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## SUMMARY

The Commission's public utility-style cost of service rules cannot produce constitutional results when applied to pre-regulation investments in cable television systems.

After the Commission, acting under the Cable Act of 1984, freed most of the industry from rate regulation, cable systems expanded and grew, both by acquisitions and by new construction. Cable systems sold for prices representing the market value of both tangible and intangible assets. Many acquisitions were financed by debt. Much of this debt remains to be paid. Many cable operators cannot reduce their rates because the resulting revenues would be insufficient to cover their interest payments.

In the face of these facts, the Commission has adopted a net original cost ratebase rule that presumptively disallows massive amounts of pre-regulation investment and virtually guarantees that a cable system that cannot afford the 17% rate reduction required under the primary "benchmark" scheme will receive no relief whatever by making a cost of service showing.

In traditional cost of service ratemaking, allowing a fair return on ratebase is supposed to produce sufficient revenue both to pay interest on debt and provide a return to equity investors. If, however, most of what was acquired with the debt is disallowed, no reasonable rate of return will produce enough revenue to pay the interest. A company that cannot pay its debts is by definition

unable to maintain credit and attract capital, and a regulatory scheme that is calculated to produce this result is by definition confiscatory.

The Commission must therefore stay or withdraw its presumptive ratebase disallowances as they apply to pre-regulation investment. It must then adopt rules that explicitly permit operators over time to recover and earn return on those investments.

The Commission's finding that the rate of return for regulated cable service is the same as the investor-required return for local exchange telephone service is inherently incredible. By any measure, cable television's business, financial, and regulatory risks are far greater than those of the telephone industry. The allowed return for cable must, therefore, also be much greater than the 11.25% return prescribed by the Commission for local exchange carriers.

The Commission should not prescribe a uniform system of accounts for cable systems using cost of service showings to justify rates. Because it is impractical to use special accounting for cost of service systems, cable operators would be forced into the unnecessary expense of converting all of their systems to the new accounts. In addition, it is likely that most cost of service cases will be filed and decided long before a satisfactory accounting system could be devised and implemented.

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

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Dkt. No. 93-215
	)	
Rate Regulation	)	
	)	
and	)	
	)	
Adoption of a Uniform Accounting System for Provision of Regulated Cable Service	)	CS Docket No. 94-28
	)	

**PETITION FOR RECONSIDERATION**

Comcast Cable Communications, Inc., a subsidiary of Comcast Corporation ("Comcast"), by its attorneys, hereby petitions for reconsideration of certain aspects of the Commission's Report and Order in the above-captioned proceeding.<sup>1/</sup> Specifically, Comcast asks that the Commission either stay or withdraw both its presumptive ratebase disallowances and its selection of an overall rate of return of 11.25% for regulated cable service. Comcast also asks

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<sup>1/</sup> Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, FCC 94-39, 9 FCC Rcd \_\_\_\_\_ (released March 30, 1994) (Cost of Service Order or Order). Comcast does not seek reconsideration of the Commission's orders released March 30, 1994 in MM Docket No. 92-266 (FCC 94-38 and FCC 94-40).

that the Commission reconsider its decision to adopt a detailed uniform system of accounts for cable systems justifying rates with a cost of service showing.<sup>2/</sup>

## I. INTRODUCTION

The Cable Act of 1992<sup>3/</sup> was intended by Congress to promote growth and expansion of cable systems and of the services they offer, as well as to protect consumer interests in the receipt of cable service.<sup>4/</sup> With respect to rate regulation, the Act charges the Commission with adopting regulations that will ensure reasonable rates for basic cable service and with establishing criteria under which to assess consumer complaints that rates for cable programming services are unreasonable.<sup>5/</sup> Comcast does not dispute that this mandate authorizes -- though by no means requires -- the Commission to impose rate regulations that limit the returns cable investors can expect from investments made after the adoption of the Act. Nowhere in the Cable Act, however, is there any indication that Congress intended rate regulation to be achieved through a massive destruction of the value of investments made before the passage of the Act. Yet the Commission's disallowance from ratebase of all but a small a fraction of the

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2/ Comcast expects to offer expert testimony on ratebase and rate of return issues, and to address other aspects of the cost of service rules, in its comments in the Further Notice stage of this proceeding.

3/ Cable Television Consumer Protection and Competition Act, Pub. L. No. 102-385, §§ 2, 3, 9, 14, 106 Stat. 1460 (1992).

