

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

FCC 95-8

In the Matter of)
)
Implementation of Sections of)
the Cable Television Consumer)
Protection and Competition)
Act of 1992: Rate Regulation)

MM Docket No. 92-266

SEVENTH ORDER ON RECONSIDERATION

Adopted: January 5, 1995

Released: January 5, 1995

By the Commission: Commissioner Barrett concurring and issuing a statement.

I. INTRODUCTION

1. In this *Seventh Order on Reconsideration*, the Commission on its own motion reconsiders the provision in its *Sixth Order on Reconsideration, Fifth Report and Order, and Seventh Notice of Proposed Rulemaking ("Sixth Reconsideration Order")*¹ requiring qualifying small systems to choose between (a) the streamlined cost-of-service procedure for recovering the headend costs of new channels that is available only to qualifying small systems and (b) the rate adjustment methodologies that are available to all operators when they add new channels. The Commission also reconsiders whether the streamlined cost-of-service procedure for recovering the headend costs of new channels should be available to qualifying single-tier systems and to qualifying larger systems for which the monthly per subscriber cost of the additional headend equipment necessary to receive an additional channel is one cent or more.

II. SMALL SYSTEM GOING FORWARD METHODOLOGY

A. Background

2. In the *Second Order on Reconsideration, Fourth Report and Order, and Fifth*

¹ FCC 94-286, adopted November 10, 1994 and released November 18, 1994, summarized at 59 Fed. Reg. 62,614 (1994). Petitions for reconsideration of the *Sixth Reconsideration Order* must be filed by January 5, 1995 and any such petitions will be considered in a subsequent order.

Notice of Proposed Rulemaking ("Fourth Report and Order") in this docket,² the Commission specified a "going forward" mechanism under which price-capped rates are adjusted for changes in the number of channels offered on the basic service tier ("BST") and on cable programming service tiers ("CPSTs"). Under this mechanism, operators first remove all external costs from the tier charge and then adjust the residual component of the tier charge by a per channel adjustment which declines as the number of channels on the system increases.³ Operators were also allowed to pass through to subscribers the programming costs associated with new channels as well as a mark-up of 7.5% on new programming expense.⁴

3. In the *Sixth Reconsideration Order*, the Commission, *inter alia*, supplemented its existing going forward rules by creating an alternative channel adjustment methodology. Cable operators adding channels to CPSTs or single-tier systems may recover from subscribers (a) a flat per channel mark-up of up to 20 cents per subscriber per month, subject to a cap on the total amount recovered through December 31, 1997, and (b) programming costs, subject to a cap that applies through December 31, 1996.⁵ Operators adding channels to CPSTs or single-tier systems on and after May 15, 1994 may use either the new rules or the existing rules to adjust rates after December 31, 1994, but must use either the existing rules or the new rules consistently with respect to all channels added after December 31, 1994.⁶

4. In the *Sixth Reconsideration Order*, the Commission also adopted a special streamlined cost-of-service procedure that permits independent small systems and small systems owned by small multiple system operators ("MSOs") to recover the costs of upgrading their headend equipment when they add new channels to CPSTs.⁷ To prevent the

² 9 FCC Rcd 4119 (1994).

³ See *Fourth Report and Order* at paras. 247-48; 47 C.F.R. § 76.922(e).

⁴ See *Fourth Report and Order* at para. 246; 47 C.F.R. § 76.922(d)(3)(xi).

⁵ See *Sixth Reconsideration Order* at paras. 64-83 (describing in detail going forward rules).

⁶ *Id.*; Letter to Peter H. Feinberg, DA94-1508 (from Chief, Cable Services Bureau, December 19, 1994) (waiver allowing operators to raise rates under the existing going forward rules after December 31, 1994 for channels added by that date, and then adjust rates under the new "going forward" rules for channels added after that date).

⁷ See *Sixth Reconsideration Order* at paras. 87-94. 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). 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).

potential for unreasonably sharp rate increases to small system subscribers, the amount a small system can recover for each channel added was limited to programming costs incurred plus the lesser of the actual cost of the headend equipment or \$5,000. Headend costs that are to be recovered through increased rates must be depreciated over the useful life of the equipment. In addition, the rate of return the small system may earn on such headend costs may not exceed 11.25%. Small systems that increase rates as a result of any channel additions pursuant to this methodology may be reimbursed for the addition of a maximum of seven channels to CPSTs between May 15, 1994 and December 31, 1997.⁸ Qualifying small systems adding channels to CPSTs were allowed to choose between this streamlined cost-of-service procedure and the going forward rules applicable to all systems.⁹

