



**FAX COVER PAGE**

**This communication is confidential and intended only for the addressee. Any distribution or duplication of this communication is prohibited. If this facsimile was not intended for you, please telephone us immediately so that we can arrange for its return at our expense. Thank you.**

To:	<b>WILLIAM F. CATON</b>	Fax Number:	<b>(202) 418-2813</b>
From:	<b>ERIC E. BREISACH</b>	Telephone Number:	<b>(202) 416-0300</b>
Fax Number:	<b>(616) 382-1568</b>	Client Billing No:	<b>11047-40</b>

Message:

DOCKET FILE COPY ORIGINAL

**This transmission consists of 11 pages, including the cover page. If there are any discrepancies, please contact our telecopy operator at (616) 382-1483.**

# HOWARD & HOWARD

ATTORNEYS  
Established 1869

The Pinchurst Office Center, Suite 101  
1400 North Woodward Avenue  
Bloomfield Hills, Michigan 48304-2856

The Kalamazoo Building, Suite 400  
107 West Michigan Avenue  
Kalamazoo, Michigan 49007-3956

The Phoenix Building, Suite 500  
222 Washington Square, North  
Lansing, Michigan 48233-1817

The Greve Court Building, Suite 200  
321 Liberty Street  
Peoria, Illinois 61602-1403

Telephone (810) 645-1483  
Fax (810) 645-1568

Telephone (616) 382-1483  
Fax (616) 382-1568

Telephone (517) 485-1483  
Fax (517) 485-1568

Telephone (309) 672-1483  
Fax (309) 672-1568

JOHN W. ALLEN \*  
KELLY A. ALLEN  
GUSTAF R. ANDREASEN  
WILLIAM G. ASIMAKIS, JR.  
DANIEL L. BAKER  
GERRY BARTLETT-McMAHON  
ROBERT C. BUCK  
ANTOINETTE BEUCHE  
ROBERT L. BIFFERMAN †  
LORI B. BOBBITT  
WALTER J. BURDA  
FERNANDO A. BORRERO \*  
ERIC E. BREISACH  
TAMMY L. BROWN  
PHILIP T. CARTER  
JEFFREY P. CHALMERS  
TODD D. CHAMBERLAIN  
MICHAEL L. CHOJNOWSKI  
KEVIN M. CHUDLER  
CHRISTOPHER C. CINNAMON  
CAROLYN M. CLAERHOUT  
WILLIAM J. CLEMENS \*\*  
DAVID C. COEY  
MATTHEW J. COFFEY

THOMAS L. COOPER  
MICHAEL C. CRUSE  
THOMAS R. CURRAN, JR.  
CHRIS T. DANIKO AS  
MARK A. DAVIS  
WILLIAM A. DORNBOG  
JON S. FALETTO \*  
STEPHEN C. FERLMANN \*  
RICHARD D. FRIES †  
JAMES H. GEARY  
JOHN GERALD GLEESON \*  
EDGAR G. GORDON  
PAUL GREEN  
ROGER M. GROVES †  
BRUCE R. GRUBB  
MICHAEL L. HALLORAN  
RICHARD I. HALPERT  
PATRICK D. HANES  
ELLEN M. HARVATH  
JOHN G. HAYWARD  
JOSEPH B. HEMKER † \*  
FREDERICK G. HOFFMAN \*  
DAVID I. HOLMES  
WILLIAM H. HONAKER †

JOHN C. HOWARD  
TIMOTHY J. HOWARD \*  
DIANA M. JAGIELLA \*  
ROBERT H. JOHNSON  
J. MICHAEL KEMP \*  
DANIEL N. KING \*\*  
JON H. KINGSEPP  
STEVEN C. KOHL  
JAMES H. KONING  
TIMOTHY E. KRAPPEL  
PETER J. LIVINGSTON  
JAMES E. LOZIER  
D. CRAIG MARTIN  
ROBERT F. MEINOLF \*  
ROBERT D. MOLLHAGEN † \*  
C. DOUGLAS MORAN  
LAWRENCE J. MURPHY † \*  
THEODORE W. OLDS \*\*  
SUSAN E. PADLEY  
CHARLES C.S. PARK  
GARY A. PETERS † \*  
MARIHA A. PROCTOR  
JEFFREY G. RAFFELSON