4/ *Id.* § 2(b).

5/ 47 U.S.C. § 543(b), (c).

investments Comcast and others made to acquire their cable systems will have precisely that effect.

Cable systems that are unable to sustain the 17% reduction in revenues called for under the revised benchmark system will, with few exceptions, also be unable to establish a revenue requirement that permits continued operation and growth under these cost of service rules. They will be forced to limit new investment and to drop out of the competition to build the information superhighway. Some – perhaps many – will be forced by regulation to reduce rates to a point at which revenues are insufficient either to cover payments on existing debt or to support refinancing. The inevitable bankruptcy proceedings and distress sales will define "confiscation" for future textbooks.

The Commission can avoid this unlawful and unproductive outcome by building into its rules provisions for a fair transition into rate regulation. The Commission must allow a cable operator to establish an orderly, gradual schedule for phasing in the rate increases that may be necessary to provide for recovery of and return on pre-regulation investment in the tangible and intangible assets of cable television systems. Such a transition mechanism will ensure that cable operators are not driven out of business by regulation. At the same time, the legitimate purposes of the Cable Act will be fulfilled, because consumers will still experience lower and more predictable rates than may have occurred without regulation.

## II. THE COST OF SERVICE RULES ARE A CYNICAL SHAM.

In the first Notice of Proposed Rulemaking in the Rate Regulation proceeding, the Commission appeared to recognize that application to the newly-regulated cable industry of the cost of service principles that are usually applied to traditional public utilities would be problematic. It therefore sought comment on the effect of cost of service ratemaking on the industry's ability to recover its investment in tangible and intangible assets, including goodwill, and to service its current debt, and on the need for a transition mechanism.<sup>6/</sup>

Similarly, the first Report and Order in that docket cited concerns about debt service as a major reason for instituting a new rulemaking proceeding to develop cost of service standards suitable for cable systems.<sup>7/</sup> The Rate Order did, however, adopt one fundamental principle to govern cost of service proceedings: "rates must be set to allow cable operators to earn a reasonable profit on provision of cable service."<sup>8/</sup>

The Cost of Service NPRM sought comment on both "traditional" cost of service approaches and on alternatives, modifications, and transitional

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6/ Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, 8 FCC Rcd 510, 524-5 (1992).

7/ Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, 8 FCC Rcd 5631, 5798-99 (1993) (Rate Order) ("For example, we are unable to gauge at this time the extent to which general disallowances of debt incurred to purchase cable systems in excess of replacement cost would affect the industry and consumers.")

8/ 8 FCC Rcd 5631, 5795; see 47 U.S.C. § 543(b)(2)(C).

mechanisms.<sup>9/</sup> Comcast and others responded by explaining the potentially devastating effect of applying unmodified traditional rules to cable operators, and by proposing a variety of possible substitutes that would recognize the financial realities of the cable industry. No party submitted evidence demonstrating that any cable operator could survive charging rates set according to cost of service rules that ignore investments made prior to enactment of the Cable Act.<sup>10/</sup>

It is thus apparent that the Commission adopted its cost of service rules, which it apparently understands to be a Constitutionally-required backup to its benchmark scheme, in the full knowledge that the rules offer no relief whatever to the very cable operators who would be the most harmed by a 17% reduction in regulated revenues -- those who in good faith borrowed money and used it to acquire, at market prices, cable systems. As a Constitutional safety net, these rules are a sham.

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**9/ Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, FCC 93-353 (released July 16, 1993) (Cost of Service NPRM or NPRM).**

**10/ Proponents of net original cost ratebase and other public utility concepts supported their views either with the contention that that approach would produce the lowest rates for consumers, see, e.g., Comments of Austin, Texas; King County, Washington; and Montgomery County, Maryland; or that public utility style rules were needed to achieve "regulatory parity" with telephone companies, see, e.g., Comments of Bell Atlantic.**

**A. The Cost Of Service Rules Must Be Revised So That They Will Produce End Results That Conform To The Requirements Of The United States Constitution.**

The constitutional limits on ratemaking are as well known to the Commission as they are to all parties in this proceeding. Rate-regulated companies are constitutionally entitled to the opportunity, not only to recover their expenses, but to make a reasonable profit on their investment.<sup>11/</sup> Regulatory agencies must ensure that the rate established allows the company to "operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed. . . ."<sup>12/</sup> The Due Process clause thus protects businesses that serve the public from legislative and regulatory attempts to establish rates that are confiscatory, *i.e.*, that unjustly favor the interests of consumers in having low rates over the interests of investors in the regulated enterprise.<sup>13/</sup>

The constitutional jurisprudence of public utility regulation constrains only the end result of ratemaking, however; it neither dictates nor sanctions any particular ratemaking methodology. Indeed, it is well established

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<sup>11/</sup> U.S. Const. amend. V; Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944).