5. In adopting this streamlined cost-of-service procedure for independent small systems and small systems owned by small MSOs, the Commission relied in part on comments filed by the Cable Telecommunications Association ("CATA"), a cable industry trade association.¹⁰ In its comments, CATA suggested that special attention should be paid to small systems because the equipment costs associated with adding channels were fixed and small systems must spread those costs over a small subscriber base.¹¹ In order to give small systems incentives to add channels, CATA suggested 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 100.¹² 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, \$1,250 for a signal processor and approximately \$2,500 for an additional satellite dish where necessary.¹³

B. Comments

6. Since the *Sixth Reconsideration Order* was released, two industry trade groups have suggested that small systems are denied the incentives necessary for them to add channels to CPSTs by the requirement that they choose between the per channel adjustment of up to 20 cents and the streamlined cost-of-service procedure for upgrading headend

⁸ See *Sixth Reconsideration Order* at paras. 93-94.

⁹ See *id.* at para. 91.

¹⁰ See CATA Comments in MM Docket 92 -266 (June 29, 1994).

¹¹ CATA Comments at 5-7. The Small Cable Business Association ("SCBA") also participated in an ex parte meeting with Commission staff on this issue.

¹² CATA Comments at 5-7.

¹³ *Id.* at 6.

equipment.¹⁴ CATA stated that for a 1,000 subscriber system adding a channel at a cost of \$5,000 in additional headend equipment, the rate increase to each subscriber per month over the useful life of the equipment would average only \$.06 to \$.07. It adds that only for systems of 200 to 300 subscribers does the streamlined cost-of-service procedure yield a monthly per subscriber rate increase approaching the 20 cents permitted under the new going forward rules. CATA also states that the streamlined cost-of-service procedure denies even the smallest system any profit for adding a channel.¹⁵ CATA urges that small systems be permitted the same profit as other systems in addition to being able to pass through headend costs.¹⁶ The Small Cable Business Association ("SCBA") argues that the going forward rules are unfair to small systems because "small systems are either prohibited from recovering their headend costs altogether or can elect to recover them with a profit of 11.25% on the hardware, but lose the \$.20 per channel" adjustment, while the per channel adjustment of up to 20 cents allows larger systems to "recover all their costs, both hardware *and programming*, and still maintain a mark-up."¹⁷ SCBA asks the Commission to allow operators to recover the cost of additional headend equipment associated with channel additions in addition to the per channel adjustment of up to 20 cents.¹⁸

7. CATA also argues that the streamlined cost-of-service procedure should be available to all small systems and was improperly limited to independent small systems and small systems owned by small MSOs.¹⁹ SCBA argues that no subscriber cap is necessary because the headend costs quickly decrease to less than one cent per subscriber per month as the size of the system increases.²⁰

C. Discussion

8. On our own motion, we find our requirement that qualifying small systems elect between the per channel adjustment methodology and the streamlined cost-of-service procedure for upgrading headend equipment insufficient to give qualifying systems an appropriate incentive to add new channels. Although the return of up to 11.25% on the cost

¹⁴ See CATA Letter to Chairman Hundt, November 23, 1994 ("CATA Letter"); Small Cable Business Association Letter to Chairman Hundt, December 7, 1994 ("SCBA Letter")

¹⁵ CATA Letter at 1-2.

¹⁶ *Id.* at 3.

¹⁷ SCBA Letter at 2-3 (emphasis in original).

¹⁸ *Id.*

¹⁹ CATA Letter at 2.

²⁰ SCBA Letter at 2.

of headend equipment was intended to allow small systems a profit when they added channels, we now believe that our formula as a whole may give such systems an insufficient incentive to add channels. This is the case because, except for very small systems, the per subscriber rate adjustment associated with the streamlined cost-of-service showing would be less than the 20 cents per subscriber per month allowed under our general going forward regulations. If the maximum \$5,000 in headend costs is depreciated by a 1,000 subscriber system with an 11.25% rate of return, for example, the monthly per subscriber cost would be just over five cents, assuming a 15 year depreciation period.²¹

9. Accordingly, independent small systems and small systems owned by small MSOs will not be required to choose between the per channel adjustment methodology and the streamlined cost-of-service procedure for upgrading headend equipment. Instead, we will allow independent small systems and small systems owned by small MSOs to recover for each channel added by using both the per channel adjustment methodology and the streamlined cost-of-service procedure for upgrading headend equipment in the following manner. First, such operators may recover the lesser of the actual cost of the headend equipment or \$5,000 associated with the channel addition. The recovery of the lesser of the actual cost of the headend equipment or \$5,000 shall otherwise remain subject to the conditions set forth in the *Sixth Reconsideration Order*, namely that the headend costs be depreciated over the useful life of the equipment, the rate of return on this investment not exceed 11.25%,²² and the headend costs may be recovered for no more than seven channels through December 31, 1997.²³ Second, in addition to recovery of headend upgrade costs in a streamlined cost-of-service proceeding, such operators may make rate adjustments to reflect channel additions and programming expenses that all other operators are permitted to make under the existing going forward rules.²⁴ Specifically, operators may make per channel adjustments under either the