BRAD A. RAYLF  
BRIAN J. REINAUD  
DAVID E. RIGGS  
BLAKE K. RINGSMUTH  
LEONARD W. SACHS \*  
BONNIE Y. SAWUSCH  
DEBORAH M. SCHEINIDER  
RAYMOND C. SCOTT \*  
MICHAEL V. SUGAET  
THOMAS J. TALLERICO †  
LAURA A. TALI  
SANDRA M. TRACOFF †  
DONALD F. TUCKER  
PATRICK R. VAN TIFLIN  
SHAMRA M. VANWAGONER  
JACQUELINE K. VESTEVICH  
STEVEN H. WESTON  
JAMES C. WICKENS  
MYRA L. WILLIS  
TIMOTHY M. WITTEBORT  
THOMAS J. WUORI  
JOHN E. YOUNG  
MARLA G. ZWAS

WILLIAM G. HOWARD  
(1846-1906)  
HARRY C. HOWARD  
(1871-1946)  
WILLIAM J. HOWARD  
(1904-1993)

ALL ATTORNEYS ADMITTED IN MICHIGAN ONLY.  
EXCEPT AS INDICATED:

- \* ALSO ADMITTED IN ILLINOIS
- † ALSO ADMITTED IN DISTRICT OF COLUMBIA
- ‡ ALSO ADMITTED IN ILLINOIS
- § ALSO ADMITTED IN INDIANA
- ¶ ALSO ADMITTED IN IOWA
- ‡ ALSO ADMITTED IN NEW YORK
- † ALSO ADMITTED IN OHIO
- ‡ ALSO ADMITTED IN PENNSYLVANIA
- † ALSO ADMITTED IN TEXAS
- ‡ ALSO ADMITTED IN VIRGINIA
- † ONLY ADMITTED IN ILLINOIS
- ‡ ONLY ADMITTED IN ILLINOIS AND MISSOURI
- † ADMITTED TO PRACTICE BEFORE THE  
PATENT AND TRADEMARK OFFICE

Kalamazoo Office  
May 5, 1995

Direct Dial (616) 382-9711

**VIA FACSIMILE (202) 418-2813**

**Mr. William F. Caton**  
Acting Secretary  
Federal Communications Commission  
1919 M Street, NW, Room 222  
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

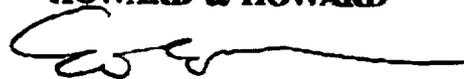
**Re: Filing in MM Docket No. 92-266 of Letter Dated May 4, 1995 to Gregory J. Vogt, Regarding Revised Regulatory Scheme for Small Cable Television Systems**

Dear Mr. Caton:

Enclosed for filing in MM. Docket No. 92-266 is the above-referenced letter. If you have any questions or need additional information, please contact us.

