rate stability on the BST, which carries broadcast signals and which every subscriber must purchase in order to receive other programming services, is sufficient reason to limit the applicability of the revised channel addition rules to CPSTs. Although at the time we adopted tier neutrality, we found that suppressing rates for the BST would give operators incentives to move services off the BST and add to regulatory complexity,[115] we believe these factors have less weight where channel additions are at issue.[25*] Second, we believe that providing enhanced incentives to add channels to CPSTs will maximize choice for subscribers, because subscribers are not required to purchase CPSTs to obtain NPTs and will, therefore, be able to determine whether the CPSTs, any NPTs or both offer the best value. Third, we agree with NATOA that applying the revised rules to the BST would increase the complexity of the regulatory task faced by local regulatory authorities.[116] Accordingly, we limit application of the new rules to CPSTs, provided that an operator offers at least one CPST to subscribers. If an operator only offers a BST, the operator may use the new rules to make rate adjustments for adding channels to the BST.

71. In the succeeding paragraphs, we explain and justify each of the elements of this going forward price cap structure. In the Technical Appendix we justify and explain the particular values we have incorporated into this price cap structure. The Technical Appendix also details why we rejected various commenters proposals with respect to the going forward price cap structure. Our rules describe the application of these requirements in detail. The Commission will release a revised version of Form 1210 subsequent to this Report and Order.

2. Per Channel Adjustment Factor

72. As indicated, we establish a "per channel adjustment factor" of up to 20 cents per channel for channels added to CPSTs. Operators may increase rates by up to 20 cents, exclusive of programming costs, for each channel added to a CPST on and after May 15, 1994, subject to the Operator's Cap of $1.20 on rate increases attributable to channel additions through December 31, 1996, and $1.40 through December 31, 1997.[26*] An operator may

[25*] Various commenters to our initial notice in this docket argued that the 1992 Cable Act intended to produce low rates for basic service. *See Rate Order* at paras. 193-194. Although we concluded that we had the authority to mandate a low-priced BST, we declined to do so. We found that a low-priced BST would give operators incentives to move services to other tiers where they could charge relatively high prices. We also found that if we mandated a lower price for BSTs than for CPSTs, it would complicate the regulatory scheme for regulators and operators. *Id.* at para. 197. However, because the 1992 Cable Act requires that the Commission consider different factors in setting BST and CPST rates, the Commission was not required to adopt tier neutral rates. *See* Communications Act §§ 623(b)(2), (c)(2); 47 USC §§ 543(b)(2), (c)(2).

[26*] An operator that added a channel on or after May 15, 1994, and raised its rates

(continued...)

choose a lower per channel adjustment, if that would further its business plan by, for example, allowing it to devote a portion of the Operator's Cap to license fees.

73. The per channel adjustment factor will compensate the operator for its costs of adding the channel plus a reasonable profit. Twenty cents falls within the historical range of 15-22 cents by which operators in a competitive environment would adjust rates for the addition of a new programming channel, exclusive of programming costs. We determined the 15-22 cent range by analyzing rate increases associated with growth in the number of channels offered in the five years prior to the 1992 Cable Act. The methodology we used in deriving the 15-22 cent range is set forth in the Technical Appendix.

74. In the *Rate Order*, we provided that any revenues received from a programmer, or shared by a programmer and an operator, must be netted against costs for purposes of calculating whether there has been an increase or decrease in external costs.[117] We extend this requirement for offsetting revenues against costs to the per channel adjustment factor for channels added to CPSTs pursuant to our revised channel adjustment rules. The revenues must be deducted from programming costs and then, to the extent revenues are remaining, from the per channel adjustment. Offsetting will apply on a channel-by-channel basis. We believe that this best balances the interest of the cable operator in being compensated for adding new programming and the interest of subscribers in receiving reasonable rates.[27*]

75. The per channel adjustment factor permitted by this Report and Order will apply only to net increases in channels from the highest number of channels offered on all CPSTs (excluding NPTs) on May 15, 1994 or any date thereafter.[28*] If an operator substitutes

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[26*](...continued)
pursuant to our existing rules, may revise its rates after December 31, 1994, using the new channel addition rules. As noted, *supra* at para. 65, an operator must use either the existing or the revised rules consistently for all channel additions on and after January 1, 1995.

[27*] Commissions received by an operator from programmers will be treated as revenues received from programmers. Any commissions cable operators receive from programmers must, therefore, be netted against programming costs for the purpose of determining whether there has been an increase or decrease in the operator's external costs. After commission revenues have been deducted from programming costs, if there are still revenues remaining, such revenues shall be deducted from the per channel adjustment.

[28*] An operator may receive a per channel adjustment for channel X if it substitutes channel Y for channel X and then adds channel X back to the system, so long as the addition of channel X represents the required net increase in the number of CPST channels. In contrast, an operator that had 20 channels on its CPSTs on May 15, 1994, 22 channels on its CPSTs on May 15, 1995, and 21 channels on its CPSTs on January 1, 1996, may not obtain a per channel adjustment for adding the 22nd channel back to its system on May 15, 1996. Rather, the 22nd channel is treated as a channel substitution. *See* para. 85, *infra*.

a new channel for an existing channel, no per channel adjustment may be made under the revised channel adjustment rules.[118] Rather, the operator should continue to charge the residual associated with the channel that was dropped. To permit an operator to receive a per channel adjustment in these situations would encourage operators to evade the purpose of the revised going forward incentives by substituting new for existing channels simply to get an additional per channel adjustment.

3. Operator's Cap

76. For the addition of new channels to CPSTs on or after May 15, 1994, we establish a per subscriber cap on the amount by which monthly cable rates may increase between January 1, 1995, and December 31, 1997. Operators may not make rate adjustments to monthly rates totalling more than $1.20 per subscriber over the first two years of the three-year period or more than $1.40 over the full three-year period.[29*] Rate changes prior to January 1, 1997 resulting from programming costs of new channels must fall within the Operator's Cap unless they are covered by the License Fee Reserve. Price increases will be counted against the Operator's Cap when rates are increased as a result of channel additions, not when the addition occurs. Any rate increases pursuant to the revised rules shall be subject to the notice and prior approval requirements of our regulations.[119] In addition, operators will be required to send the Commission copies of the notices sent to subscribers.

77. The Operator's Cap on the rate increase attributable to the addition of new channels to CPSTs is necessary because without such a cap, the per channel mark-up could create an incentive for operators to add large numbers of channels to CPSTs so as to increase the aggregate mark-up received. In the absence of rate regulation, cable operators with market power may be motivated to raise rates unreasonably. Because the rates of cable operators not subject to effective competition are lowered by regulation, these operators might use their market power to increase the number of channels on their CPSTs so as to regain the monopoly profits not available as a result of regulation. This result would undermine the 17% competitive rate reduction previously ordered by the Commission and could raise overall rates toward monopoly levels that would have occurred in the absence of the 1992 Cable Act. The result would be unreasonable CPST prices, contrary to the statutory requirements of the 1992 Cable Act. An unreasonable CPST rate also would cause the CPST to be an unattractive choice for subscribers, thereby removing it as a viable competitor to an NPT. The absence of a viable competitor would result in the lack of market constraints on NPT pricing. The result could be unreasonable NPT rates, in addition to unreasonable CPST rates. Thus, the Operator's Cap will help assure that both CPST and NPT rates remain reasonable.