<sup>12/</sup> Hope at 605.

<sup>13/</sup> Hope at 602.

that a ratemaking method that has been found constitutional in one context may not produce an appropriate or constitutional result in another context.<sup>14/</sup>

By stubbornly refusing to acknowledge the financial realities of the cable industry the Commission has committed the fundamental error of assuming that a method that has been found constitutional in other circumstances will produce constitutional results for the cable industry.

The combination of traditional ratemaking treatment of interest expense and the disallowance of purchased intangible assets inevitably means that cost of service rates will be too low to cover all of the interest expense properly allocable to regulated operations. A company that cannot make its interest payments is definitionally unable to maintain credit and will not be able to attract new capital. The rates produced by these cost of service rules will thus be confiscatory, not only because methods inappropriate to the circumstances are being employed, but because they will be too low.

**B. The Goal Of Excluding Costs That Would Not Have Been Incurred In A Competitive Environment Is Not A Lawful Goal For The Cost Of Service Rules.**

The Commission commits Constitutional error when it elevates the disallowance of costs that allegedly would not have been incurred in a competitive environment to the status of a primary goal of cost of service regulation.

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<sup>14/</sup> Jersey Central Power & Light Co. v. F.E.R.C., 810 F.2d 1168, 1180 (D.C. Cir. 1987) ("The fact that a particular ratemaking standard is generally permissible does not per se legitimate the end result of the rate orders it produces.").

Comcast recognizes that the Cable Act sets the goal of rate regulation of the basic cable service tier as protecting subscribers from rates higher than the rates that would be charged under competition.<sup>15/</sup> The Commission gave full expression to this goal in selecting the so-called competitive benchmark as its primary method of rate regulation. Not even Congress, however, can impose a rate on a company -- "competitive" or otherwise -- for whom that rate would be confiscatory. "The power to regulate is not the power to destroy." Smyth v. Ames, 169 U.S. 466 (1898). Therefore, cost of service, which is the secondary method of regulation, may not also be tied to the "competitive" standard. Instead, the explicit and overriding goal of cost of service must be the achievement of rates that allow the cable operator to continue to operate the business, attract capital and maintain credit -- rates that are, in short, compensatory and constitutional.<sup>16/</sup>

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<sup>15/</sup> 47 U.S.C. § 543(b). With respect cable programming services, however, the rates charged by systems subject to competition are but one of a list of factors that the Commission is to take into account in deciding rate complaints.

<sup>16/</sup> The Commission apparently believes that the availability of hardship procedures excuses the Commission and franchising authorities from considering an operator's financial viability in an ordinary cost of service case. However, the hardship procedures are so burdensome and time consuming that any operator in sufficiently dire straits to impress the Commission with its need would be bankrupt before the proceeding could be completed. Furthermore, the hardship procedures suffer the same constitutional infirmity as the cost of service rules, in that they too are ultimately tied to "competitive" rates and therefore do not offer relief to operators for whom immediate imposition of such rates would be confiscatory.

**C. There Is No Basis In The Record Of This Proceeding For Presumptively Excluding Any Cost On The Grounds That The Cost Would Not Have Been Incurred In A Competitive Environment.**

There is no evidence in the record of this rulemaking proceeding concerning the costs that are incurred or recovered by cable systems operating in a competitive environment. To suggest otherwise in the absence of any facts is arbitrary, capricious and an abuse of discretion.<sup>17/</sup> Indeed, the Commission possesses no information about cable costs at all, except for the showings made in the pending cost of service cases. It is only now initiating cost studies to gather such data. The Commission cannot, therefore, justify any of its presumptive disallowances on the grounds that systems facing competition would not have incurred the costs in question. Its claim that the cost of service rules reflect the costs that would be incurred in a competitive environment is entirely specious and tantamount to legal seppuku.<sup>18/</sup>

**D. The Commission Has Selected The Wrong Regulatory Model For Its Cable Cost Of Service Rules.**

The Cable Act charged the Commission with a task no regulatory agency has faced in many decades: the task of imposing rate regulation on an unregulated, rapidly growing industry. The Act did not specify the ratemaking

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17/ 5 U.S.C.A. § 706(2)(A).