Very truly yours,

**HOWARD & HOWARD**



Eric E. Breisach

Enclosure  
cc: David Kinley

No. of Copies rec'd 1  
List ABCDE

RECEIVED  
MAY 5 1995  
FEDERAL COMMUNICATIONS  
COMMISSION  
SECRETARY

**HOWARD & HOWARD**ATTORNEYS  
Established 1869The Pinchum Office Center, Suite 101  
1400 North Woodward Avenue  
Bloomfield Hills, Michigan 48304-2856Telephone (810) 645-1483  
Fax (810) 645-1568The Kalamazoo Building, Suite 400  
107 West Michigan Avenue  
Kalamazoo, Michigan 49007-3956Telephone (616) 382-1483  
Fax (616) 382-1568The Phoenix Building, Suite 500  
222 Washington Square, North  
Lansing, Michigan 48933-1817Telephone (517) 485-1483  
Fax (517) 485-1568The Creve Coeur Building, Suite 200  
321 Liberty Street  
Peoria, Illinois 61602-1403Telephone (309) 672-1483  
Fax (309) 672-1568JOHN W. ALLEN T  
KELLY A. ALLEN  
GUSTAF R. ANDREASEN  
WILLIAM G. ASIMAKIS, JR.  
DANIEL L. BAKER  
GERRY BARTLETT M. MAHON  
ROBERT C. BECK  
ANTOINETTE BEUCHE  
ROBERT L. BIEDERMAN T  
LORI B. BOBBITT  
WALTER J. BORDA  
FERNANDO A. BORREGO \*  
ERIC F. BREISACH  
TAMMY L. BROWN  
PHILIP C. CARTER  
JEFFREY P. CHALMERS  
TODD D. CHAMBERLAIN  
MICHAEL L. CHOJNOWSKI  
KEVIN M. CHUDLER  
CHRISTOPHER C. CINNAMON  
CAROLYN M. CLAERHOUT  
WILLIAM J. CLEMENS \*\*  
DAVID C. COEY  
MATTHEW J. COFFEYTHOMAS L. COOPER  
MICHAEL G. CRUSE  
THOMAS R. CURRAN, JR.  
CHRIS T. DANIKOLAS  
MARK A. DAVIS  
WILLIAM A. DORNBOSS  
JON S. FALETTO \*  
STEPHEN C. FERLMANN \*  
RICHARD D. FRIES \*  
JAMES H. GEARY  
JOHN GERALD GLEESON \*  
EDGAR G. GORDON  
PAUL GREEN  
ROGER M. GROVES \*\*  
BRUCE R. GRUBB  
MICHELE L. HALLORAN  
RICHARD L. HALPERT  
PATRICK D. HANES  
ELLEN M. HARVATH  
JOHN G. HAYWARD  
JOSEPH B. HEMKER T  
FREDERICK G. HOFFMAN \*  
DAVID L. HOLMES  
WILLIAM H. HUNAKER □JOHN C. HOWARD  
TIMOTHY J. HOWARD \*  
DIANA M. JAGIELLA \*  
ROBERT B. JOHNSTON  
J. MICHAEL KEMP \*  
DANIEL N. KING \*\*  
JON H. KINGSEPP  
STEVEN C. KOHL  
JAMES H. KONING  
TIMOTHY E. KRAEPEL  
PETER J. LIVINGSTON  
JAMES F. LOZIER  
D. CRAIG MARTIN  
ROBERT F. MFLONE \*  
ROBERT D. MOLLHAAGEN I \*  
C. DOUGLAS MORAN  
LAWRENCE J. MURPHY T  
THEODORE W. OIDS \*\*  
SUSAN E. PADLEY  
CHARLES C.S. PARK  
GARY A. PETERS \*\*  
MARTHA A. PROCTOR  
JEFFREY G. RAPHELSONBRAD A. RAYLE  
BRIAN J. RENAUD  
DAVID E. RIGGS  
BLAKE K. RINGSMUTH  
LEONARD W. SACHS \*  
BONNIE Y. SAWUSCH  
DEBORAH M. SCHNEIDER  
RAYMOND E. SCOTT □  
MICHAEL V. SUGAET  
THOMAS J. TALLERICO \*  
LAURA A. TALT  
SANDRA M. TRACOFF \*  
DONALD F. TUCKER  
PATRICK R. VAN TIFLIN  
SHAMRA M. VANWAGONER  
JACQUELINE K. VESTEVICH  
STEVEN H. WESTON  
JAMES C. WICKENS  
MYRA L. WILLIS  
TIMOTHY M. WITTFBORT  
THOMAS J. WUORI  
JOHN E. YOUNG  
MARLA G. ZWASWILLIAM G. HOWARD  
(1846-1906)  
HARRY C. HOWARD  
(1871-1946)  
WILLIAM J. HOWARD  
(1904-1993)ALL ATTORNEYS ADMITTED IN MICHIGAN ONLY,  
EXCEPT AS INDICATED.\* ALSO ADMITTED IN DELAWARE  
\* ALSO ADMITTED IN DISTRICT OF COLUMBIA  
\* ALSO ADMITTED IN ILLINOIS  
\* ALSO ADMITTED IN INDIANA  
\* ALSO ADMITTED IN IOWA  
\* ALSO ADMITTED IN NEW YORK  
\* ALSO ADMITTED IN OHIO  
\* ALSO ADMITTED IN PENNSYLVANIA  
\* ALSO ADMITTED IN TEXAS  
\* ALSO ADMITTED IN VIRGINIA  
\* ONLY ADMITTED IN ILLINOIS AND MISSOURI  
□ ADMITTED TO PRACTICE BEFORE THE  
PATENT AND TRADEMARK OFFICEKalamazoo Office  
May 4, 1995

