EX PARTE OR LATE FILED

National Cable Television Association

Neal M. Goldberg
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March 10, 1995

William F. Caton
Secretary
Federal Communications Commission
1919 M Street, N.W.
Room 222
Washington, D.C. 20554

RECEIVED
MAR 10 1995
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Re: Ex Parte Notice: MM Docket No. 93-215

Dear Mr. Caton:

On March 9, 1995, Daniel Brenner and Neal Goldberg (National Cable Television Association), Bruce Owen and Michael Baumann (Economists, Incorporated) and Christopher Savage (Cole, Raywid & Braverman) met with John Nakahata of Chairman Hundt's office, Maureen O'Connell of Commissioner Quello's office, Lisa Smith of Commissioner Barrett's office, Mary McManus of Commissioner Ness' office, Jill Luckett of Commissioner Chong's office and Greg Vogt and Hugh Boyle of the Cable Services Bureau. They discussed issues relating to the Commission's proposal for rules governing the cost-of-service showings made by cable operators to justify their rates. In particular, they addressed issues regarding "start-up losses" and "acquisition costs" as reflected in the attached materials which were distributed at the meeting.

Sincerely,

Neal M. Goldberg

Neal M. Goldberg

Attachments

cc: (w/o attachments)
John Nakahata
Maureen O'Connell
Lisa Smith
Mary McManus
Jill Luckett
Greg Vogt
Hugh Boyle

CHRONOLOGY

May 1993:	The FCC states that it lacks data to set detailed cost rules and will issue a Further Notice of Proposed Rulemaking. "General cost-of-service principles" will apply until rules are issued.
September 1, 1993:	"Rereg I" takes effect.
November 1993:	The FCC holds that cost-of-service rate justifications will be due on November 15, 1993 just like benchmark filings, even though no cost-of-service rules yet exist. Chairman Quello states that new rules, when issued, will not be applied to cases filed under "general" principles. Various cost-of-service cases filed under "general cost-of-service principles" on 11/15/93. Major filers include Continental and Comcast. One week later, the FCC rules that Basic and CPS rates must be justified using the same methodology (that is, operators cannot "mix and match" benchmark and cost-of-service for a single franchise). Operators have until December 31 to refile benchmark cases as cost cases, or vice versa.
December 31, 1993:	Various additional cost-of-service cases filed.
February 1994:	The FCC adopts interim cost-of-service rules. They include presumptions against acquisition intangibles and against more than two years of start-up losses. The Commission states that the new rules will not take effect until May 15, 1994, and that rates prior to that time will be reviewed under "general" principles. New benchmarks also established with 17% average reduction and new economic rationale.
March 1994:	The text of both the cost-of-service and the benchmark orders are released. The inconsistency between benchmarks (17% of revenue is monopoly profits) and cost-of-service (100% of acquisition intangibles presumptively disallowed) becomes apparent. Text also shows that 2-year limit for start-up losses is based on FASB-51, an accounting rule unrelated to regulatory determination of rate base. Summer 1994 deadline set for filings under the interim rules.
May 1994:	Comcast & others seek reconsideration of the interim rules; Continental & others appeal the interim rules to D.C. Circuit.

CHRONOLOGY (con't)

June 1994:	Continental and others file in support of reconsideration, explaining why a presumptive disallowance of 100% of acquisition premiums is inconsistent with the economic analysis leading to the 17% benchmark reduction. USTA files in support of reconsideration, arguing that acquisition intangibles should be out of the rate base, but that the amortization expense associated with them should be counted for cost-of-service purposes.
July 1, 1994:	Continental and others file comments on the interim rules advancing both of the points just noted, as well as a letter from Deloitte & Touche explaining that FASB-51 is unrelated to the measurement of rate base.
July & August 1994:	Various parties file cost-of-service justifications for rates rather than comply with the new 17% benchmark reduction. New filers include Jones, Prime, Dimension, Viacom and Western. Some cost analyses are based on inclusion of intangibles, others are not. Typically, the rate justified on the Form 1220 substantially exceeds the rate being charged at the time of the filing.
December 1994:	The FCC receives the Kane Reece analysis showing that it takes an average of 13 years for a cable system to earn 11.25% on a cumulative basis. This provides confirmation that the 2-year start-up allowance in the interim rules is inadequate.

Acquisition Costs

- The book value (original cost rate base) of a business has no necessary relationship to the market value of the business
- This is true whether or not the business is a monopoly
- The S&P 500 have a market value to book ratio of 2.76
- When a business is acquired, accountants usually adjust the book value of the company to reflect the price paid. These adjustments include asset write-ups and goodwill.
- The difference between book value and market value is attributable to a number of factors.
- One element of the difference between market and book may be "monopoly rents," but that is unlikely to explain all of the gap
- From the point of view of the acquiring firm, the price paid for the assets is the legitimate "original cost"
- From an economic point of view, to achieve efficient pricing, the rate base should be "competitive market value"

The hot dog stand

	Period 0	*Period 1*	*Period 2*	*Period 3*	*Period 4*	*Period 5*	*Period 6*	*Period 7*
Price		$5.00	$5.00	$5.00	$6.00	$6.00	$6.00	$7.00
Quantity		100	200	300	400	500	600	700
Revenues		$500	$1,000	$1,500	$2,400	$3,000	$3,600	$4,900
Dogs, buns, etc. (cost per dog)		$6	$6	$6	$6	$6	$6	$6
Operating costs		$600	$1,200	$1,800	$2,400	$3,000	$3,600	$4,200
Operating income		($100)	($200)	($300)	$0	$0	$0	$700
Investment	$2,000	$100	$100	$100	$100	$100	$100	$100
Cash flow	($2,000)	($200)	($300)	($400)	($100)	($100)	($100)	$600
Interest at 10%		$200	$240	$294	$363	$410	$461	$517
Accumulated capital req.	$2,000	$2,400	$2,940	$3,634	$4,097	$4,607	$5,168	$5,085
Depreciation		$100	$100	$100	$100	$100	$100	$100
Book value	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000	$2,000
Rate base (interim rules)	$2,000	$2,400	$2,940	$2,940	$2,940	$2,940	$2,940	$2,940
Market value (NPV of cash flow @ 10%)	$126	$2,338	$2,792	$3,402	$4,182	$4,710	$5,291	$5,930
Excess of market value over book value		$338	$792	$1,402	$2,182	$2,710	$3,291	$3,930

ACCOUNTING

Excess value allocated to asset write-up and intangibles such as goodwill, subscriber lists, and going-concern value.