18/ See MCI Telecommunications Corp. v. FCC, 917 F.2d 30, 39 (D.C. Cir. 1990) (Tariff 12 remand); see also AT&T v. FCC, 836 F.2d 1386 (D.C. Cir. 1988) (remanding automatic refund rule for rate of return enforcement); California v. FCC, 905 F.2d 1217 (9th Cir. 1990) (vacating Computer III rules).

methods to be employed. The Commission was thus free to develop a regulatory model suitable to the unique circumstances of the cable industry. Instead, the Commission reflexively and irresponsibly chose as its model traditional public utility regulation, a model suited only to mature industries from which cable differs in many critical respects.

Traditional utilities and common carriers have been subject to original cost rate regulation for decades, cable systems have never been. When investments are made in a traditional utility, investors are aware that the return on their investment is directly affected -- if not dictated -- by regulatory policy. When such utilities are sold, the price reflects recognition that ratemakers typically will not include intangible assets in the regulated ratebase.<sup>19/</sup> Original cost ratebase approaches are not inherently fair or constitutional, although with notice investors may adjust to it. For most unregulated businesses, the suggestion that investors' return will be limited to an amount equal to the company's cost of capital times the book value of tangible assets would be absurd. Traditional utility rules are, however, fair to investors who knew they were investing in a regulated utility operating under these rules. These rules are inherently unfair to debtholders who loaned money to cable operators and to cable equity holders, who were willing to forego dividends indefinitely in anticipation of cable's growth potential.

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<sup>19/</sup> See, e.g., National Association of Regulatory Utility Commissioners Bulletin, May 2, 1994, p.2 (State regulatory staff objections to proposed sale price of telephone exchanges.)

Cable companies have far more debt than a typical utility, or an S&P 400 firm, and thus interest expense is a far greater proportion of revenue requirement for a cable operator than it is for a utility. Traditional ratemaking practice does not treat interest as an expense. Rather, regulators assume that, if a fair return on equity is combined with actual cost of debt to produce a weighted average cost of capital ("WACC"), and that WACC is applied to this ratebase, sufficient revenue requirement will be produced to both pay interest and provide dividends to equity holders.

This only works if most of the assets purchased with the debt and equity capital are in the ratebase. If most of Comcast's assets are excluded from ratebase, no conceivable rate of return (WACC) will produce sufficient revenues to pay the interest. Comcast, like many other publicly-held cable companies, but unlike a traditional utility, pays a nominal dividend. Cable shareholders expect this. But banks expect to be paid, and neither Comcast nor any other cable operator can remain in business if it does not pay its interest obligations.

**E. The Commission Must Provide For Transitional Recovery Of Pre-regulation Investment In Its Cost Of Service Rules.**

**1. Major changes require transitions.**

Congress's abrupt decision in 1992 to impose rate regulation on an industry that it had previously deliberately freed from such regulation<sup>20/</sup> subjects

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<sup>20/</sup> See Section 601 of the Communications Act of 1934, as amended, 47 U.S.C. § 521.

the Commission's cost of service rules to heightened constitutional scrutiny.<sup>21/</sup>

The observations of the Supreme Court in Duquesne Light Co. v. Barasch, 488

U.S. 288, 315 (1989) are pertinent:

[A] decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions.

Duquesne at 315. The Commission's experience on appeal of Comsat's first rate case is also instructive. Comsat had a capital structure unusual for a public utility: 100% equity. The Commission without prior notice prescribed an overall rate of return based on a hypothetical capital structure with 45% debt. The Court of Appeals ruled that the Commission was required to phase-in this change over a period of years to mitigate the effect of the new rule and assure Comsat an adequate return.<sup>22/</sup>

Changing from an unregulated to a regulated environment creates potential economic discontinuities far greater than were present in Duquesne and Comsat, and raises serious constitutional questions about the extent to which investors who were encouraged by deregulation to devote capital to the expansion

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21/ Nor can it be overlooked that this Commission ruled that effective competition exists. Investors purchasing cable systems thereafter, relied upon this policy finding that eliminated regulation. See Bowen v. Georgetown University Hospital, 488 U.S. 204, 220 (1988) (J. Scalia, concurring).