[29*] The Operator's Cap will apply only to operators using the 20 cent per channel adjustment in our new rules. It will not apply to operators that elect to use our existing rules to adjust rates for channel additions occurring on and after May 15, 1994.

78. In addition, we adopt the Operator's Cap because there is no evidence that consumers want to pay for an unlimited number of channels in CPSTs.[120] The cap will also provide operators with incentives to choose which new services offered on CPSTs would be most valued by subscribers. Finally, because the per channel adjustment of up to 20 cents reflects an average based on historical data, adjusted for the lack of effective competition, it may provide some operators with a greater incentive to add channels than would exist in a competitive market. The Operator's Cap prevents operators from adding unlimited numbers of channels in these circumstances. The Operator's Cap will thus keep overall regulated rates reasonable and will provide an incentive to operators to add channels to CPSTs that subscribers will demand most.

79. As we explain in the Technical Appendix, before setting the Operator's Cap, we conducted an extensive analysis of rate changes instituted by cable operators prior to regulation and adjusted for the lack of effective competition faced by most systems at that time. In that analysis we observed that, in the five years prior to regulation, operators generally added on average 2.4 new channels per year to their basic and upper tiers. Our Operator's Cap would permit six channels to be added to CPSTs through December 31, 1996, assuming operators seek the full 20 cents mark-up per channel. In addition, a seventh channel may be added between January 1, 1997 and December 31, 1997 for an additional 20 cents.[30*] To ensure that rate increases associated with channel additions do not constitute an abuse of an operator's continuing market power and to ensure that rates remain reasonable, as explained below, the per channel adjustment is imposed to approximate rate adjustments an operator facing effective competition would receive for adding a channel.[121]

4. License Fee Reserve

80. We also establish a License Fee Reserve of 30 cents which operators may use, between January 1, 1995 and December 31, 1996, to recover programming costs for new channels. The License Fee Reserve may be applied against the initial license fee or any increase in the license fee for channels added during the first two years that the Operator's Cap is in effect. During this period, operators also may use all or any portion of the amount permitted as a per channel adjustment under the Operator's Cap to pay for license fees in excess of the License Fee Reserve. License fees incurred in the third year the Operator's Cap is in effect may be passed through to subscribers as external costs without counting against

[30*] The Commission recognizes that the Operator's Cap may limit the number of additional services to be added to CPSTs through December 31, 1997. This limitation, however, affects CPSTs only. Because we are allowing operators to place unlimited numbers of new services on NPTs at prices that operators choose, we believe operators will have adequate incentives to offer additional programming services. Hence, the cap will limit price increases on CPSTs without unduly restricting the ability of operators to provide new programming to their customers.

either the License Fee Reserve or the Operator's Cap.[31*]

81. The 30 cents License Fee Reserve would allow 6 channels to be added at an average license fee of 5 cents per channel.[32*] The 5-cents average, per channel license fee falls within the historical range of 4-12 cents which we observed. Within that range, we determined that a choice toward the lower end of the range was appropriate because the 12 cent upper figure included price increases for programming already on operators' systems as well as for new programming. The methodology we used in deriving the License Fee Reserve is explained in the Technical Appendix.

82. We have adopted a License Fee Reserve in response to programmers' concerns that a cap on total rate increases attributable to new channels, without a reserve for license fees, might give rate-regulated cable operators incentives to increase profits by adding only no cost or low cost channels.[122] That is, if we adopted only the $1.20 cap for the first two years of the Operator's Cap, which includes the 20 cent per channel adjustment, operators might add six channels over the first two years with no license fees so as to maximize their share of the rate increase. The License Fee Reserve makes no judgment about the relative value to subscribers of high or low cost channels, but seeks to replicate the incentives operators would have to add channels in a competitive market, which accommodates both low and high cost services.

5. Programming Cost Increase Mark-Up

83. We have decided not to allow operators using the per channel adjustment under our new rules to take the 7.5% mark-up on programming cost increases, including retransmission consent fees and copyright fees incurred for coverage of broadcast signals, for channels for which the per channel mark-up of up to 20 cents was taken.[33*] Our analysis indicates that the per channel adjustment of up to 20 cents for additional channels, in addition to the License Fee Reserve, will provide full and fair compensation to operators adding channels to CPSTs. Operators who have added channels prior to the effective date of the new rules will not be harmed by this change since the operators may elect to add channels to CPSTs under the old or the new rules.

[31*] As noted, an inflation adjustment may be passed through to subscribers pursuant to 47 C.F.R. § 76.922(d)(2) without regard to the License Fee Reserve or Operator's Cap.

[32*] An operator taking the maximum 20 cents per channel adjustment could add 6 channels under the $1.20 Operator's Cap applicable during the same period.

[33*] In addition, as described below, we seek comment on whether the 7.5% markup should be restricted further. *See* paras. 133-134, *infra*.

6. Deletion And Substitution of Channels

84. The attached regulations also specify how operators shall adjust rates for BSTs and CPSTs when channels are dropped from, or moved between, BSTs and CPSTs. In general, when dropping a channel from a BST or CPST, operators will be required to make their rates reflect the net reduction in external costs as is required under our existing rules.[123] Operators also will be required to reduce the price of that tier by the "residual" associated with that channel. For channels that were on a BST or CPST on or before May 14, 1994 or channels added after that date pursuant to the current rules, the per channel residual is the charge for the tier, minus the external costs for the tier, and any per channel adjustments made after that date, divided by the number of channels on the tier. For channels added to a CPST on or after May 15, 1994 pursuant to our new channel addition rules, the residuals shall be the actual per channel adjustment taken for that channel when it was added to the tier plus any inflation adjustment since that time. The residual and programming cost shall be calculated as of the date the channel is dropped.

85. As noted above, when an operator substitutes a new channel for an existing channel on a CPST, no per channel adjustment may be taken. The residual for the new channel is that of the channel it replaced. Operators substituting channels will be required to adjust their rates for changes in license fees as provided by our current rules. To preserve the overall effectiveness of the Operator's Cap and the License Fee Reserve, if the license fee for the new service is greater than the license fee for the replaced service, and the operator chooses to pass that increase through to subscribers, the excess shall count against the aggregate of the Operator's Cap and the License Fee Reserve. If the license fee for the new channel is less than the license fee for the replaced channel, no credit shall be given against the cap or the reserve, so as not to create an artificial incentive to replace higher license fee channels with lower license fee channels. With respect to channels to which the 7.5% mark-up on new programming costs applies, the operator shall treat the mark-up as part of its programming costs and subtract the mark-up from its external costs when a channel is dropped. When such a channel is substituted, the operator may retain in its rates the 7.5% mark-up on the license fee of the dropped channel, so long as that amount is not more than 7.5% of the license fee of the new channel.