ECONOMICS

Allocable to:
- **Possible "monopoly rents"**
- **Competitive value rate base**

POINTS RELATED TO ACQUISITIONS

1. A cable system's accumulated losses and low earnings are part of the investment in the system, and the process of incurring them while building the business contributes substantially to the system's market value. The evidence in the Kane Reece study shows that the average "acquisition premium" (the excess of purchase price over the net book value of hard assets) is not out of line with the average value of accumulated start-up losses and low earnings. A presumptive disallowance of acquisition premiums is, therefore, not warranted.

2. Judge Breyer's ***Distrigas*** opinion applies directly to acquisition premiums as well as to accumulated losses and low earnings. The amount invested in a cable system as of the date of regulation is whatever the buyer paid for it. Going back before regulation to try to undo the effects of transactions between unregulated entities is certainly not done under general cost-of-service principles, and doesn't make sense as a policy matter (if it is legal at all) for the interim rules.

3. The unfairness of the situation for cable is illustrated by the Commission's own accounting rules for telephone companies. Section 32.9000 of the Commission's rules states that "original cost" is the money cost of property "at the time it was first dedicated to use by a ***regulated*** telecommunications entity, whether the accounting company or a predecessor entity". This is a fair statement of the "general cost-of-service principle" that actually applies here: acquisition premiums are disallowed when one regulated entity buys another regulated entity. But where the affected entities were not regulated (as in the case of cable before the effectiveness of the 1992 Act), there is no basis in "general cost-of-service principles" for disallowing the acquisition premium. The rule for adopted for cable ignores the question of whether the buyer and/or seller were regulated: Section 76.922(g)(6)(i) defines "original cost" for cable as the money cost of property "at the time it was first used to provide [any] cable service".

START-UP LOSSES

- Start-up losses are a natural part of a new business
- Start-up losses must be financed just as capital equipment must be financed
- In terms of defining the initial capital requirements of a business, start-up losses cannot be distinguished from capital equipment
- Start-up losses in capital-intensive industries frequently extend beyond two years and there is no economic basis for considering only the first two years' losses
- Start-up losses may occur whether or not the business is a monopoly; but if the business is a monopoly start-up losses probably will be smaller than otherwise
- Start-up losses include the cost of the capital required to finance the losses

The hot dog stand

	Period 0	Period 1	Period 2	Period 3	Period 4	Period 5	Period 6	Period 7
Price		$5.00	$5.00	$5.00	$6.00	$6.00	$6.00	$7.00
Quantity		100	200	300	400	500	600	700
Revenues		$500	$1,000	$1,500	$2,400	$3,000	$3,600	$4,900
Dogs, buns, etc: (cost per dog)		$6	$6	$6	$6	$6	$6	$6
Operating costs		$600	$1,200	$1,800	$2,400	$3,000	$3,600	$4,200
Operating income		($100)	($200)	($300)	$0	$0	$0	$700
Investment	$2,000	$100	$100	$100	$100	$100	$100	$100
Cash flow	($2,000)	($200)	($300)	($400)	($100)	($100)	($100)	$600

KEY POINTS ON START-UP LOSSES

1. **An extended period of losses is inevitable.** It is impossible to build a cable business without spending a lot of money at the beginning, when revenues and subscribership are low. The operator is forced to continue to invest in the system, in the form of additional capital infusions until cash flow turns positive, and in the form of deferred earnings on the money actually invested.

2. **The 2-year limit is not based on economic reality.** The interim rules include a two-year limit on start-up losses. This limitation is drawn from FASB-51, a 1981 pronouncement of the Financial Accounting Standards Board. It has nothing to do with the regulatory question, which is how to measure the rate base (i.e., how much money has been invested in a cable system). As Deloitte & Touche explained in their letter, FASB-51 addresses completely different issues.

3. **Evidence before the Commission proves that a 2-year allowance is not enough.** The Kane Reece study proves that a two-year limit is economically unrealistic. The study shows that it takes thirteen years before an average cable operator earns 11.25% on the actual investment in the system.

4. **Operators are entitled to an opportunity to reasonable earnings on their actual investments in cable systems.** The most basic "general cost-of-service principle" is that the regulated firm is entitled to an opportunity to earn a reasonable return on the amount of capital invested in the business. Limiting start-up losses in rate base to two years makes that impossible.

5. **Cost-of-Service case law supports a full allowance for start-up losses and low earnings.**

    a. The one case that directly addresses the issue is ***City of Ottawa, Illinois v. Sammons Communications,*** 836 F. Supp. 555 (N.D. Ill. 1993). The city argued that rates were too high because current year earnings were high. Sammons argued that it was unfair to ignore the losses and low earnings from prior periods. The Court agreed: "To do otherwise would disregard the reality that the costs of building or rebuilding a cable system are concentrated in the early years. The rate of return during these early years is typically low or even negative. Years after the investment, however, returns increase. The proper way to evaluate the reasonableness of rates is to incorporate into the analysis what happens in the earlier years." 836 F. Supp. at 561.

KEY POINTS ON START-UP LOSSES (con't)

5. **Case law (con't):**

   b. The D.C. Circuit accepts the key point. In ***Virgin Islands Telephone Company v. FCC,*** 989 F.2d 1231 (D.C. Cir. 1993), the court reversed the FCC for ordering refunds based on data from only part of a two-year monitoring period. The court held that rate-of-return review only makes sense within a particular "temporal mooring." Here, the Bureau's assumption seems to be that the correct "temporal mooring" for assessing cable earnings is one year, with the 2-year start-up losses as a limited exception grafted on to that base. The correct analysis, as ***Sammons*** shows, is to assess an operator's earnings over a reasonable life of the investment, taking account of all start-up losses and low earnings.

   c. Economically and financially, the cumulative losses and low earnings of a cable system constitute part of the capital invested in the system. These losses and low earnings were embedded in the systems as of the date of reregulation under the 1992 Act. As Judge (now Justice) Breyer asked (in the course of an opinion reversing FERC), "does any regulator ever look back prior to the time of regulation, and seek to separate the value of shareholder equity into 'legitimate' and 'illegitimate' parts, depending on the source of the value of what the shareholders own prior to regulation?" ***Distrigas of Massachusetts Corp. v. Federal Energy Regulatory Commission,*** 737 F.2d 1208, 1215-16 (1st Cir. 1984). Many of the industry's disagreements with the Bureau would disappear if the Bureau would start the regulatory inquiry from where the operators really were, economically and financially, as of the date of regulation.