22/ See Communications Satellite Corporation v. FCC, 611 F.2d 883, 907-909 (1977).

and growth of the cable television industry may be deprived of the fruits of their pre-regulation investments.

**2. Congress did not intend the Cable Act to have retroactive effect.**

The Supreme Court has recently confirmed that agency rules that apply retroactively will not be enforced unless Congress has explicitly granted the agency authority to adopt retroactive rules.<sup>23/</sup> A retroactive rule is one that "attaches new legal consequences to events completed before its enactment." The Commission's cost of service rules attach radical new consequences to acquisitions completed before their enactment. Because the Cable Act does not specifically authorize retroactivity, these rules are unenforceable.

**3. Proclaiming all of the rules to be rebuttable presumptions provides only the illusion of a transitional mechanism.**

The Commission appears to believe that it can save its cost of service rules from challenge with the proviso that they are only presumptions that can be rebutted in individual cases. This is a self-serving delusion. As the court of appeals has recognized, the Commission's ratemaking presumptions, such as those embodied in its telephone accounting rules and ratebase rules, carry great weight and are not likely to be rebutted.<sup>24/</sup>

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**23/ See Landgraf v. USI Film Products, 1994 WL 144450 (U.S.); Rivers v. Roadway Express, 1994 WL 144506 (U.S.).**

**24/ See Mountain States Tel. and Tel. Co. v. FCC, 939 F.2d 1021, 1026-29 (D.C. Cir. 1991).**

It is highly unlikely that any franchising authority will allow costs the Commission has "presumptively" disallowed, or that the Commission's staff will accept arguments in individual cases that the Commission has rejected in this proceeding. Furthermore, the standards that must be met to rebut presumptive disallowances are vague and, to the extent they include consideration of "competitive" rate levels, improper for costs resulting from pre-regulation transactions.

If there is to be a fair transition to regulation, the Commission must make specific provisions for that transition in the rules and not trust it will be created through case-by-case adjudication of rate cases.

4. **At the very least, the Commission must clarify that franchising authorities and the Commission's staff may allow amortization of assets that are excluded from the ratebase.**

When regulators disallow from ratebase large amounts of prudent investment, they often establish an amortization period during which that investment can at least be recovered, even if no return is earned on it. Although the Commission's order explicitly rejects all proposed transition mechanisms that involve inclusion of so-called "excess" acquisition costs in ratebase, Comcast does not read the Order to prohibit amortization as a transition device.<sup>25/</sup> The Commission should on reconsideration make specific provision for amortization of otherwise disallowed investment, so that franchising authorities, who are

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<sup>25/</sup> Order 99 96-97.

prohibited from settling cases and must explain their decisions to the Commission on appeal, will not be unduly discouraged from using this time-honored device for balancing consumer and investor interests.

**III. THE COMMISSION MUST STAY OR WITHDRAW ITS PRESUMPTIVE DISALLOWANCE FROM RATEBASE OF MASSIVE AMOUNTS OF LEGITIMATE INVESTMENT IN CABLE TELEVISION SYSTEMS.**

**A. The Commission Must Allow Recovery Of And Return On The Net Investment In Intangible Assets Acquired Prior To Regulation.**

The cost of service rules purport to recognize that certain of a cable system's intangible assets -- organizational costs, franchise costs, customer lists -- have real value.<sup>26/</sup> However, the valuation rules adopted for these assets, which attempt to imitate the original owner's book cost that was applied to tangible assets, assure that no cable system likely to file a cost of service case will benefit from inclusion of these assets in ratebase.

Valuable intangible assets exist in nearly every commercial entity. However, as a result of GAAP, the dollar amount of such value appears on a balance sheet only when a purchase occurs. Consequently, in nearly every purchase transaction involving a commercial entity, the full value of such intangible assets is recognized. When an arms length transaction occurs between a willing buyer and willing seller, the purchase price by definition represents the fair market value of a business. The buyer willingly agrees to pay for not only the

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<sup>26/</sup> Order 99 86-88.

tangible assets of the enterprise at their current fair market value, but also willingly pays fair market value for the intangible assets as well.