86. When a channel is shifted between a BST and a CPST or between CPSTs, it shall be treated as if it was dropped from one tier and the residual and programming cost associated with the shifted channel shall be shifted to the other tier. The residuals associated with the shifted channel shall be adjusted by reference to the number of subscribers on each tier to ensure aggregate revenues remain the same.[34*] Revenue neutrality protects consumers

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[34*] An operator may use the equivalent billing unit ("EBU") methodology in calculating the number of subscribers on a tier, provided it does so for both the tier from which the channel is shifted and the tier to which the channel is shifted and provided that the operator (continued...)

by ensuring that our requirements do not create incentives for operators to move channels to tiers with more subscribers solely to increase revenues. And because the per channel adjustment of up to 20 cents applies only to the CPSTs, an operator may not move a channel for which it received a per channel adjustment under the new rules from a CPST to the BST. Our revised rules describe in detail the application of these requirements.

7. Headend Upgrades for Small Systems

A. Background

87. The Commission recognizes that regulatory and administrative burdens placed on small systems[35*] and small multiple system operators ("MSOs") by our regulations may be greater than the burdens faced by other operators.[36*] The Commission has adopted various transition and administrative procedures in order to alleviate regulatory burdens experienced by small systems and small MSOs.[124]

B. Comments

88. In order to give small systems incentives to add channels, CATA suggests that the Commission adopt a sliding scale that would permit higher rates to be charged for new channels as the subscriber base decreases from 1,000 to 100.[125] CATA's comments indicate that the capital used to purchase cable equipment must come from additional fees charged subscribers before reasonable profits can be made.[126] Since equipment costs are fixed, the smaller the system, the longer it will take to recover equipment costs and the less incentive

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[34*](...continued)
otherwise meets the conditions for using EBU methodology. *See Public Notice: Question and Answer on Cable Television Rate Regulation* (July 27, 1994) Question and Answer 1.

[35*] A small system is a cable system that serves 1,000 or fewer subscribers from the system's principal headend, including any technically integrated headends and microwave receive sites. *See* 47 C.F.R. § 76.901(c).

[36*] A small MSO is defined as a MSO that has 250,000 or fewer total subscribers, owns only systems with less than 10,000 subscribers each, and has an average system size of 1,000 or fewer subscribers. *See* 47 C.F.R. § 76.922(b)(5); *see also Cost Order* at para. 278. We note that the Commission has solicited comments on whether it should retain its current definitions of small operators and small systems owned by small MSOs and whether it should employ the current Small Business Administration definition of small cable company. *See Fifth Order on Reconsideration and Further Notice of Proposed Rulemaking* ("*Further Notice*"), MM Docket No. 92-266 and 93-215, FCC 94-234, 59 FR 51869 (1994). The definitions of these terms may be affected by the comments received in response to the *Further Notice*.

there is to add channels.[127]

89. According to CATA, typical per channel equipment costs associated with the addition of satellite-delivered channels are $500 to $1,000 for a receiver to convert from satellite frequencies to video baseband, $800 for a descrambler, and $1,250 for a signal processor.[128] CATA states that labor costs are dependent on various factors, including whether additional satellite dishes are needed.[129] In addition, CATA comments that an additional satellite dish costs approximately $2,500.[130]

90. Summit also submitted comments focusing on the ability of small cable systems to recover equipment costs associated with the addition of new channels.[131] Summit states that even the combination of a pass-through of programming cost plus a mark-up does not cover the costs of headend equipment required to add a channel to a small cable system and, therefore, these costs should be accorded external cost treatment.[132]

C. <u>Discussion</u>

91. We have decided to adopt a special streamlined cost-of-service procedure for independent small systems and small systems owned by small MSOs that upgrade their headend equipment to add new channels to CPSTs. This procedure addresses CATA's concern that small systems may find it difficult to recover the fixed costs of the headend equipment required for adding channels, since the cost must be recovered over a small subscriber base. We limit this relief to independent small systems and small systems owned by small MSOs because (1) systems with more than 1,000 subscribers can spread the fixed costs of headend equipment over a larger customer base and (2) small systems owned by larger operators should have adequate financial resources to add channels under our generally applicable rules. Qualified small systems that add channels to their CPSTs, therefore, have the option of either using this special procedure or using the existing or revised going forward rules applicable to all operators.

92. Under this streamlined cost-of-service procedure for upgrading headend equipment, independent small systems and small systems owned by small MSOs may increase rates to recover the costs associated with new headend equipment that is used to add channels to CPSTs. In order to recover costs for headend equipment, qualified small systems will be required to certify to the Commission the level of costs they have actually incurred for adding headend equipment.

93. Notwithstanding these concerns, we do not want to burden subscribers of small systems with paying high rate increases. Therefore, as we have done with our new per channel adjustment formula, we have decided to limit the amount small systems may recover under this special allowance to prevent unreasonably sharp rate increases to small system subscribers. The amount a small system may recover for each channel added shall be limited to programming costs incurred plus the lesser of the actual cost of the headend equipment or

$5,000.[37*] Headend costs that are to be recovered through increased rates must be depreciated over the useful life of the equipment.[38*] In addition, we find that the rate of return the small system may earn on this investment may not exceed 11.25%.[39*]

94. Small systems may apply this streamlined cost-of-service procedure for channels added after May 14, 1994, but may not use this methodology to increase rates to reflect channel additions until January 1, 1995. Moreover, small systems that increase rates as a result of any channel additions pursuant to either this methodology may add a maximum of seven channels to CPSTs over the next three years. This is equal to the number of channels that a system taking the maximum 20 cent per channel adjustment may add under the Operator's Cap.

8. Systems with More than 100 Channels

95. In our *Fifth Notice*, we noted that the *Fourth Report and Order (Fourth Report)* in MM Docket No. 92-266 established per channel adjustments for systems with total channels on regulated tiers of 100 channels or fewer. It did not establish per channel rates for systems that provide more than 100 channels.[133] We solicited comment on whether we should establish a method for adjusting capped rates in situations where there are more than 100 regulated channels and, if so, what that method should be. We also sought comment on whether we could use mathematical formulations derived from existing data or tables. We asked whether instead of adopting a method for setting rates for offerings of more than 100 channels, we should cap rates at the 100 channel level unless the operator could justify a higher rate based on a cost-of-service showing. We solicited comments on how any of these proposals would affect incentives for operators to provide additional channels on an a la carte basis. We additionally asked whether our going forward methodology should be modified to provide greater or lesser compensation to operators for adjustments to capped rates when channels are added or deleted from BSTs and CPSTs, and whether this would better meet our

[37*] This figure is consistent with CATA's representation that the addition of a satellite channel can cost between $2,500 and $5,000. *See* CATA Comments at 6.

[38*] While the Commission has not prescribed depreciation rates, cable operators are required to follow reasonable depreciation practices. Depreciation and useful life of the equipment are to be submitted to the Commission with the cost certification.