6. **Regulatory practice also supports a full allowance for losses and low earnings.** Allowing all early losses and low earnings into the rate base is completely consistent with the way the FCC and state PUCs review the reasonableness of telephone company rates. In any capital-intensive business, costs are very high in early years and lower in later years (as the investment is depreciated). A strict year-by-year cost analysis would lead to very high initial rates and very low rates in later years. This pricing approach makes no sense in the marketplace, and regulators do not require it of telephone companies. Instead, telephone companies are allowed to restate their costs to reflect, essentially, an average cost over a reasonable time horizon. Rates are then set on the basis of the average. A prominent recent example is the acceptance of 13 years as a reasonable pay-back period for telephone company Video Dialtone offerings. The mechanics are slightly different from cable's proposed "accumulated return deficiency" analysis, but the economic effect is identical.

is excessive, or is unrelated to providing rate regulated cable service, we can disallow that cost in whole or in part.[11] We have evaluated rate base and expense items to determine whether Star Cable should be permitted to recover those items in its rates. In some cases, we have found costs that are not allowable, and we have made appropriate adjustments. Even with our adjustments and disallowances, however, we find that Star Cable's CPS rate for the period under review has been justified.

8. **Rate Base:** Rate base represents the amount of investment the cable company makes in its facilities to provide service to its customers. Under traditional cost of service principles, it is necessary to determine the allowable rate base in order to calculate the revenue requirement based on the applied rate of return. In analyzing Star Cable's filing, we reviewed the components of Star Cable's rate base to determine the investment upon which Star Cable is entitled to earn a return. For purposes of this review, we made adjustments to the rate base as discussed below.

(a) Operating Losses: Star Cable proposes to include start-up losses of $217,811 in its rate base, of which $119,445 has been allocated to the CPS portion of the rate base. For this review we are allowing operating losses accumulated over the prematurity period as defined by Statement of Financial Accounting Standards No. 51, Financial Reporting by Cable Television Companies ("FAS 51").[12] Under FAS 51, the prematurity phase of a cable television system is presumptively no longer than two years, although it may arguably be longer. Star Cable did not provide any argument that its prematurity period was longer than two years. Accordingly, for purposes of this analysis, the recovery of accumulated start-up losses in Star Cable's rate base is limited to two years.

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[10](...continued)
traditional formulation, the company's revenue requirement is equal to the expenses of providing service and its return on investment.

[11] The Commission made clear that the fact that an operator has incurred costs does not necessarily establish its right to recover those costs from subscribers. *See Rate Order*, 8 FCC Rcd at 5794, n.619. "When electing [to make] a cost of service showing, the cable operator assumes the risk that its rate could be lowered if such action is justified by the cost showing." *Id.* at 5800, para. 272.

[12] FAS 51 establishes standards of financial accounting and reporting for costs, expenses, and revenues applicable to the construction and operation of cable television systems. These standards are considered to be generally accepted accounting principles, and provide guidance as "general cost of service principles," in the absence of specific rules. Under these standards, when a cable system is partially under construction and partially in service (the prematurity period), costs incurred that relate to both current and future operations shall be partially capitalized as start-up costs and partially expensed.

Deloitte &
Touche

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June 30, 1994

Continental Cablevision, Inc.
The Pilot House
Lewis Wharf
Boston, Ma. 02110

Dear Sir/Madame:

INTRODUCTION

This report is in response to your request, dated June 23, 1994, regarding the background and purpose of Statement of Financial Accounting Standards No. 51, "Financial Reporting by Cable Television Companies" (SFAS 51). Based upon the discussion below, this report is intended solely for the use of management of Continental Cablevision, Inc. (the Company) and of regulatory authorities with whom the Company or any of its subsidiaries may file Federal Communications Commission Form 1220 (Form 1220) for purposes of determining the maximum permitted rate for the Company's regulated cable television services using a cost-of-service approach.

BACKGROUND

SFAS 51 was issued in 1981 for the purpose of establishing certain generally accepted accounting principles for financial reporting by cable television companies. SFAS 51 extracts and codifies without significant change the specialized principles and practices from AICPA Statement of Position 79-2, "Accounting by Cable Television Companies." It establishes financial accounting and reporting standards for certain costs, expenses, and revenues related to cable television systems.

An exposure draft of this statement was issued on June 12, 1981 for public comment. The Financial Accounting Standards Board received 23 comment letters in response to the exposure draft. None of these letters were filed by entities with any regulatory authority or oversight over cable television companies.

DISCUSSION

Based upon our discussions with Company's management, it is our understanding that one of the issues in cost-of-service rate making for regulated cable television systems is determining a reasonable return on the investment made in the cable television system and, therefore, a determination of what amounts should be viewed as having been invested in cable television systems. As discussed below, we believe that SFAS 51 was not promulgated for the purpose of answering these questions.

Paragraphs 4 through 9 of SFAS 51 discuss a "prematurity period" and the related accounting for certain costs during that period. Appendix A of SFAS 51 defines the beginning of the prematurity period as the period beginning with the first earned subscriber revenue and provides guidelines for determining the length of the prematurity period. Paragraph 4 of SFAS 51 states that there is a presumption that the prematurity period usually will not exceed two years.

During the prematurity period, paragraph 6 of SFAS 51 specifies those costs which should be capitalized and those costs which should be expensed as period costs. SFAS 51 does not address the treatment of costs incurred prior to the prematurity period.

SFAS 51 does not address the question of whether investors in cable systems will receive or have received returns on the investments they make in such systems which could be deemed appropriate for regulatory rate setting purposes. SFAS 51 does not address the question of how to measure, for regulatory rate setting purposes, how much has been invested in a cable television system or how the reasonableness of the return on such amounts invested should be assessed.

CONCLUDING COMMENTS

As discussed above, SFAS 51 provides guidance for management to account for and report on cable television operations under generally accepted accounting principles. We believe it was not adopted for purposes of determining costs which should be either included or excluded in the cost-of-service approach to rate making filed with regulatory authorities on Form 1220, nor was it adopted for purposes of determining the classification of costs that might be included in such filings.

The ultimate responsibility for costs included on Form 1220, and the classification for such costs for regulatory purposes rests with you as the preparers of the Forms, based upon rules established by the Federal Communications Commission or other appropriate regulatory and/or legal authorities.

Your truly,

Deloitte & Touche

FASB 51

Jackson

1991/92 Edition

ORIGINAL PRONOUNCEMENTS

ACCOUNTING STANDARDS

as of June 1, 1991

VOLUME I

FASB Statements of Standards

Financial Accounting Standards Board

IRWIN 1991, Homewood, Illinois 60430

Statement of Financial Accounting Standards No. 51
Financial Reporting by Cable Television Companies

STATUS

Issued: November 1981

Effective Date: For fiscal years beginning after December 15, 1981

Affects: Amends FAS 32, Appendix A

Affected by: Paragraph 2 superseded by FAS 71

SUMMARY

This Statement extracts the specialized accounting principles and practices from AICPA Statement of Position 79-2, *Accounting by Cable Television Companies*, and establishes standards of financial accounting and reporting for costs, expenses, and revenues applicable to the construction and operation of a cable television system. During a period while a cable television system is partially under construction and partially in service (the prematurity period), costs incurred that relate to both current and future operations shall be partially capitalized and partially expensed.