For example, Garden State Cablevision, L.P., was purchased from the New York Times Company in 1989 for \$428 million plus a \$55 million minority tax certificate granted by the Commission.<sup>27/</sup> Of this amount, about \$114 million represented the fair market value of the tangible assets of the system. About \$160 million represented the value of seasoned subscriber lists, while about \$136 million was paid for franchise rights.<sup>28/</sup> Since acquisition, no distributions have been made, and there have been significant additional contributions to capital.

Comcast estimates that, under the Commission's cost of service rules, Garden state would be able to include in ratebase only about \$45 million, representing the approximate net book value of tangible assets on the books of the New York Times, plus net additions since acquisition. Using this ratebase, the return component of the annual regulated revenue requirement for all regulated services would be only about \$6.7 million. This is a patently absurd result, since

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**27/** The general partner is Garden State Cablevision, Inc., of which J. Bruce Llewellyn is Chairman of the Board. Comcast is a limited partner in this system.

**28/** The remainder represents going concern value and goodwill. Garden State's balance sheet as of December 31, 1993 reflects an unamortized balance for intangible assets of \$169,808,366.

Garden State's annual interest payments allocable to regulated services amount to \$13.2 million.<sup>29/</sup>

The Commission must act immediately to avoid results such as this in cost of service cases that will be decided before the Commission completes the Further Notice stage of this rulemaking docket. It can either issue an order on reconsideration withdrawing the portions of the Order that establish presumptions against inclusion of intangible assets in ratebase, or it can simply stay those parts of the order pending reconsideration pursuant to § 1.429(k) of the Commission's Rules.<sup>30/</sup>

**B. Recovery Of And Return On Investments Not Being Recovered In Current Rates Can Be Phased In Over Time.**

In many cases a rate that allows full recovery of and return on pre-regulation investment might be significantly higher than a system's current rate. In such a case the Commission need not allow rates to be suddenly and dramatically increased. It can instead require that increases be taken gradually over time in a manner fair to both consumers and investors.

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<sup>29/</sup> Garden State does not have the option of using benchmark rates, because setting rates at that level would reduce revenues to an extent sufficient to place Garden State in violation of its debt covenants.

<sup>30/</sup> 47 C.F.R. §1.429(k).

**IV. THERE SHOULD BE NO PRESUMPTION THAT COST OF SERVICE RATES CALCULATED USING RATES OF RETURN ABOVE 11.25% ARE TOO HIGH.**

In the Order the Commission established an overall after tax return of 11.25% -- remarkably, the same rate of return as is currently prescribed for local exchange carrier interstate services -- as presumptively correct for all cable operators in all cost of service cases.<sup>31/</sup> This rate of return finding is characterized as "interim", and is subject to further comment in the next phase of this docket.<sup>32/</sup>

This rate of return is far too low. To avoid irreparable harm to those cable operators whose cost of service cases may be heard before the Commission completes its new rate of return analysis, the Commission must immediately withdraw the presumption against showings by individual operators that they require a higher return.

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<sup>31/</sup> Comcast continues to oppose the use of a single, industrywide rate of return for cable cost of service cases. The cable industry is too diverse for a single rate of return to be appropriate for each participant. Furthermore, because cable relies on shorter-term debt financing than is common in the telephone business, the cost of capital, and thus the minimum required return, for a cable company can change significantly in a short period of time. Any rate of return prescription for the cable industry is likely to be obsolete by the time it is actually applied in a rate case.

<sup>32/</sup> Comcast intends to present new evidence as to the cost of capital of the cable industry in the response to the Further Notice.

**A. It Is Simply Not Credible That The Rate Of Return Required For Regulated Cable Television Service Is The Same As The Rate Of Return Required For Interstate Access Telephone Service.**

Currently, local exchange telephone companies (LECs) subject to rate of return regulation are allowed to target rates to achieve an 11.25% rate of return; they may earn up to 11.5% without risk of an "overearning" complaint.<sup>33/</sup> LECs subject to price caps may earn 12.25% without sharing, and may keep half of any additional earnings up to 16.25%.<sup>34/</sup>

The Commission's selection of 11.25% as the rate of return for cable companies implies that the Commission believes the cable television business and most of the local exchange business to face similar business, financial and regulatory risks. Indeed with respect to price cap LECs, earnings up to 16.25% suggest that the Commission believes these firms experience substantially more risk than cable television operators. This absurd belief flies in the face of observable fact.