[39*] We previously selected 11.25% as the presumptive rate of return in our interim cost-of-service rules. *See Report and Order and Further Notice of Proposed Rulemaking*, MM Docket Nos. 92-266, 93-215, 9 FCC Rcd 4527 (1994) (*"Cost Order"* or *"Cost Further Notice"*) at paras. 204-208. Because this is an optional streamlined procedure that allows independent small systems and small systems owned by small MSOs to recover for headend equipment costs associated with the addition of new channels, we are not permitting these system operators to rebut the 11.25% rate of return in this context. They could, however, attempt to do so in the context of regular cost-of-service proceedings.

goals of encouraging infrastructure development and growth of programming. We stated that operators should provide a complete factual justification for any claims that the current methodology is inadequate.[134]

96. With respect to the Commission's request for comments on how to deal with systems with 100-plus channels, CATA states that if the Commission would increase the per channel adjustment to 25 to 50 cents, there would be no need for a special mechanism for systems with over 100 channels.[135] Time Warner, Inc. ("Time Warner") argues that the Commission cannot derive a formula for 100-plus channel systems from the existing data tables because those tables are based upon data for systems with fewer than 100 channels and include systems that did not implement any upgrade.[136] Providence Journal asks the Commission to deregulate rates for channels in excess of 100.[137] TCI proposes that the Commission set a demarcation point at 75 regulated channels, allow cable operators to choose which 75 channels are regulated, and deregulate all additional channels.[138] GTE Service Corporation, a telephone company, favors establishing rates for 100-plus channel systems in accordance with price cap principles, rather than requiring a cost-of-service showing.[139]

97. Our existing going forward regulations use a declining per channel adjustment as the number of channels on a system increase. In contrast, in this Report and Order we have decided to allow (1) a flat per channel adjustment for the addition of new channels to CPSTs, subject to an Operator's Cap, and the License Fee Reserve, and (2) NPTs for which cable operators set the price. Because our revised regulations allow operators to set the price for an unlimited number of channels on NPTs, we do not believe it is necessary to adopt any other rules that are based on a specific number of channels.[40*]

9. Term of the Revised Channel Addition Rules

98. The new rule for adjusting rates when channels are added, deleted or substituted on CPSTs will be in place through December 31, 1997, and will be reviewed prior to the end of that period to determine if there is any reason to continue to provide incentives to increase the number of channels on any CPST. The new rule will expire on that date and will be replaced by our existing rule unless it is reinstated by the Commission. The special streamlined cost-of-service procedure for headend equipment costs for small systems also will expire on December 31, 1997 unless it is reinstated by the Commission.

[40*] Cable operators continuing to add channels under our current rules may receive a per channel incentive only for the first 100 channels on BSTs and CPSTs. *See Fifth Notice* at para. 255.

VI. Negative Option Billing

A. Background

99. Section 3(f) of the 1992 Cable Act prohibits negative option billing, which occurs when a cable operator charges a subscriber for any service or equipment that the subscriber has not affirmatively requested by name.[140] A subscriber's failure to refuse a cable operator's proposal to provide such service or equipment may not be deemed to be an affirmative request for such service or equipment.[141] The *Rate Order* provided that changes in the mix of programming in a tier, including additions or deletions of channels, will not be subject to the negative option billing provision unless they change the fundamental nature of the tier.[142] We believe that, on balance, the benefits to subscribers from giving operators the ability to diversify, improve or otherwise modify their offerings in a tier outweigh the slight reduction in subscriber choice that results from exempting such changes from the negative option billing prohibition.[143]

100. In the *Rate Order*, we held that it is not necessary to subject any service changes accompanied by a price increase to the negative option billing prohibition, provided that these changes do not change the fundamental nature of the tier, because subscribers will receive 30 days' advance notice of any rate, programming or channel changes, and any actual or implicit rate changes will be subject to our rate regulations.[144] We also stated that restructuring tiers and equipment, including restructuring necessary to comply with the 1992 Cable Act, will not violate the ban on negative option billing, unless the restructuring constitutes a change in the fundamental nature of the tier.[145] Finally, we stated that the negative option billing prohibition does not apply to system-wide equipment improvements accompanied by rate increases.[146]

101. The *Rate Order* provided that operators could pass increases in external costs and inflation adjustments through to subscribers.[147] We did not address whether passing these costs through constitutes negative option billing.

102. In the *Third Reconsideration Order,* we concluded that the Commission and state and local governments have concurrent jurisdiction to regulate negative option billing. The rationale for this conclusion was that regulation of negative option billing, while discussed in the section of the 1992 Cable Act governing rate regulation, is more in the nature of a consumer protection measure than rate regulation *per se*.[148] Section(8)(c)(1) of the 1992 Cable Act, codified in Section 632(c)(1) of the Communications Act, provides that nothing in the "Consumer Protection Laws" title of the Communications Act may "be construed to prohibit any State or any franchise authority from enacting or enforcing any consumer protection law, to the extent not specifically preempted by this title."[149] Given our conclusion that Section 3(f) of 1992 Cable Act is a consumer protection measure, we stated that Section 632(c)(1) of the Communications Act preserves the ability of a state or local government to regulate negative option billing except to the extent such regulation is "specifically preempted."[150]

103. We found in the *Third Reconsideration Order* that there is nothing in the language of Section 3(f) of the 1992 Cable Act or its legislative history to suggest that state and local authorities are specifically preempted from regulating negative option billing.[151] In fact, the legislative history refers to the efforts of state attorneys general in this area, which further supported our conclusion that there is no specific preemption. However, we also stated that if we became aware of a particular state or local regulation of negative option billing that went beyond consumer protection and instead approached actual regulation of "rates for the provision of cable service" we would consider the question of federal preemption in that specific factual context.[152]

B. Comments

104. On reconsideration, Time Warner and NCTA request that we clarify what channel additions to a tier will not require affirmative marketing under Section 3 (f) of the 1992 Cable Act. They also asked us to declare that local authorities may not require affirmative marketing for channel additions under state or local laws.[153] More specifically, NCTA asks us to clarify that three specific "scenarios" do not trigger the federal negative option billing rule and that state or local authorities are preempted from enacting or enforcing their own negative option billing laws. The three scenarios are:

(1) a cable operator raises its rates (with no change in service or equipment offerings) as a result of passing through external costs or inflation adjustments, as provided by the Commission's rules;

(2) an operator changes its rates as a result of the addition or deletion of channels to its regulated tiers pursuant to the Commission's "going forward" regulations; and

(3) an operator replaces an existing channel of service on a regulated tier with a different channel of service, with or without a change in the rates.