Statement of Financial Accounting Standards No. 51
Financial Reporting by Cable Television Companies

CONTENTS

INTRODUCTION

1. As discussed in FASB Statement No. 32, *Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters*, the FASB is extracting the specialized[1] accounting and reporting principles and practices from AICPA Statements of Position (SOPs) and Guides on accounting and auditing matters and issuing them in FASB Statements after appropriate due process. This Statement extracts the specialized principles and practices from SOP 79-2, *Accounting by Cable Television Companies*, and establishes financial accounting and reporting standards for certain costs, expenses, and revenues related to cable television systems.

2. The FASB currently has a project under consideration for the effect of rate regulation on accounting for regulated enterprises. Under current practice, the Addendum to APB Opinion No. 2, *Accounting for the "Investment Credit,"* applies only to businesses that are regulated for rate-making purposes on an individual-company-cost-of-service basis and, therefore, does not apply to the financial statements of cable television companies.

3. The Board has concluded that it can reach an informed decision on the basis of existing information without a public hearing and that the effective date and transition specified in paragraph 16 are advisable in the circumstances.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Prematurity Period

4. Before revenue is earned from the first subscriber, management shall establish the beginning and end of the **prematurity period**,[2] subject to a presumption that the prematurity period usually will not exceed two years. The prematurity period frequently will be shorter than two years; a longer period may be reasonably justified only in major urban markets. After the prematurity period is established by management, it shall not be changed except as a result of highly unusual circumstances.

5. A portion[3] of a cable television system that is in the prematurity period and can be clearly distinguished from the remainder of the system shall be accounted for separately. Such a portion would have most of the following characteristics:

a. Geographical differences, such as coverage of a noncontiguous or separately awarded franchise area
b. Mechanical differences, such as a separate head-end[4]
c. Timing differences, such as starting construction or marketing at a significantly later date
d. Investment decision differences, such as separate break-even and return-on-investment analyses or separate approval of start of construction

[1]The term *specialized* is used to refer to those accounting and reporting principles and practices in AICPA Guides and SOPs that are neither superseded by nor contained in Accounting Research Bulletins, APB Opinions, FASB Statements, or FASB Interpretations.

[2]Terms defined in the glossary (Appendix A) are in **boldface type** the first time they appear in this Statement.

[3]Some cable television companies have used the word *segment* to refer to a portion of a cable television system. In view of the use of *segment* in a different context in FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise*, the word *portion* has been used here.

[4]Refer to paragraph 17 for a description of *head-end* in the definition of **cable television plant**.

e. Separate accounting records, separate budgets and forecasts, or other accountability differences

Costs incurred by the remainder of the system shall be charged to the portion in the prematurity period only if they are specifically identified with the operations of that portion. Separate projections for the portion shall be developed and the portion's capitalized costs shall be evaluated separately during the prematurity period for recoverability (paragraph 14).

6. During the prematurity period:

a. Costs of cable television plant, including materials, direct labor, and construction overhead shall continue to be capitalized in full.
b. **Subscriber-related costs** and general and administrative expenses shall be expensed as period costs.
c. Programming costs and other system costs[5] that are incurred in anticipation of servicing a fully operating system and that will not vary significantly regardless of the number of subscribers shall be allocated between current and future operations. The proportion attributable to current operations shall be expensed currently and the remainder shall be capitalized. The amount to be expensed currently shall be determined by multiplying the total of such costs for the month by the fraction described in paragraph 7 determined for that month.

7. The following fraction shall be determined each month of the prematurity period. The denominator of the fraction shall be the total number of subscribers expected at the end of the prematurity period. The numerator of the fraction shall be the greatest of (a) the average number of subscribers expected that month as estimated at the beginning of the prematurity period, (b) the average number of subscribers that would be attained using at least equal (that is, straight-line) monthly progress in adding new subscribers towards the estimate of subscribers at the end of the prematurity period, and (c) the average number of actual subscribers.

8. During the prematurity period, depreciation and amortization expense shall be determined by multiplying (a) the monthly depreciation and amortization of total capitalized costs expected on completion of the prematurity period by (b) the fraction described in paragraph 7, using the depreciation method that will be applied by the company after the prematurity period.

9. The amount of interest cost that is capitalized during the prematurity period shall be determined in accordance with FASB Statement No. 34, *Capitalization of Interest Cost*, by applying an interest capitalization rate determined in accordance with paragraphs 13 and 14 of Statement 34 to the average amount of qualifying assets[6] for the system during the period. Qualifying assets shall be determined in accordance with the guidance in paragraphs 16 and 18 of Statement 34. The amount of interest cost capitalized shall not exceed the total amount of interest cost incurred by the cable television system in that period.

Amortization of Capitalized Costs

10. Costs that have been capitalized in accordance with paragraph 6(c) shall be amortized over the same period used to depreciate the main cable television plant.

Hookup Revenue and Costs

11. Initial hookup revenue shall be recognized as revenue to the extent of **direct selling costs**[7] incurred. The remainder shall be deferred and amortized to income over the estimated average period that subscribers are expected to remain connected to the system.

12. Initial subscriber installation costs, including material, labor, and overhead costs of the drop,[8] shall be capitalized and depreciated over a period no longer than the depreciation period used for cable television plant. The costs of subsequently disconnecting and reconnecting shall be charged to expense.

Franchise Costs

13. Costs of successful franchise applications shall be capitalized and amortized in accordance with the provisions of APB Opinion No. 17, *Intangible Assets*. Costs of unsuccessful franchise applications and abandoned franchises shall be charged to expense.

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[5]Those costs include property taxes based on valuation as a fully operating system; pole, underground duct, antenna site, and microwave rental based on rental costs for a fully operating system; and local origination programming to satisfy franchise requirements.

[6]During the prematurity period, a portion of the system is in use in the earnings activity of the enterprise and is not eligible for interest capitalization. The portion of the cost of the system that represents a qualifying asset is the amount of accumulated expenditures in excess of the fraction specified in paragraph 7 of the total estimated cost of the system at the end of the prematurity period.

[7]Such costs are subscriber-related costs that are expensed in accordance with paragraph 6(b).