Direct Dial (616) 382-9711

**VIA FACSIMILE AND U.S. MAIL****Mr. Gregory J. Vogt**  
Deputy Chief, Cable Services Bureau  
Federal Communications Commission  
2033 M Street, NW  
Washington, D.C. 20554**Re: System/Company Size Issues; Alternate Methodology To Compute Rates And  
Reduce Regulatory Burdens For Qualifying Companies**

Dear Greg:

We write this letter on behalf of the Small Cable Business Association as a follow-up to our letter of April 10, 1995 in which we raised a number of serious questions about the substance of any benefit under the staff's outline to provide small system relief. Following further discussions, clarifications, and much effort by the Cable Services Bureau, it now appears that a staff recommendation so long as it contains various elements, would provide meaningful relief to many smaller systems/companies and would therefore be wholeheartedly supported by SCBA.

We provide a summary of key plan provisions which outline the necessary elements to provide meaningful relief. We then provide greater detail regarding the reasons why such provisions are required.

Mr. Gregory J. Vogt  
May 4, 1995  
Page 2

---

### **SUMMARY OF KEY PLAN PROVISIONS**

- **System/Company Size Definitions**
  - Small system - one with 15,000 or fewer subscribers.
  - Small company cap - a company with 400,000 or fewer total subscribers.
  - Expedited good cause waiver process to allow systems/operators not in technical compliance with definitions to be afforded small system treatment where justified.
    - Linking small systems together via fiber optic cable to create lower operating costs should be one ground for issuance of a waiver and that fact should be stated in any FCC Order adopting revised treatment.
  - Small system qualification should attach to a system and be retained by future owners, even if the acquiring company has more than 400,000 total subscribers
- **Rate Computation**
  - Rates may be computed using readily available information such as:
    - Tax returns;
    - Financial statements.
  - FCC interim cost-of-service standards do not apply to small systems - rate may include a return of and return on all:
    - Prior period operating losses;
    - Acquisition intangibles.
  - Information may be adjusted for items such as:
    - Recovery of prior period net operating losses;
    - Revised depreciation methods and lives (i.e., revise tax returns to not use Modified Asset Cost Recovery System).

**Mr. Gregory J. Vogt**

**May 4, 1995**

**Page 3**

---

- Operators may choose to compute the rate of return using a hypothetical capital structure of 60 percent debt, 40 percent equity using the following costs:
  - Debt at the operator's actual cost of debt;
  - Equity at 20 percent (pre-tax).
- Operators should have flexibility to use choose a simple and fair cost allocation method.
- **Rate Regulation Procedures**
  - Rates below a fixed level (i.e., \$1.20 per channel including equipment) should be presumptively reasonable.
  - Certified local franchise authorities ("LFAs") may initiate review and proceedings to demonstrate whether an operator's rate is unreasonable:
    - LFA may seek information regarding how the operator computed its rate;
    - Operator may file interlocutory appeal with the Commission if it believes document/information production requirements are unreasonably burdensome.
  - LFA may issue decision as to whether it believes rates are unreasonable
    - If decision is adverse to operator, operator has right of appeal to the Commission;
    - An automatic stay will apply upon the filing of an appeal
    - Because operator has presumption, appeal form should be simple as operator has no burden of proof at this juncture;
    - The Commission first decides whether the LFA has met its burden of proof;
      - If LFA has not met burden, appeal is granted and local order remanded;

Mr. Gregory J. Vogt  
May 4, 1995  
Page 4

---

- If LFA has met its burden, the operator has an opportunity to make its case in principal before the Commission that its rates are reasonable.
- Operators may charge more than \$1.20 per channel for regulated services, but above this level, small systems must show the reasonableness of their rates. Nevertheless, the small system computation method still applies (i.e., the interim standards and other cost-of-service requirements placed on larger operators shall not apply).
- The per channel price to determine the reasonableness of rates (i.e., \$1.20) must be increased on an annual basis to reflect general industry inflation and external cost changes.
- Availability
  - Small system rate regulation computation methods and procedures must be available to all qualifying systems to either justify current rates or increase rates. This methodology would be available regardless of a system's current regulatory status (i.e., whether or not it has previously used benchmark or cost-of-service justifications).
- Equipment Rates
  - Small systems should have flexibility to choose a simplified method of computing equipment and installation rates so long as the statutory cost-based pricing requirement is satisfied.