105. In support of its position, NCTA points to the *Rate Order*, where we stated that the negative option billing prohibition is not violated by: (1) changes in the mix of programming on a tier, including additions or deletions of channels; (2) rate changes accompanying changes in regulated programming unless there is a fundamental change in service; or (3) restructuring of tiers and equipment if subscribers will continue to receive the same number of channels and the same equipment unless there is a fundamental change in service.[154] NCTA claims that these provisions make clear that, as a matter of federal law, neither rate increases resulting from Commission approved pass-throughs of external costs or inflation adjustments nor channel changes resulting from the addition or deletion of programming to a regulated tier would violate the negative option billing rule. Moreover, NCTA argues that because the three situations in its letter "plainly implicate rate regulation," rather than the marketing or billing of those services, and "clearly are not violative of federal

negative option billing requirements, state and local authorities are preempted from enforcing their laws in a manner inconsistent with the federal determinations."[155]

106. NCTA states that the practical consequences of permitting state and local authorities to require that cable operators obtain subscribers' affirmative consent before implementing federally permitted rate increases or channel changes would be far reaching.[156] According to NCTA, without federal preemption, a cable operator could be effectively precluded from achieving the return permitted under the Commission's price cap and going forward rules[157] NCTA also states that if any of these minor changes were considered to be subject to the negative option billing prohibition, subscribers who do not affirmatively "request" the "service" would have their service discontinued, and most subscribers would not even realize why their service had been cut off.[158]

C. Discussion

1. Application of the Negative Option Billing Rules to the Three Scenarios

107. In determining whether any of the scenarios involve negative option billing, we are guided by the language of the negative option billing provision, its legislative history, and our prior interpretations. Section 3(f) states that "[a] cable operator shall not charge a subscriber for any service or equipment that the subscriber has not affirmatively requested by name." "Service" may be read very broadly.[41*] But if "service" were read in that manner, the negative option billing provision would require a cable operator to obtain subscribers' affirmative consent before making any change in offerings, including even relatively minor changes such as the addition of one channel to a large tier, and the legislative history makes clear that such an interpretation is not appropriate. With regard to the negative option billing provision, the Conference Committee explained:

> The language adopted by the conferees ensures that cable operators will not be able to charge customers for tiers or packages of programming services or equipment that they do not affirmatively request as well as individually-priced programs or channels. This provision is not intended to apply to changes in the mix of programming services that are included in various tiers of cable service.[159]

[41*] "Cable service" is defined in the Communications Act § 602(6) as "(A) the one-way transmission to subscribers of (i) video programming, or (ii) other programming service, and (B) subscriber interaction, if any, which is required for the selection of such video programming or other programming service." Codified at 47 U.S.C. § 522(6). Communications Act § 602(16) defines "service tier" as "a category of cable service or other services provided by a cable operator and for which a separate rate is charged by the cable operator." Codified at 47 U.S.C. § 522(16).

In light of that guidance, we have concluded that "a change in the mix of channels in a tier, including additions or deletions of channels, will not be subject to the negative option billing provision, unless they change the fundamental nature of the tier."[160] We adhere to that construction of the negative option billing provision.

108. With respect to NCTA's first scenario, which involved passing through external costs or inflation adjustments, we hold that these types of rate changes do not in and of themselves invoke the federal negative option billing rule. As an initial matter, they do not constitute "service or equipment" within the meaning of Section 3(f). Moreover, under our rate regulations, operators are specifically permitted to pass through to subscribers increases in external costs and inflation adjustments.[161] These types of rate changes do not constitute a change in the fundamental nature of a tier, and, therefore, do not implicate the federal negative option billing prohibition for that reason as well.

109. With regard to the second and third scenarios identified in NCTA's letter, we specifically addressed how we would treat channel changes with respect to negative option billing in the *Rate Order*. We stated that "a change in the mix of channels in a tier, including additions or deletions of channels, will not be subject to the negative option billing provision, unless they change the fundamental nature of the tier."[162] We believe that, on balance, consumers benefit from giving operators the ability to diversify, improve or otherwise modify their offerings without obtaining every subscribers' affirmative consent.[163]

110. Determinations as to what constitutes a change in the fundamental nature of a tier will generally depend on the individual circumstances of each case. However, as we indicated in the *Rate Order*, if an operator deleted all existing channels from a particular tier and added a completely new set of channels, this would change the fundamental nature of the tier, thus requiring subscribers' prior affirmative assent.[164] Accordingly, channel changes involving relatively few channels generally will not change the fundamental nature of that tier, and thus will not implicate the federal negative option billing rule. Consistent with this approach, additions of channels and rate adjustments within the Operator's Cap and License Fee Reserve of our revised going forward rules generally will not change the fundamental nature of a tier.[42*] As we indicated in the *Rate Order*, because our rules require operators to give subscribers 30-days' advance notice of any changes in rates, programming or channel positions,[43*] we do not believe subscribers need the additional protection of the negative option billing provision for relatively modest changes.[165]

[42*] Affirmative marketing also is not required when an operator moves channels pursuant to our conditions for establishment of NPTs, so long as the movements do not change the fundamental nature of the tier. *See* discussion at para. ___, *infra*.

[43*] The 30-days' notice requirement applies to all rate or service changes, including the addition, deletion or substitution of channels, whether or not the fundamental nature of the tier is affected.

2. State Authority

111. Section 632(c)(1) of the Communications Act provides that "[n]othing in this title shall be construed to prohibit any State or any franchising authority from enacting or enforcing any consumer protection law, to the extent not specifically preempted by this title." This provision makes clear that state and local authorities generally may apply statutes proscribing fraud or misleading advertising practices to cable operators. We have recognized that negative option billing practices are also usually "in the nature of a consumer protection measure rather than a rate regulation provision *per se*."[166] Hence, state and local consumer protection laws apply to negative option billing practices. For example, if a cable operator engaged in a practice that violated the terms of the negative option billing provision added by the 1992 Cable Act and the terms of a state or local negative option billing rule, enforcement could proceed under state and local law as well as under federal law.

112. However, Section 3(a)(1) of the 1992 Cable Act makes clear that regulation of "the rates for the provision of cable service" is governed exclusively by the federal statute and Commission regulations. It therefore "specifically preempts" state and local regulation that is inconsistent with the federal rules. We have recognized that there may be cases where "state or local regulation of negative option billing goes beyond consumer protection and instead approaches actual regulation of 'rates for the provision of cable service.'"[167] In such a case, state or local regulation would be prohibited by the 1992 Cable Act. The scenarios NCTA presents require us to consider again the relationship between Section 632(c)(1) of the Communications Act and Section 3(a)(1) of the 1992 Cable Act.

113. We conclude that a two-step approach is warranted. First, is the state or local negative option rule consistent with the federal rule? If it is, then the state or local rule may be enforced. If the state or local rule is inconsistent with the federal rule, then it is necessary to consider whether its enforcement "approaches, actual regulation of 'rates for the provision of cable service.'"[168] In elaborating on that inquiry, we now conclude that state or local consumer protection laws may not be enforced in a manner that conflicts with or undermines our rate regulation rules established pursuant to Section 3 of the 1992 Cable Act. If there is an actual conflict between federal and state law or where state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress, the state law is preempted.[169]

114. Underlying our approach is our construction of Section 632(c)(1) of the Communications Act. That provision makes clear, in our view, that Congress has not so comprehensively occupied the cable field that there is no room for the enforcement of state consumer protection laws. In the absence of Section 632(c)(1) of the Communications Act, a powerful argument could be made to the contrary, because the 1992 Cable Act is comprehensive legislation that relates to nearly all aspects of cable television.[170] Moreover, Section 632(c)(1) of the Communications Act makes clear that there is room for enforcement of state and local consumer protection laws, along with federal enforcement, wherever state or local law does not conflict with federal law. But where there is conflict that would

undermine our enforcement of the rate rules Congress ordered us to implement, state and local law must give way.