[8]Refer to paragraph 17 for a description of *drop* in the definition of *cable television plant*.

Recoverability

14. Capitalized plant and intangible assets shall be evaluated periodically to determine whether the costs are recoverable (through operations or sale of the system). If recoverability is doubtful, capitalized costs shall be written down to recoverable values. Capitalization of costs shall not cease when the total cost reaches an amount that is not fully recoverable. Capitalization of costs shall continue, and the provision required to reduce capitalized costs to recoverable value shall be increased.

Amendment to Statement No. 32

15. The reference to AICPA Statement of Position 79-2, *Accounting by Cable Television Companies*, is deleted from Appendix A of Statement 32.

Effective Date and Transition

16. The provisions of this Statement shall be effective for fiscal years beginning after December 15, 1981. Earlier application is permitted but not required. The provisions of this Statement may be, but are not required to be, applied retroactively for previously issued financial statements. If applied retroactively and if the estimates of subscribers needed to make the calculations required by some provisions of this Statement are not readily available, actual historical subscriber data may be used instead.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters

Appendix A

GLOSSARY

17. This appendix defines certain terms that are used in this Statement.

Cable Television Plant

The cable television plant required to render service to the subscriber includes the following equipment:

a. *Head-end*—This includes the equipment used to receive signals of distant television or radio stations, whether directly from the transmitter or from a microwave relay system. It also includes the studio facilities required for operator-originated programming, if any.
b. *Cable*—This consists of cable and amplifiers (which maintain the quality of the signal) covering the subscriber area, either on utility poles or underground.
c. *Drops*—These consist of the hardware that provides access to the main cable, the short length of cable that brings the signal from the main cable to the subscriber's television set, and other associated hardware, which may include a trap to block particular channels.
d. *Converters and descramblers*—These devices are attached to the subscriber's television sets when more than 12 channels are provided or when special services are provided, such as "pay cable" or 2-way communication.

Direct Selling Costs

Direct selling costs include commissions, the portion of a salesperson's compensation other than commissions for obtaining new subscribers, local advertising targeted for acquisition of new subscribers, and costs of processing documents related to new subscribers acquired. Direct selling costs do not include supervisory and administrative expenses or indirect expenses, such as rent and costs of facilities.

Prematurity Period

During the prematurity period, the cable television system is partially under construction and partially in service. The prematurity period begins with the first earned subscriber revenue. Its end will vary with circumstances of the system but will be determined based on plans for completion of the first major construction period[9] or achievement of a specified predeter-

[9]The construction period of a cable television system varies with the size of the franchise area, density of population, and difficulty of physical construction. The construction period is not completed until the head-end, main cable, and distribution cables are installed, and includes a reasonable time to provide for installation of subscriber drops and related hardware. During the construction period, many system operators complete installation of drops and begin to provide service to some subscribers in some parts of the system while construction continues. Providing the signal for the first time is referred to as "energizing" the system.

mined subscriber level at which no additional investment will be required for other than cable television plant. The length of the prematurity period varies with the franchise development and construction plans. Such plans may consist of:

a. Small franchise that is characterized by the absence of free television signal and a short construction period. The entire system is "energized" at one time near the end of the construction period.
b. Medium-size franchise that is characterized by some direct competition from free television and by a more extensive geographical franchise area lending itself to incremental construction. Some parts of the system are "energized" as construction progresses.
c. Large metropolitan franchise that is characterized by heavy direct competition from free television and fringe area signal inadequacy, high cost, and difficult construction. Many parts of the system are "energized" as construction progresses.

Except in the smallest systems, programming is usually delivered to portions of the system and some revenues are obtained before construction of the entire system is complete. Thus, virtually every cable television system experiences a prematurity period during which it is receiving some revenue while continuing to incur substantial costs related to the establishment of the total system.

Subscriber-Related Costs
These are costs incurred to obtain and retain subscribers to the cable television system and include costs of billing and collection, bad debts, and mailings; repairs and maintenance of taps and connections; franchise fees related to revenues or number of subscribers; general and administrative system costs, such as salary of the system manager and office rent; programming costs for additional channels used in the marketing effort or costs related to revenues from, or number of subscribers to, per channel or per program service; and direct selling costs.

Appendix B

BACKGROUND INFORMATION AND SUMMARY OF CONSIDERATION OF COMMENTS ON EXPOSURE DRAFT

18. This Statement extracts the specialized accounting and reporting principles and practices from SOP 79-2 and codifies them as FASB standards without significant change. Board members have assented to the issuance of this Statement on the basis that it is an appropriate extraction of those existing specialized principles and practices and that a comprehensive reconsideration of those principles and practices was not contemplated in undertaking this FASB project. Some of the background material, discussion of accounting alternatives, and general accounting guidance have not been carried forward from the SOP. The Board's conceptual framework project on accounting recognition criteria will address revenue recognition issues that may pertain to those addressed in this Statement. A Statement of Financial Accounting Concepts resulting from that project in due course will serve as a basis for evaluating existing standards and practices. Accordingly, the Board may wish to evaluate the standards in this Statement when its conceptual framework project is completed.

19. SOP 79-2 was developed to clarify and standardize the diverse accounting practices being followed in the cable television industry, particularly the practices relating to accounting for costs during the prematurity period while the cable television system is partially under construction and partially in service. Before 1979, cable television companies differed as to the types of costs capitalized during the prematurity period and used different criteria to determine the date at which capitalization of some costs ceases and amortization of those costs begins. The SOP specified that all direct construction costs should be capitalized and that costs attributable to current operations and their administration should be charged to expense. For certain costs that relate to the cable television system and that benefit both current and future operations, the SOP specified that a proportion of such costs should be charged to current operations and the remainder should be capitalized.

20. An Exposure Draft of a proposed Statement, *Financial Accounting and Reporting by Cable Television Companies*, was issued June 12, 1981. The Board received 23 comment letters in response to the Exposure Draft. Certain of the comments received and the Board's consideration of them are discussed in this appendix.

21. The transition provisions in the Exposure Draft called for retroactive restatement except for companies that do not expect to have systems in the prematurity period in the future. These companies were permitted to continue their previous method of accounting for already mature systems. Several respondents from the cable television industry suggested that the transition provisions be modified to allow prospective application because retroactive application would require greater accounting effort than the resulting informational benefits. They believe that many cable television companies were

expensing some costs that SOP 79-2 recommended be capitalized. They recommended that prospective application be permitted because of the additional administrative burden that retroactive application would entail. The Board has considered these comments and the fact that major cable television companies have complied with SOP 79-2 and concluded that prospective application should be permitted.