Mr. Gregory J. Vogt  
May 4, 1995  
Page 5

---

### **EXPLANATION OF POSITIONS**

In the remainder of this letter, we outline the rationale for some of the plan elements that we have listed as essential to ensure that the plan provides real substantive and procedural relief.

#### **System/Company Size**

##### **System/Company Size Relationship**

In our April 10, 1995 letter, we expressed concern that although the staff was moving in the right direction to increase the system size definition, many operators of small systems would be left in the cold because the definition of small was out of proportion with the company size "cap". The cleanest and fairest way for the Commission to avoid denying relief to operators of smaller systems that need relief because of the financial characteristics of operating smaller systems is to eliminate the cap. This has been SCBA's position on the record since the Commission first proposed an operator cap. Nevertheless, imposition of a cap is still a workable situation, so long as the cap is set at a realistically high level. Prior caps have simply been too low.

SCBA proposes that the system size definition be increased from current levels. For example, the A.C. Nielsen Cable On-Line Data Exchange (CODE), reveals that increasing the company size limitation to 400,000 and changing the system size to 15,000 increases the percent of systems included in the relief, without a significant increase in the percent of national subscriber affected<sup>1</sup>. The combination of system size of 15,000 or fewer subscribers and a company size definition of 400,000 subscribers would include many of the smaller system operators who are in need of relief.

##### **Public Policy For Larger Small Company Definition**

The need for larger operators of smaller systems is important from a public policy perspective. The cable industry has experienced significant consolidation over the past two years. This consolidation has brought many benefits through economies of scale and lower cost of providing service. The Commission must also allow for consolidation of smaller systems. Most of these systems are not affiliated with one of the major MSOs -- for good reason -- the profit margins required by large companies are absent from most smaller

---

<sup>1</sup>The CODE database indicates that this combination would impact 61.7 percent of systems nationally, while affecting only 11.9 percent of the national subscribers.

**Mr. Gregory J. Vogt**

**May 4, 1995**

**Page 6**

---

systems. Nevertheless, there are companies that specialize in acquiring and reducing the operating costs of smaller systems. These companies are also often able to bring greater technical expertise as well as access to capital that would otherwise not be available to small system subscribers. The Commission needs to allow for smaller MSOs who are willing to increase the quality and level of service available to subscribers. An initial cap at 400,000 provides for an initial incentive.

### Waiver Process

As we have discussed, no matter how carefully crafted, any definition always draws an arbitrary line. This line will exclude operators who should legitimately be entitled to relief. An essential element of the new rules must be a simple and expedient waiver process to allow systems and operators that do not meet the technical definitional parameters to avail themselves of the small system provisions.

Waivers should be routinely granted upon the showing of good cause. One example of good cause that should be identified by the Commission in any Order is that of small system headend interconnection. To reduce certain capital and operating costs, some smaller system operators have begun interconnecting headends, thereby creating larger systems as defined in legal terms. With the exception of lower headend costs, these systems still have the same attributes as smaller systems and should be entitled to relief (i.e., density, travel costs, programming, etc. remain unchanged). To the extent investment and operating costs have decreased, it will result in a decreased rate computation. Nevertheless, savings from headend interconnection would be far outweighed by loss of small system status. Because it is in the public interest to increase the efficiency of operations, the Commission should routinely grant waivers to smaller systems who are disqualified only because of interconnection.

### Grandfathering

Systems that qualify for small system treatment must retain that characteristic, even if it is sold to a larger system. It is the small operator that is hurt, not the large MSO, if grandfathering is not permitted. System sale prices are based on projected future cash flows. If small systems are permitted to be grandfathered, while the acquiring company will charge higher rates, it is because its acquisition costs were higher. If small system treatment does not vest with the system, owners will not be able to recover their investments in their systems.