115. The scenarios NCTA presents involve situations where enforcement of state and local negative option billing rules would be inconsistent with the federal rule and enforcement might undermine implementation of the cable rate rules we have promulgated pursuant to Congress's instruction. With respect to the first scenario, the federal negative option billing rule plainly would not require cable operators to obtain affirmative consent from subscribers before passing through external costs and inflation adjustments as permitted by our rules, as explained above. In addition, enforcement of a state or local negative option billing rule requiring affirmative consent prior to the pass-through of external costs and cost-of-service increases, as permitted by our rate rules, would undermine the federal regime governing cable rates. We have issued detailed rate rules implementing Section 3 of the 1992 Cable Act. Under our rules, most cable operators must reduce their rates from pre-1992 levels, many by as much as 17%, to ensure that cable rates are reasonable. However, as the first scenario presented by NCTA recognizes, our rules also allow cable operators to increase their rates to reflect increases in the cost-of-living or other external costs, most of which are beyond cable operators' control. The 17% rate reduction and the rules authorizing the pass-through of external costs and inflation adjustments are of a piece; the rate cut would not be fair to cable operators if they were prohibited from raising rates to reflect increased costs that are beyond their control. The result would be unreasonably low rates, contrary to Congress's command that we must ensure that cable operators that do not face effective competition charge "reasonable" rates.[171]

116. If state or local officials were able to enforce negative option billing rules that, contrary to the federal negative option billing rule, require cable operators to obtain affirmative consent before increasing rates to reflect increases in inflation or other external costs, our cable rate rules would be fatally undermined. As NCTA states, cable operators would not be permitted to increase rates until a subscriber completed a form authorizing the rate increase, even though the increase was fully justified under our rate rules. As a practical matter, chaos would ensue every time a cable operator tried to increase rates as permitted under our rate rules, and our rules authorize cable operators to pass through external costs quarterly.[172] Rate increases would not be permitted until each subscriber gave affirmative consent, and subscribers would have no reason to consent unless cable operators threatened to cut off service and followed through on that threat with respect to subscribers who failed to complete and mail the form authorizing the rate increase. Moreover, since many subscribers undoubtedly fail to read carefully every mailing from their cable operator, many subscribers would have their service cut off, to their surprise and dismay, each time a cable operator passed through external costs. That would impose significant transaction costs on cable operators and subscribers for no good reason. Accordingly, we conclude that state and local authorities may not enforce negative option billing rules that preclude cable operators from passing through cost-of-living increases and other external costs that are permitted to be

passed through under our rate rules.[44*]

117. The other two scenarios presented by NCTA involve the addition, deletion and replacement of channels. Our negative option billing regulation makes clear that the requirement that cable operators obtain affirmative consent before charging for a new service "shall not preclude the addition or deletion of a specific program from a service offering, the addition or deletion of specific channels from an existing tier of service, or the restructuring or division of existing tiers of service that do not result in a fundamental change in the nature of an existing service, or tier of service."[173] Accordingly, the replacement of a single channel, NCTA's third scenario, would not be prohibited by the federal negative option billing provision, because that would not result in a "fundamental change" unless the tier was very small. With respect to NCTA's second scenario, involving the addition or deletion of channels, the answer would depend on how many channels were added or deleted and other factors relevant to determining whether a "fundamental change" had occurred. As stated above, however, changes that are permitted under our "Operator's Cap" generally would not constitute "fundamental changes."

118. If the addition, deletion, or replacement of channels did not constitute a fundamental change in a tier, so that the federal negative option billing rule was not triggered, preemption of enforcement of a stricter state or local negative option billing rule would depend on whether enforcement would conflict with or undermine our rate regulation rules established pursuant to Section 3 of the 1992 Cable Act. It is not possible to provide a blanket response to NCTA's second and third scenarios in the absence of a specific set of facts to evaluate. However, it bears emphasis that our rate rules governing the addition, deletion, and replacement of channels are designed to ensure reasonable rates without impeding the provision of new services. Indeed, our rate rules are designed to encourage the provision of new services that subscribers desire at the reasonable rates mandated by Congress. Therefore, an interpretation of state or local law that required a cable operator to obtain the affirmative consent of every subscriber before making a change that did not fundamentally alter the affected tier would, in most cases, interfere with the accomplishment of Congress's objectives. The transaction costs imposed by a negative option billing requirement would create a major incentive for cable operators to freeze their service offerings. Thus, the goals of the rate regulation regime we have designed pursuant to Congress's direction would be frustrated and undermined if state and local governments enforced negative option billing rules that thwarted the accomplishment of the goals of our rate regulations. Indeed, state and local officials in effect would set cable rates by discouraging the addition, deletion, or replacement of channels even where the change did not fundamentally alter the nature of a tier.

[44*] Certified local franchising authorities may review such rate changes on the BST pursuant to our rate regulations and may file a complaint with the Commission regarding rate changes on CPSTs.

119. We recognize that we stated in the *Third Reconsideration Order* that "[S]ection 3(a) of the 1992 Cable Act generally does not 'specifically preempt' state and local governments from enacting and enforcing state or local consumer protection laws that may address negative option billing practices of cable operators."[174] We believe that statement remains correct following our further consideration of when enforcement of state or local negative option billing rules would "approach actual regulation of 'rates for the provision of cable service.'"[175] In most cases, we think state and local officials would enforce negative option billing rules that are consistent with the federal rules. In relatively few cases, in our view, would state or local officials be likely to seek to enforce negative option billing rules that conflict with or undermine federal rate regulation provisions. But in any event, on further consideration we are convinced that, however numerous such cases are likely to be, state and local officials may not enforce negative option billing rules that obstruct the accomplishment of the objectives of Congress's cable rate provisions.