22. Some respondents stated that paragraph 8(a) of the Exposure Draft implied that all interest cost incurred during the prematurity period should be capitalized, even though a portion of the cable television system is in use. The Board believes that paragraph 18 of Statement 34 prohibits capitalization of interest cost on the portion of the cable television system that is substantially complete and ready for its intended use. Accordingly, this Statement clarifies that all interest cost incurred during the prematurity period is not necessarily eligible to be capitalized.

23. Some respondents requested that guidance be included regarding accounting for costs of franchise applications. They indicated that practice varies with respect to the accounting for such costs and that additional guidance would enhance uniformity in practice. The Board has included such guidance to clarify the accounting for costs of franchise applications.

24. Some respondents suggested that the definition of direct selling costs be clarified regarding the circumstances under which advertising may be included. The Board believes that the intent of SOP 79-2 was to limit such costs to those pertaining to direct efforts to obtain new subscribers. Accordingly, the definition has been clarified to indicate that local advertising targeted for acquisition of new subscribers is a direct selling cost.

25. Several respondents suggested various substantive changes to the Exposure Draft (such as eliminating certain of the choices for the numerator of the capitalization fraction, reconsideration of provisions for deferral of hookup revenue and expensing of direct selling costs, changing the amortization period for costs capitalized during the prematurity period, and including certain general and administrative costs with other costs that are deferred during the prematurity period). Adoption of those suggestions would have required a reconsideration of some of the provisions of SOP 79-2. Such a reconsideration is not contemplated in the extraction project unless a proposed change meets one of the three criteria for change included in the "Notice for Recipients of This Exposure Draft" or is broadly supported. None of the proposed changes met the criteria for change and none was broadly supported. Accordingly, the Board did not adopt those suggestions.

Fund, 984 F.2d 762, 767 (7th Cir.1993) and *Krant v. Wisconsin Laborers Health Fund*, 992 F.2d 113, 117 (7th Cir.1993)).[16] Nor is there any call under the circumstances to explore any of the complexities of ERISA preemption. It is after all unnecessary for a plaintiff to prove its right to damages on more than one theory—it can recover those damages only once in any event.

Conclusion

There is no genuine issue of material fact as to the coverage of the claimed expenses by the Plan, and Camelot is entitled to a judgment as a matter of law. Although each of Planters and Nestle had asserted an affirmative defense seeking to point the finger at the other as to when the breach in Plan performance occurred, once again neither has provided *evidence* to support its position—and pleading alone does not do the job under Rule 56(e).

In terms of the evidentiary record, the Plan nonperformance straddled the time of the Nestle takeover—and Planters and Nestle have chosen to present a common front in resisting Camelot's motion as well as in support of their own. Judgment is ordered to be entered jointly and severally against all three defendants in the sum of $93,154.90 plus prejudgment interest, and so long as Camelot receives payment defendants may sort out the matter of ultimate liability among themselves.[17]

CITY OF OTTAWA, ILLINOIS; City of Marseilles, Illinois; Village of Naplate, Illinois; and City of Streator, Illinois, Plaintiffs,

v.

SAMMONS COMMUNICATIONS, INC. and Sammons Communications of Illinois, Inc., Defendants.

No. 87 C 1325.

United States District Court, N.D. Illinois E.D.

Nov. 4, 1993.

Municipalities brought action challenging cable television company's rates. The District Court, Norgle, J., held that: (1) municipalities which did not hold hearings to solicit written comments were barred from challenging rates, and (2) rates were reasonable.

Judgment for defendant.

1. Telecommunications 449.10(1)

Because Court of Appeals struck down Federal Communications Commission regulation ab initio, cable television rates were improperly deregulated.

2. Telecommunications 449.10(1)

Municipalities which had failed to comply with federal regulations governing regulation of cable television rights and never conducted public hearings and never solicited written comments were barred from challenging rates charged by cable television company. Communications Act of 1934, § 623(b-d), as amended, 47 U.S.C.(1988 Ed.) § 543(b-d).

16. It must be said, though, that *Vershaw* (though one of the cases that upholds the availability of equitable estoppel in ERISA cases) would cause Camelot serious difficulties in advancing its argument along those lines here.

17. This Court has not been provided with the necessary information to enable it to deal with Camelot's prayer for an award of attorneys' fees. That question remains for future determination as soon as Camelot tenders it, but the existence of the open question does not detract from the finality of the judgment ordered here (*Budinich v. Becton-Dickinson & Co.*, 486 U.S. 196, 108 S.Ct. 1717, 100 L.Ed.2d 178 (1988)). It would be constructive if counsel for the parties were to confer in advance of Camelot's filing in an effort to narrow (if not to eliminate entirely) the issues involved in the fee determination.

3. Telecommunications ⇨449.5(3)

Where municipalities failed to take final action within 180 days on any basic cable rate increases proposed by cable television company, the increases were deemed granted as a matter of law under the Cable Act. Communications Act of 1934, § 623(d), as amended, 47 U.S.C.(1988 Ed.) § 543(d).

4. Telecommunications ⇨449(3)

Basic cable television rates charged by cable company were reasonable and appropriate; certain franchise agreements explicitly provided that it was entitled to 6% increase per year, municipalities failed to hold necessary public hearings on rate increases, and rate increases were shown reasonable by testimony of certified public accountant and cable industry consultant. Communications Act of 1934, § 621(c), as amended, 47 U.S.C.A. § 541(c); § 623(d), as amended, 47 U.S.C.(1988 Ed.) § 543(d).

John A. Hayner, Ottawa, IL, for City of Ottawa, Ill., City of Marseilles, Ill., Village of Naplate, Ill., City of Streator, Ill. and Village of Seneca, Ill.

Marshall John Schmitt, Michael E. Rigney, William Denby Heinz, Jenner & Block, Chicago, IL, for Sammons Communications, Inc. and Sammons Communications of Illinois, Inc.

Craig M. Armstrong, Armstrong & Surin, Ottawa, IL, for Arthur J. Kraus.

OPINION AND ORDER

NORGLE, District Judge:

This matter having been tried before the court between June 10 and June 15, 1993, and after hearing the evidence and arguments at trial, the court enters the following findings of fact and conclusions of law pursuant to Fed.R.Civ.P. 52. Judgment is entered in favor of defendants and against plaintiffs on all remaining counts of the complaint for reasons set forth below.

FINDINGS OF FACT [1]

1. The court conducted a bench trial on the remaining counts, I, III, V, and VII, which allege breaches of franchise contract provisions restricting cable television service rate increases. (Tr. at 1, 50, 237, 409; Sch. (a) at ¶ 12).[2]

2. Plaintiffs are four Illinois municipalities: the Cities of Ottawa ("Ottawa"), Marseilles ("Marseilles"), and Streator ("Streator"), and the Village of Naplate ("Naplate") (collectively "municipalities").