²¹ The Commission has not prescribed depreciation rates for headend equipment, but requires cable operators to follow reasonable depreciation practices in depreciating equipment over its useful life. See *Sixth Reconsideration Order* at para 93 and note 38*. The Cable Services Bureau, acting on delegated authority in examining cost-of-service rate justifications, concluded that operators generally assign 15-year useful lives to headend equipment and adjusted cable operator's proposed useful lives upward to reflect that norm. See, e.g., *In re U.S. Cable Corp.*, DA 94-1145 (adopted by Chief, Cable Services Bureau and released November 9, 1994); *In re United Video Cablevision, Inc.*, DA 94-1144 (adopted by Chief, Cable Services Bureau and released November 9, 1994).

²² Operators are permitted to recover an 11.25% rate of return on the lesser of the actual cost of the headend equipment associated with adding a channel or \$5,000. Therefore, if the cost of the headend equipment associated with adding a channel is \$5,000 or more, the operator is entitled to recover \$5,000 plus an 11.25% rate of return on the \$5,000 investment

²³ See *Sixth Reconsideration Order* at paras. 91-94.

²⁴ See 47 C.F.R. §§ 76.922(d)(3), 76.922(e).

new or the "old" going forward rules.²⁵ As explained in the *Sixth Reconsideration Order*, operators that elect the new going forward rules are allowed to recover programming expenses associated with adding channels subject to the License Fee Reserve and the Operator's Cap.²⁶

10. In addition, we believe that limiting eligibility to use the streamlined cost-of-service procedure for upgrading headend equipment to independent small systems and small systems owned by small MSOs may fail to give slightly larger systems an appropriate incentive to add channels. Accordingly, we have decided to allow larger systems to use the streamlined cost of service approach subject to the same conditions as independent small systems and small systems owned by small MSOs provided that (a) the systems are either independently owned or owned by small MSOs and (b) the monthly per subscriber cost of the additional headend equipment necessary to receive an additional channel is one cent or more.²⁷ We are providing this relief for systems that are slightly larger than those that fall under the definition of a small system because we believe that such operators may have higher than average costs and may not always have access to the financial resources or other purchasing discounts of larger companies. However, since average equipment costs were built into the per channel adjustment of up to 20 cents, we believe that it is unnecessary to allow systems with additional per subscriber headend equipment costs of less than one cent for each channel added to use the streamlined cost-of-service procedure for upgrading headend equipment. We believe that such operators may have sufficient resources to add channels without the additional incentive created by the streamlined cost-of-service procedure. However, we note that we may reconsider this issue in light of the comments we have received in response to our *Fifth Order on Reconsideration and Further Notice of Proposed Rulemaking*.²⁸ In that notice, the Commission 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. The definitions of these terms in the instant item may be affected by the outcome of the *Further Notice*.

11. In the *Sixth Reconsideration Order*, the Commission provided that rates for the BST will continue to be governed exclusively by our current rules, except that where a system offered only one tier on May 14, 1994, the cable operator will be allowed to use the revised

²⁵ *Id.*; see also *Sixth Reconsideration Order* at paras. 64-65.

²⁶ *Id.* at paras. 66-67. Of course, headend costs are not included in the Operator's Cap.

²⁷ The monthly per subscriber cost of the additional headend equipment necessary to receive the additional channel must be one full cent or more. For this purpose, operators may not round up monthly per subscriber costs of less than one cent. Additionally, operators must depreciate these costs at the same rate as they depreciate all similar equipment.

²⁸ FCC 94-234, summarized at 59 Fed. Reg. 51,869 (1994), at paras. 9-12.

per channel adjustment of up to 20 cents.²⁹ We did not, however similarly provide that the streamlined cost-of-service procedure for headend upgrades by eligible small systems would be available to operators of single-tier systems.³⁰ We did not intend to exclude single-tier systems from this procedure and, therefore, on our own motion, we reconsider the limitation of the streamlined cost-of-service procedure for headend upgrades to CPSTs. We conclude that the streamlined cost-of-service procedure should also apply to single-tier systems because we recognize that qualifying systems have the same small customer base over which to spread the cost of new equipment associated with providing additional channels, whether or not they have CPSTs. We also recognize that single-tier systems are commonly smaller systems. Accordingly, we believe that the streamlined cost-of-service procedure for headend upgrades associated with channel additions should apply to single-tier systems as well as CPSTs.