Telephone is a highly profitable business, attracting equity investors with its history of paying regularly-increasing dividends over many decades. The cable business has yet to become profitable, does not pay dividends, and attracts public equity investors, if at all, only with the promise of growth in the very long

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**33/ See Represcribing the Authorized Rate Return for Interstate Services of Local Exchange Carriers, 5 FCC Rcd. 7507 (1990).**

**34/ See Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786 (1990).**

term. Telephone bonds are highly rated, while most cable debt is not even considered investment grade. Telephone is an essential basic utility service, while cable is an optional entertainment service. Regulators are generally perceived as protective of LECs, whereas they are seen as hostile to cable.

In short, cable's financial, business, and regulatory risks are all far higher than the risks of investing in the telephone business. By any logic, the allowed return for cable service must also be far higher than that prescribed for the telephone industry.

**B. The Rate Of Return Finding Is Based On Stale Data And Must Be Revisited Expeditiously In Light Of Changed Financial Market Conditions.**

Both short and long term interest rates have risen significantly since the Commission reached its decisions in this docket.<sup>35/</sup> Given the prevalence of variable-rate debt and the lack of long-term financing in the cable industry, interest rate changes such as this have a greater and more rapid effect on the cost of debt for cable than would be the case for a traditional utility financed with 30 year bonds.

Because conditions have changed so rapidly, the Commission must act expeditiously to revise its cost of capital findings. In the interim, the Commission must at minimum announce immediately that all cable operators in

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<sup>35/</sup> The prime rate has risen from 6.00% to 6.75%, while LIBOR has risen from 3.75% to 4.68%. Compare Cost of Service Order ¶ 189, citing The New York Times, Feb. 18, 1994, at D 12 with The New York Times, May 9, 1994, at D 5. Aa-rated utility bonds and long-term Treasury bonds have risen almost 100 basis points during the same time period. Id.

cost of service cases may recompute the presumptive rate of return using current, individual cost of debt information.

**C. Regulation Has Increased The Risk Of Investing In Regulated Cable Television Operations.**

It is apparent from the Order that the Commission believes the risks of regulated cable service to be lower than the risks of other parts of the operators' business. This may be true of the telephone industry, but it is not true for cable.

The Commission's actions have greatly increased the uncertainty, and therefore the risks, perceived by potential investors in cable. The large rate decreases imposed on reconsideration in the Rate Regulation proceeding have left investors with the indelible impression that the Commission is hostile to cable. More concretely, the Commission's proposal in the Further Notice to consider imposing a productivity adjustment that will have the effect of limiting future rate increases for regulated cable systems to less than the rate of inflation creates a strong note of uncertainty about the future for all cable systems, and raises the unsettling possibility that all will eventually be forced to resort to cost of service showings to obtain sufficient revenues to stay in business.<sup>36/</sup>

The Commission should take no comfort in the notion that it has saved cable television from itself by regulating it. Instead, it must acknowledge that it has greatly increased the difficulties facing this industry. It must then act

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<sup>36/</sup> Comcast intends to address the "productivity adjustment" in detail in its comments in response to the Further Notice.

quickly to create new cost of service rules under which cable systems can justify the rates they must charge if they are to survive and grow.

**V. THE COMMISSION SHOULD RECONSIDER ITS DECISION TO ADOPT A UNIFORM SYSTEM OF ACCOUNTS FOR CABLE TELEVISION SYSTEMS MAKING COST OF SERVICE SHOWINGS.**

The Order adopts the concept of a detailed uniform system of accounts for cable systems making cost of service showings. An actual proposal, modeled closely on Part 32 of the Commission's rules, the Uniform System of Accounts for Telephone Companies (USOA), is offered for comment in a separate rulemaking docket.

Comcast will offer its comments on the accounting proposal in the rulemaking proceeding. However, to the extent that the determination to use a uniform accounting system will not be reconsidered in that docket, Comcast asks that it be reconsidered in the instant proceeding.

It is not feasible for cable operators that are parts of larger organizations to create new accounting systems for only those systems that must use cost of service to justify rates. All systems would have to be converted to the new accounts. This would be expensive and time consuming. Most of this expenditure would be wasted because, as the Commission has stated, "it is unnecessary to require uniform accounting under the benchmark/priccap approach."<sup>37/</sup>

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<sup>37/</sup> Order, § 218.