3. The municipalities are located in whole or in part in LaSalle County, Illinois. (Sch. (a) at ¶ 1).

4. The municipalities claim that defendants Sammons Communications of Illinois, Inc. ("Sammons of Illinois") and Sammons Communications, Inc. ("Sammons Communications") (collectively "defendants"), a cable television provider and its corporate parent respectively, breached certain franchise agreements by charging unreasonable rates for basic cable service. (Final Pretrial Order at 2; Cmplt. at 5–6, 11, 17–18, 22).

5. The defendants are Delaware corporations licensed to do business in Illinois. (Sch. (a) at ¶ 2).

6. On June 29, 1992 the court denied defendants' motion for summary judgment, which asserted that their franchises were deregulated between January 1987 and November 1988 by the Cable Communications Policy Act of 1984, 47 U.S.C. § 521 *et seq.* (the "Cable Act"). *City of Ottawa v. Sammons Communications, Inc.*, 795 F.Supp. 261, 262 (N.D.Ill.1992). The court held that the decision in *ACLU v. FCC*, 823 F.2d 1554 (D.C.Cir.1987), *cert. denied*, 485 U.S. 959, 108 S.Ct. 1220, 99 L.Ed.2d 421 (1988) applied retroactively and that, accordingly, the FCC regulations under which Sammons of Illinois was deregulated were void *ab initio*. *Sammons*, 795 F.Supp. at 265.

1. To the extent any finding in this portion of the opinion is a conclusion of law, the court so deems it a conclusion of law.

2. "Sch." shall refer to the schedules attached to the Final Pretrial Order filed on April 26, 1993. "Tr." shall refer to the trial transcript. Exhibits shall be cited as "PX" (plaintiffs') or "DX" (defendants').

7. Defendants further asserted that, in any event, the rates at issue were reasonable. (Sch. (i); Answer at 18–20).

8. It is thus agreed by the parties that the primary issue in this case is the reasonableness of Sammons of Illinois's rate increases after January 1987. (Sch. (b) at ¶¶ 2 & 3).

9. Pursuant to franchise agreements and ordinances, Sammons of Illinois provides cable services to subscribers who live in the municipalities. (Sch. (a) at ¶ 3).

10. Sammons Communications, which owns the stock of Sammons of Illinois, is not a party to the relevant franchise agreements and does not provide cable service in the municipalities. (PX 1 at 1; PX 3 at 1; 61 Television and Cable Factbook D–410, D–418, D–423 (Albert Warren ed. 1993); *see* Sch. (a) at ¶ 3).

11. Each franchise agreement or ordinance addresses Sammons of Illinois's authority to raise rates. (Sch. (a) at ¶ 5).

12. Each franchise agreement or ordinance also contains a separability clause providing that, if a provision of the franchise agreement is found to be inconsistent or at variance with any rule, regulation, or policy of the Federal Communications Commission ("FCC") or any other agency having jurisdiction, the remaining provisions of the agreement are still valid and binding upon the parties. (Sch. (a) at ¶ 6).

13. The franchise agreements were all entered into and the ordinances passed before December 29, 1984, the effective date of the Cable Act. (Sch. (a) at ¶ 4).

14. The Cable Act prohibited cable franchising authorities from regulating cable television service rates after December 29, 1986. 47 U.S.C. § 543(b), (c). Local regulation of cable service rates, however, was allowed in areas deemed "not subject to effective competition" as defined in regulations issued by the FCC. *Id.* at §§ 543(c), 557. Pursuant to the Cable Act, the FCC issued regulations which allow franchising authorities "to regulate rates for the provision of basic cable service in circumstances in which a cable system is not subject to effective competition." *Id.* at § 543(b)(1). (Sch. (a) at ¶ 7).

15. The Cable Act specifically provided that any provision of any franchise agreement that was inconsistent with the provisions of the Cable Act was preempted and superseded by federal law. *Id.* at § 556(c). (Sch. (a) at ¶ 8).

16. The Cable Act provided that any franchise agreement in effect on December 29, 1984 would remain in effect, subject to express provisions of the Cable Act, so that regardless of the effect of the Cable Act on rate provisions of a franchise agreement, each agreement was otherwise still valid and binding on the parties. 47 U.S.C. § 557. All the agreements in this case were in effect on December 29, 1984. (Sch. (a) at ¶ 9).

17. The Cable Act also provided that any request for an increase in regulated rates for which the franchising authority does not take action within 180 days shall be deemed granted. 47 U.S.C. § 543(d). (Sch. (1) at ¶ 9).

18. At all times relevant to this action, to the extent the municipalities were entitled to regulate Sammons of Illinois, 47 C.F.R. § 76.33 required the municipalities to solicit the views of interested parties, at least through written submissions, and issue a written statement regarding all decisions to regulate Sammons of Illinois. (Sch. (1) at ¶ 10).

19. To implement the Cable Act, the FCC amended its regulations in a report and order released April 19, 1985. Therein, the FCC listed each of the municipalities as being located within a franchise market with effective competition. *Report and Order,* 50 Fed.Reg. 18,637 (May 2, 1985); 47 C.F.R. §§ 76.33, 76.54 (1986). (Sch. (a) at ¶ 10).

20. Before January 1, 1987, Sammons of Illinois notified each of the municipalities and subscribers in the municipalities that it would raise its cable service rates as of that date. (Sch. (a) at ¶¶ 11, 19; Sch. (1) at ¶ 14; Tr. at 255).

21. The basic rate Sammons of Illinois charged in 1986 in the municipalities was $7.28 per month. After the Cable Act deregulated rates, Sammons of Illinois increased

its basic cable rate to $9.50, effective January 1, 1987. (Sch. (a) at ¶ 17).

22. On July 17, 1987, the United States Circuit Court of Appeals for the District of Columbia Circuit issued an opinion reviewing FCC regulations implementing the Cable Act. *ACLU*, 823 F.2d 1554. In that opinion, the court upheld most of the FCC regulations, but found that the signal availability standard the FCC used to determine whether an area was subject to "effective competition" was "arbitrary and capricious." *Id.* at 1572–73. The court remanded "that issue to the agency for a reasoned explanation of its chosen standard or the development of a new standard." *Id.* at 1573. (Sch. (a) at ¶ 13).