IV. Regulatory Flexibility Act Analysis

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

13. 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.

14. 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 *Report and Order and Further Notice of Proposed Rulemaking*.³¹ Consistent with our rules, the SBA also filed an ex parte letter on August 3, 1994.

15. Significant alternatives considered and rejected. In the course of this proceeding, petitioners representing cable interests and franchising authorities submitted several alternatives aimed at minimizing administrative burdens. The Commission has attempted to accommodate the concerns expressed by these parties. In this order, the Commission is providing additional incentives to qualifying small systems to add channels to CPSTs and single-tier systems.

²⁹ *Sixth Reconsideration Order* at para. 65.

³⁰ *Id.* at para. 91.

³¹ 8 FCC Rcd 5631 (1993).

V. Paperwork Reduction Act

16. The requirements adopted herein have been analyzed with respect to the Paperwork Reduction Act of 1980 and found not to impose a new or modified information collection requirement on the public.

VI. Ordering Clauses

17. 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 Seventh Order on Reconsideration, ARE ADOPTED and Part 76 of the Commission's rules, 47 C.F.R. Part 76, IS AMENDED as set forth in Appendix C.

18. IT IS FURTHER ORDERED that the Secretary shall send a copy of this Order 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).

19. IT IS FURTHER ORDERED that the requirements and regulations established in this decision shall become effective 30 days following publication in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION


William F. Caton
Acting Secretary

APPENDIX A

Title 47, Part 76 of the Code of Federal Regulations is amended as follows:

PART 76 -- CABLE TELEVISION SERVICE

1. The authority citation for Part 76 continues to read as follows:

Authority: Secs. 2, 3, 4, 301, 303, 307, 308, 309, 48 Stat. as amended, 1064, 1065, 1066, 1081, 1082, 1083, 1084, 1085, 1101; 47 U.S.C. Secs. 152, 153, 154, 301, 303, 307, 308, 309, 532, 535, 542, 543, 552 as amended, 106 Stat. 1460.

2. Section 76.922 is amended to revise paragraphs (e)(7) to read as follows:

Section 76.922 Rates for the basic service tier and cable programming service tiers.

* * * * *

(7) Headend upgrades. When adding channels to CPSTs and single-tier systems, cable systems that (a) are either independently owned or owned by small MSOs and incur additional monthly per subscriber headend costs of one full cent or more for an additional channel or (b) are either independently owned or owned by small MSOs as defined in Section 76.922(b)(5), may choose among the methodologies set forth in paragraphs (e)(2) and (e)(3) of this Section. In addition, such systems may increase rates to recover the actual cost of the headend equipment required to add up to seven such channels to CPSTs and single-tier systems, not to exceed \$5,000 per additional channel. Rate increases pursuant to this paragraph may occur between January 1, 1995, and December 31, 1997, as a result of additional channels offered on those tiers after May 14, 1994. Headend costs shall be depreciated over the useful life of the headend equipment. The rate of return on this investment shall not exceed 11.25 percent. In order to recover costs for headend equipment pursuant to this paragraph, systems must certify to the Commission their eligibility to use this paragraph, the level of costs they have actually incurred for adding the headend equipment and the depreciation schedule for the equipment.

* * * * *

CONCURRING STATEMENT

OF

COMMISSIONER ANDREW C. BARRETT

Re: In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Seventh Order on Reconsideration -- MM Docket 92-266 (Small System Going Forward Issues)

By this decision, the Commission provides relief for independent small systems and small systems owned by small multiple system operators by revising its "going forward" rules. These rules were established by the Commission to govern the permitted rate adjustments for the addition of channels on regulated tiers of service. I concur in today's decision.

As you are aware, I strongly opposed the Commission's "going forward" decision.¹ My dissatisfaction with the Commission's going forward methodology was, in large part, founded in the lack of flexibility and certainty for cable operators as they seek to launch programming services and develop service offerings for their systems. Despite these misgivings, I emphasize that my support of today's decision is based on the Commission's acknowledgement that greater flexibility is necessary to make certain that small systems have an incentive to add programming services, and not on any change of opinion with respect to the underlying "going forward" framework.

¹See, Dissenting Statement of Commissioner Andrew C. Barrett, Sixth Order on Reconsideration, Fifth Report and Order, and Seventh Notice of Proposed Rulemaking, FCC 94-286, adopted November 10, 1994 and released November 18, 1994, summarized at 59 Fed. Reg. 62,614 (1994)