Mr. Gregory J. Vogt  
May 4, 1995  
Page 7

---

### Rate Calculation

#### Information Source/No Presumptive Standards

The rate calculation process must be simple. Operators must have the option of using readily available information such as that derived from tax returns or financial statements. Such amounts must be adjustable to include recovery of and return on prior year losses. Similarly, such computations must not be restricted in any way and all costs must be recoverable. In other words, the restrictive Commission cost-of-service interim presumptions, or any subsequent finalization of such restrictions, cannot apply to small systems. The rate relief afforded under this plan must be meaningful.

#### Cost-Of-Capital

The systems must be able to use a targeted capital structure (i.e., 60 percent debt and 40 percent equity) upon which to earn returns. This structure is essential to permit these systems to reduce their debt levels and move towards the levels targeted by the Commission in its cost-of-service Order. The cost of debt should be the operator's actual cost and the cost of equity must be at least 20 percent.

#### Cost Allocation

A simple but fair cost-causative allocation mechanism must be available for operators to allocate costs and ratebase between the various regulated services as well as unregulated services. The allocation method must recognize the reality that most small systems typically offer fewer premium/unregulated services. Consequently, these systems literally live and die based on the performance of their basic tier. Operators should be given discretion to choose an appropriate cost allocation method.

### Rate Regulation Procedures

#### The Presumption

Rates for regulated service that are below a certain per channel amount should be presumptively reasonable. SCBA understands that the Commission is reviewing average rate information to determine an appropriate level. The level must be high enough to realistically cover the legitimate costs of smaller system. Based on discussions with SCBA members, to include most systems needing relief, the level should be in excess of \$1.20 per

Mr. Gregory J. Vogt  
May 4, 1995  
Page 8

---

channel<sup>2</sup>. This per channel amount should be subject to annual review and revision by the Commission to reflect changes in general price levels and external cost changes.

### Procedures

To provide effective relief from undue LFA proceedings, the Commission should not require a cable operator to make its principal rate showing until the LFA has demonstrated to the Commission's satisfaction that the rates charged by the operator are unreasonable. This would not impact an LFA's ability to undertake rate proceedings. Rather, the LFA could undertake its review, and if adverse, the operator would have a right of appeal to the Commission. During the pendency of the appeal, an automatic stay would be in effect. If the Commission decided that the LFA had carried its burden, the operator would then have an opportunity to prove the reasonableness of its rates to the Commission.

Additionally, if an operator believed that an LFA was making information and document production requests that were not reasonable, the operator could seek interlocutory relief from the Commission.

### Availability

Given that the small system methodology is intended to provide both substantive and procedural relief to the operators of small systems, operators must be able to both maintain and increase rates as justified by the cost data. Many smaller systems have been disparately burdened by the impact of rate regulation since April 1993<sup>3</sup>. Consequently, their current rate structures may not be providing the statutorily mandated "reasonable" return, if they are providing any return at all. The only meaningful relief is to allow small systems to establish and change rates within the parameters of any revised small system rate setting structure.

---

<sup>2</sup>SCBA has previously filed detailed computations supporting and quantifying above benchmark rates for smaller systems. A rate of \$1.20 per channel or more is fully justified. *Supplemental Comments In Further Support Of Interim Benchmark Adjustments For Low Density and Smaller Cable Operators*, MM Docket No. 92-266, Filed February 15, 1994.

<sup>3</sup>Smaller systems have been adversely impacted by the prolonged rate freeze as well as the delayed implementation of rate regulation for systems with fewer than 1,000 subscribers because while rates were frozen, increases in external costs were permanently excluded from recovery.

Mr. Gregory J. Vogt  
May 4, 1995  
Page 9

---

### Equipment Rates

The current Form 1205 equipment cost computations are complex and time consuming, placing disparate burdens on small systems. The Commission should provide operators with the flexibility to price equipment and installation rates within the statutory cost-based requirement.

### Summary

This skeletal outline of proposed relief would provide meaningful relief from overly burdensome rate regulation provisions and procedures. Every component is important. Omission of any one component could be fatal to the effectiveness of the plan. If you have any questions or comments, please call us so that we may continue assisting the Commission in this important matter.

Very truly yours,

HOWARD & HOWARD



Eric E. Breisach

cc: David Kinley  
\\367\ceb\acba\gvogt.myt