23. On September 28, 1987, the FCC released its *Further Notice of Proposed Rule Making* to revise the "signal availability standard" which it used to define effective competition, and invited comments from the public. *Further Notice of Proposed Rule Making*, 52 Fed.Reg. 36,802 (Oct. 1, 1987). (Sch. (a) at ¶ 14).

24. In announcing both the revision process and rule changes unrelated to signal availability, the FCC stated that "[a]part from these immediate amendments, we note that our existing rules remain in effect, as the court's decision in *ACLU* did not reverse them." (Sch. (a) at ¶ 15).

25. On April 29, 1988, the FCC released its *Second Report and Order* amending the signal availability standard. *Second Report and Order*, 53 Fed.Reg. 17,049 (May 13, 1988). Under the new standard, the municipalities were not considered to be areas subject to "effective competition." The FCC's amended regulations became effective October 29, 1988. *See id.* (Sch. (a) at ¶ 16).

26. The FCC delayed full implementation of the new rules for six months to provide "a sufficient amount of time for a cable operator to adapt to the onset of regulation as a consequence of changes made herein." (Sch. (1) at ¶ 8).

27. In 1988, before the FCC's amended signal availability standard took effect, Sammons of Illinois raised its basic monthly rate to $11.00. (Sch. (a) at ¶ 17).

28. The Cable Act provided that, in addition to any other rate increase which was subject to municipal approval, any rate subject to regulation could be increased at the discretion of the cable operator by an amount not to exceed 5% per year. 47 U.S.C. § 543(e)(1). (Sch. (1) at ¶ 17).

29. After October 30, 1988, Sammons of Illinois increased its basic cable rates by 5% or less, as permitted under the Cable Act. Sammons of Illinois's basic monthly cable rates were:

Year	Rate
1989 (starting November 1)	$11.55
1990 (starting November 1)	$12.10
1991 (starting May 1)	$12.70
1992	$13.30

At the time of trial, Sammons of Illinois's rate totaled $13.95. (Sch. (a) at ¶ 18; PXs 9–13; Sch. (1) at ¶ 20).

30. Since 1982, Sammons of Illinois has added nineteen channels to its service offerings. (Tr. at 243–44).

31. All of Sammons of Illinois's rate increases were announced by notice to the mayors of the municipalities and by issuance of a press release approximately thirty days before the effective date of the increase. (Sch. (a) at ¶ 19; Tr. at 255).

32. Subscribers received notice of all increases before they became effective. (Sch. (a) at ¶ 19; Tr. at 255; PX 9).

33. The municipalities did not conduct public hearings for any of the rate increases announced by Sammons of Illinois since 1986. (Sch. (a) at ¶ 20; Tr. at 256).

34. The municipalities called one witness in their case-in-chief, Jay C. Smith ("Smith").

35. Defendants called three witnesses, C. Cody Colquitt ("Colquitt"), Sandra K. Turley ("Turley") and Bruce N. Burnham ("Burnham").

36. Smith is a consultant to public agencies that regulate cable providers. Smith testified that the rates Sammons of Illinois charged in 1987, 1988, 1989, 1990, and 1991 were unreasonable because, based on his calculations, the rate of return on Sammons of Illinois's investment in each of those years exceeded what Smith considered reasonable. (Tr. at 5–136).

Cite as 836 F.Supp. 555 (N.D.Ill. 1993)

37. The court rejects Smith's opinion and finds that the preponderance of the evidence establishes that Sammons of Illinois's rates were reasonable.

38. Smith testified that he used "a utility cost of service method" to analyze the reasonableness of Sammons of Illinois's rates. The municipalities, however, "may not subject a cable system to regulation as a common carrier or utility." (*Compare* Tr. at 13–14 *with* 47 U.S.C. § 541(c)).

39. The municipalities contended at trial that Sammons of Illinois had used a rate of return analysis in the past to justify rate increases. The evidence on this point, however, established that Sammons of Illinois submitted rate of return information only because the City Council of Ottawa had requested it. Sammons of Illinois neither adopted nor endorsed a rate of return method. Moreover, to Turley's knowledge, Sammons of Illinois never used a rate of return analysis to set rates. (Tr. at 139–43, 248; PXs 23, 25).

40. Smith relied upon Sammons of Illinois's accounting data for the years 1987 through 1991. Smith did not consider data covering the time period before 1987. (Tr. at 12–13, 66, 128–29).

41. Smith particularly requested Sammons of Illinois's revenues and expenses for each municipality. Sammons of Illinois, however, records its revenues and expenses in the municipalities as part of the Ottawa Complex, which is a group of municipalities, including the plaintiff municipalities, that are served by common equipment and personnel. The municipalities in the complex are too small to justify building a cable network and supporting an administrative staff to serve each one separately. Instead, Sammons of Illinois designs the physical plant and hires administrative staff to serve a group of municipalities. In short, Sammons of Illinois administers the different franchises in the Ottawa Complex on a complex-wide basis because of economies of scale, ease of financial reporting, ease of sharing assets, and the geographical proximity of the communities. (Tr. at 174–75, 250–51).

42. When Smith learned that the data for the revenues and expenses for each municipality was unavailable, he requested that Sammons of Illinois allocate revenues and expenses to each municipality. Such allocations can be made by multiplying a given revenue or expense by a ratio that is an approximation of the municipality's share of that revenue or cost within the complex. In this case, Sammons of Illinois used two ratios, depending on what was being allocated: (a) the number of cable miles in each municipality compared to the total number of cable miles within the Ottawa Complex, or (b) the total revenue earned in each municipality compared to the total revenue earned in the entire complex. (Tr. at 131–32, 175; PX 14).

43. Although these allocations were not entirely arbitrary, they do not show a complete picture because of cross-subsidization. The cost of providing service is never the same for all subscribers. For example, in denser areas, less cable plant and fewer technicians per subscriber are necessary. Administratively, however, it is impractical to establish individualized rates for each subscriber. As a result, some subscribers, like those in denser areas, subsidize other subscribers, like those in more remote areas. The same effect occurs at a municipality level. The *per capita* cost of serving subscribers in Ottawa, which is denser and closer to Sammons of Illinois's transmission facilities and offices, is less than the cost of living in Marseilles. The allocation of revenues and expenses introduces artificial variances into the reasonableness analysis depending on the ratio used for the allocation and how that ratio is affected by items influencing the degree of cross-subsidization, like density of population. (Tr. at 196, 430).

44. Although Ottawa subscribers might pay more on a *per capita* basis, the economies of scale and lower administrative costs resulting from the sharing of facilities and staff lowers the overall costs to these subscribers. Accordingly, a balance must be struck between the economies of scale generated by aggregating municipalities into complexes and the disparities introduced among communities within a complex. The municipalities introduced no evidence to demon-