VII. Affiliate Transactions

A. Background

120. In the *Cost Order*[176] in MM Docket No. 93-215, the Commission promulgated a rule for valuing transactions between cable operators and affiliated companies. The Commission found that it would be inconsistent with Congressional intent to allow rates for regulated cable service to reflect the prices affiliates charge each other for transactions that occur at other than an arm's length. The Commission found that allowing cable companies to pass increases in their costs through to rate payers could motivate those companies to pay excessive amounts for assets and services obtained from unregulated affiliates.[177] The Commission also found that allowing service pass-throughs could induce cable companies to undercharge unregulated affiliates since the undercharges could be offset by increased charges to subscribers.[178]

121. We therefore adopted a rule for affiliate transactions that applies to cable operators who elect cost-of-service regulation or seek to adjust benchmark/price cap rates for affiliated programming costs. This rule applies valuation methods that are similar to those telephone companies are now required to apply. The rules distinguish between asset[45*] transfers and the provision of services.[179] Under the rule, charges for assets purchased by a cable operator from an affiliate, or sold by a cable operator to an affiliate is valued at the asset provider's prevailing company price, if the provider has sold the same kind of asset to a substantial number of third parties at a generally available price.[180] Absent a prevailing company price, the cable company is required to value the asset at the higher of net book cost and estimated fair market value when the regulated cable system is the seller, and at the lower

[45*] For the purpose of evaluating affiliate transactions that involves programming, we classify programming as an asset.

of net book cost and estimated fair market value when the regulated cable system is the buyer.[181]

122. Charges for services purchased by a cable operator from an affiliate or sold by a cable operator to an affiliate are valued at the provider's prevailing company price, if the provider has sold the same kind of service to a substantial number of third parties at a generally available price. When the provider has established no prevailing company price, the cable operator is required to value the service at the service provider's cost.[182]

123. In the *Cost Further Notice,* we tentatively concluded that the general changes we proposed for affiliate transactions involving telephone companies should be applied to cable operators.[183] Accordingly, the Commission proposed a further limitation on the application of the prevailing company price as a measure of a reasonable price for an affiliate transaction.[184] We tentatively concluded that the use of prevailing company pricing as a valuation method for transactions between cable operators and their affiliates should only be permitted where the predominant purpose of the transaction is to serve nonaffiliates. To that end, we proposed that any affiliate that sells less than 75 percent of its output to non-affiliates has too large a volume of affiliate transactions to be deemed to have a predominant purpose of serving non-affiliates. We therefore proposed to continue to allow prevailing company pricing as a valuation method for affiliate transactions only where at least 75 percent of the cable operators output is sold to non-affiliates.[185]

B. <u>Comments</u>

124. The cable industry generally opposes the proposed rule arguing that the proposal would require operators and programmers to adopt costly, inefficient and unnecessary methodologies to document the estimated fair market value of the assets or services exchanged. Time Warner and TCI argue that the 75% bright-line test would impose administrative burdens that would be excessive and outweigh the speculative benefits that might result.[186]

125. BellSouth endorses the existing rule and opposes the proposed rule as unduly burdensome.[187]

126. Several other parties oppose the proposed rules on the grounds that these requirements would discourage vertical integration and would result in decreased investment in quality cable programming.[188] Several programmers also argue that the current rules permit vertical integration and thus encourage investment in programming while the proposed rules would penalize cable operators for carriage of programs produced by affiliated programmers and effectively discourage vertical integration.[189] Other parties, observing that rules similar to the proposed rules for cable are being considered for local exchange carriers, argue that regulatory parity warrants the application of such rules to cable companies.[190] Bell Atlantic states that while the proposed rules may be too restrictive, the Commission should adopt uniform rules for cable and telephone companies.[191]

127. USTA opposes the proposed cable rules, however, arguing that the proposal is inappropriate for both cable operators and telephone companies.[192] NCTA also opposes the proposal and states that the only rationale for the rules comes from an incorrect premise that the application of such rules in the telephone context necessitates similar rules in the cable industry.[193]

C. Discussion

128. We decline to adopt the proposal to prevent cable operators from valuing assets or services at the operators' prevailing company prices unless the providing affiliates sell more than 75% of their output to nonaffiliates. We find that this proposal would prevent, in many cases, cable operators from establishing a prevailing company price for programming services that have achieved wide distribution among cable operators. The record demonstrates, for example, that under the proposed rule, cable operators would be unable to value at a prevailing company price such ubiquitous services as the Cable News Network, TNT, WTBS, ESPN, MTV, and USA due to these programmer's affiliations with major MSOs.[194] We will, therefore, not adopt the proposed rule because there is no evidence in the record to suggest that a cable operator would have an incentive to pay excessive amounts for assets or services obtained from affiliates where an asset or service is widely distributed among cable operators.

129. In addition, we are concerned that by preventing cable operators from valuing programming at the prevailing company price, we may discourage major MSOs with substantial resources from investing in cable programming and related services that could benefit subscribers. Thus, the proposed rule may discourage efficiencies in the distribution, marketing and purchase of programming which may, in turn, reduce subscriber fees and cable rates. Programmers may also lose access to cable industry financing for innovative, creative video programming.

130. We will, therefore, retain the existing cable affiliate transaction rule which provides that a cable operator may value an asset or service at the prevailing company price if the provider has sold the same kind of service or asset to a substantial number of third parties at a generally available price. We find that for cable affiliate transactions, the sale of an asset to a substantial number of third parties will ensure that cable operators will not have an incentive to pay excessive prices when they obtain services and assets from affiliates because in such cases the primary purpose of the transaction would not be to provide services and assets to the affiliated programmer. However, we will continue to examine our test for the establishment of a prevailing company price in MM Docket No. 93-215 and as we gain experience with our current cable affiliate transaction rule, we may seek further comment in order to refine the rule.

131. Finally, the *Cost Further Notice* sought comment on (1) the proposal to require cable operators that do not meet the prevailing company price test to value services at the higher of cost and fair market value when the cable operator is the seller and the lower of

cost and fair market value when the cable operator is the buyer;[46*] (2) whether the current definition of an affiliate should be retained;[47*] (3) whether the interim cable affiliate transaction rules should be adopted as our final rules;[195] and (4) whether our final cable affiliate transaction rule should be included in the uniform system of accounts that we adopted for cable operators.[196] We will address these issues in conjunction with our general consideration of final cost rules in MM Docket No. 93-215 at a later time.

VIII. Seventh Notice of Proposed Rulemaking

132. As discussed above,[197] we have determined that operators electing to use the 20 cent per channel adjustment may not take the 7.5% mark-up on programming cost increases, including retransmission consent fees and copyright fees incurred for carriage of broadcast signals, for channels added on or after May 15, 1994. We made this determination because our analysis indicates that the 20 cent per channel adjustment will provide full and fair compensation to operators adding new channels to CPSTs.

133. We also believe that for operators using the per channel adjustment of up to 20 cents, maintaining the 7.5% mark-up on programming cost increases for channels offered before May 15, 1994 may no longer be necessary given the total incentive structure provided in our revised going forward rules. In addition, the 7.5% mark-up on such channels may create an artificial incentive for the operator to continue to offer programming that the operator would not otherwise continue to offer. For these reasons, we tentatively conclude that the 7.5% mark-up is unnecessary for such operators with respect to increases in programming costs for channels offered before May 15, 1994. We solicit comment on whether operators electing to use the per channel adjustment of up to 20 cents under the new rules should be allowed to take the 7.5% mark-up on increases in programming costs, including retransmission consent fees and copyright fees incurred for carriage of broadcast signals, for channels added before May 15, 1994. If we decide that such operators may not take a 7.5% mark-up on increases in programming costs, we will not consider requiring cable operators to prospectively remove from rates any 7.5% mark-up added prior to the effective date of a final rule on this issue.

