these components provide no legal precedent to support their position. The inclusion each of these cost components is appropriate, necessary, and well-grounded in regulatory precedent.

A. Start-Up Expenses. In our Comments, we urged the Commission to permit cable operators to include in their rate base all deferred start-up costs, defined as the "excess of expenditures required to build and operate the fixed plant over revenues received from the initially small subscriber base." See Stan-Fran Corporation, Docket #AFD-10 and #AFD-2 (Mass. Comm. Antenna TV Comm. 1976). The inclusion of start-up costs is appropriate because they represent the reasonable and prudent expenditures that were necessary to make the cable system a viable entity. There is extensive precedent from both courts and regulatory agencies supporting the inclusion of deferred costs from the start-up phase in the rate base, whether such costs are defined as "start-up costs," 16/ "going concern value," 17/ or "deferred operating expenses." 18/ Numerous Commenters agree that cable operators are entitled to include start-up costs in their rate base. 19/ To the extent cable operators have not

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16/ See, e.g., Communications Satellite Corp., 56 F.C.C.2d 1101 (1975), remanded on other grounds, Communications Satellite Corp. v. FCC, 611 F.2d 883 (D.C. Cir. 1977), St. Lawrence Gas Co. v. Public Service Commission, 42 N.Y.2d 461, 368 N.E. 2d 1234 (N.Y. 1977), Stan-Fran Corporation, Docket #AFD-10 and #AFD-2 (Mass. Comm. Antenna Tel. Comm. 1976).

17/ See, e.g.,Wilcox v. Consolidated Gas Co., 212 U.S. 19 (1909).

18/ See, e.g., Teleprompter Cable Communications Corp. v. Board of Public Utility Commissioners, 154 N.J. Super 1, 380 A.2d 1140 (1977).

19/ See, e.g., Comments of Tele-Communications, Inc. ("accumulated losses should be given rate base treatment"), p. 24-25; Comments of

recovered fully their early operating expenses, cable operators must be permitted to include such unrecovered expenses in their rate base.

B. Budgeted Capital Expenditures. In our Comments, we next urged the Commission to permit cable operators to include in their rate base all budgeted capital expenditures to be made within the following twelve months. It is essential that cable operators be able to include budgeted capital expenditures in their rate base in advance so that they have the requisite lead time to install the new equipment and/or make the necessary improvements in their systems. If cable operators do not have access to these funds, they cannot be expected to provide a modern communications infrastructure and remain competitive. The Commission has recognized that telecommunications entities must be able to include in their rate base the construction costs that are anticipated within the next twelve months. See Communications Satellite Corp. v. FCC, 611 F.2d. 883 (D.C. Cir. 1977). Numerous commenters (such as NCTA, CATA, and Continental Cablevision) similarly recognize that cable operators are entitled to include their budgeted capital expenditures in their rate base.

C. Interest Paid To Borrow Funds. In our Comments, we also urged the Commission to permit cable operators to include in their rate base the funds expended to finance construction and the early operation of the system. The Commission consistently has permitted common carriers to include such funds, commonly referred to as "Allowance for Funds Used During Construction" or "AFUDC," in their rate base. See, e.g., 1989 Rate Base Decision 4 FCC Rcd 1697 (1989); Illinois Bell Telephone Co. v.

Cablevision Systems Corporation ("Commission should allow operators to include within rate base all operating losses"), pp. 31-32.

FCC., 911 F.2d 776 (D.C. Cir. 1990), appeal after remand, 988 F.2d 1254 (D.C. Cir. 1993).

D. Deferred Depreciation. Finally, in our Comments we urged the Commission to permit cable operators to include any deferred depreciation in their rate base. The Commission recognizes that cable operators must be permitted to recover depreciation. NPRM at ¶ 25. The Commission also has recognized that "depreciable assets are included in the rate base and earn a return until the costs are recovered through depreciation." 1989 Rate Base Decision, 4 FCC Rcd 1697, and that depreciation must be deferred until it can be recovered. 1991 Rate Base Decision, 7 FCC Rcd 296 (1991).

IV. As A Transition Mechanism From An Unregulated To A Regulated World, Cable Operators Must Be Permitted To Include Their Full Acquisition Costs In Their Rate Base.

In our initial Comments, we urged the Commission to permit cable operators who bought their systems after construction, but prior to the current rate regulation, to include in their rate base the full acquisition cost of their cable systems as a transition mechanism from an unregulated to a regulated environment. We noted the Constitutional requirements that mandate cable operators' recovery of their entire acquisition costs, see, e.g., Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1943), Federal Power Commission v. Natural Gas Pipeline Co., 315 U.S. 575, 585 (1942), as well as Commission precedent supporting recovery of full acquisition costs. See, e.g., 1991 Rate Base Decision, 7 FCC Rcd 296. All cable operators, numerous state regulatory agencies (including the Massachusetts Community Antenna Television Commission) and even some telcos (such as BellSouth) recognize that it is only fair, not to mention