[46*] This proposal would change the requirement under our existing rule which provides that affiliate transactions that do not meet the prevailing company price test and involve the sale of services shall be recorded at cost. *See Cost Further Notice* at para. 312.

[47*] Under the current definition, an entity is affiliated with a cable system operator when it has a five percent or greater ownership interest in the cable system operator. This definition also specifies that a cable system operator is affiliated with another entity when it has a five percent or greater interest in that entity and that two companies that do not own each other are affiliated when a single entity has a five percent or greater interest in each of the two companies. *See Cost Further Notice* at paras. 242-248, 313 n.577.

134. We believe that the 7.5% mark-up on new programming costs when channels are initially added to a system ought be preserved for systems that continue to use the existing going forward rules because the 7.5% mark-up is an important part of the total package of incentives to add new programming under the existing rules.[48*] Our rules permitting operators to pass through external costs are generally intended to compensate for added costs outside the operators' control and not to provide an additional mark-up without a clear policy purpose. In contrast to the situation where the goal of providing incentives to add new programming services justifies a mark-up, there appears to be no strong reason to allow a mark-up on programming cost increases for a service already being offered. We therefore solicit comment on whether operators electing to use the current going forward rules should be permitted to pass-through the 7.5% mark-up on programming cost increases after the initial mark-up on the programming cost of new channels. We will not, however, consider prospectively removing from rates any 7.5% mark-up that was reflected in rates prior to our reaching a decision on this issue.

IX. Regulatory Flexibility Act Analysis

A. Final Analysis for the Fifth Report and Order and Sixth Order on Reconsideration.

134. Pursuant to the Regulatory Flexibility Act of 1980, 5 U.S.C. §§ 601-612, the Commission's final analysis with respect to the *Sixth Order on Reconsideration and Fifth Report and Order* is as follows:

135. Need and purpose of this action. The Commission, in compliance with § 3 of the Cable Television Consumer Protection and Competition Act of 1992, 47 U.S.C. § 543 (1992), pertaining to rate regulation, adopts revised rules and procedures intended to ensure that cable services are offered at reasonable rates with minimum regulatory and administrative burdens on cable entities.

136. Summary of issues raised by the public in response to the Initial Regulatory Flexibility Analysis. There were no comments submitted in response to the Initial Regulatory Flexibility Analysis. The Chief Counsel for Advocacy of the United States Small Business Administration (SBA) filed comments in the original rulemaking order. The Commission addressed the concerns raised by the Office of Advocacy in the *Rate Order*. The SBA also filed reply comments in response to the *Fifth Notice*.

[48*] We note that the Commission did not directly adopt the 7.5% mark-up on increases in programming costs of channels offered before May 15, 1994, and that the mark-up on increases in programming costs was added when the Cable Services Bureau developed the FCC Form 1210 to implement the Commission's Order.

137. Significant alternatives considered and rejected. Petitioners representing cable interests and franchising authorities submitted several alternatives aimed at minimizing administrative burdens. In the course of this proceeding, the Commission has attempted to accommodate the concerns expressed by these parties. For example, the revised going forward mechanisms are designed to enhance incentives to add new channels to regulated tiers without creating new regulatory burdens and to provide additional options tailored to the concerns of small systems. In addition, the New Products Tier is designed to ensure that regulated cable service rates are reasonable while reducing administrative burdens.

B. Initial Regulatory Flexibility Analysis for the Seventh Notice of Proposed Rulemaking.

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

139. Reason for action. The Cable Television Consumer Protection and Competition Act of 1992 requires the Commission to prescribe rules and regulations for determining reasonable rates for basic tier cable service and to establish criteria for identifying unreasonable rates for cable programming services. The Commission has adopted rate regulations for cable systems not subject to effective competition. This *Notice* proposes to revise regulations governing new programming costs for channels on a system before May 15, 1994.

140. Objectives. To propose rules to implement Section 3 of the Cable Television Consumer Protection and Competition Act of 1992. We also desire to adopt rules that will be easily interpreted and readily applicable and, whenever possible, minimize the regulatory burden on affected parties.

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

142. Description, potential impact and number of small entities affected. We anticipate a possible impact on small entities because the *Notice* addresses the rates charged by cable operators that are not subject to effective competition, including small systems.

143. Reporting, record keeping and other compliance requirements. None.

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

145. Any significant alternatives minimizing impact on small entities and consistent with stated objectives. None.

X. Paperwork Reduction Act

146. The requirements adopted herein have been analyzed with respect to the Paperwork Reduction Act of 1980 and found to impose a new or modified information collection requirement on the public. Implementation of any new or modified requirement will be subject to approval by the Office of Management and Budget as prescribed by the Act.

XI. Procedural Provisions

147. *Ex parte* Rules - Non-Restricted Proceeding. This is a non-restricted notice and comment rulemaking proceeding. *Ex parte* presentations are permitted, except during the Sunshine Agenda period, provided that they are disclosed as provided in Commission rules. *See generally* 47 C.F.R. Sections 1.1202, 1.1203, and 1.1206(a).

148. Pursuant to applicable procedures set forth in Sections 1.415 and 1.419 of the Commission's Rules, 47 C.F.R. Sections 1.415 and 1.419, interested parties may file comments on or before January 13, 1995 and reply comments on or before February 13, 1995. To file formally in this proceeding, you must file an original plus four copies of all comments, reply comments, and supporting comments. If you want each Commissioner to receive a personal copy of your comments and reply comments, you must file an original plus nine copies. You should send comments and reply comments to Office of the Secretary, Federal Communications Commission, 1919 M Street, N.W. Washington, D.C. 20554. Comments and reply comments will be available for public inspection during regular business hours in the FCC Reference Center, Room 239, Federal Communications Commission, 1919 M Street N.W., Washington D.C. 20554.

XII. Ordering Clauses

149. Accordingly, IT IS ORDERED that, pursuant to Sections 4(i), 4(j), 303 (r), 612, 622(c) and 623 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 303(r), 532, 542(c) and 543, the rules, requirements and policies discussed in this Sixth Order on Reconsideration and Fifth Report and Order, ARE ADOPTED and Part 76 of the Commission's rules, 47 C.F.R. Part 76, IS AMENDED as set forth in Appendix C.

150. IT IS FURTHER ORDERED that, pursuant to Sections 4(i), 4(j), 303(r), 612(c), 622(c) and 623 of the Communications Act of 1934, 47 U.S.C. §§ 154 (i), 154 (j), 303(r),

532 (c), 542(c), and 543, NOTICE IS HEREBY GIVEN of proposed amendments to Part 76, in accordance with the proposals, discussions, and statement of issues in this Seventh Notice of Proposed Rulemaking, and that COMMENT IS SOUGHT regarding such proposals, discussion, and statement of issues.

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

152. IT IS FURTHER ORDERED that the requirements and regulations established in this decision shall become effective January 1, 1995, with the exception of new reporting requirements which will become effective on that date or as soon thereafter as they may be approved by the Office of Management and Budget.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton

William F. Caton
Acting Secretary