mean that the regulation is invalid."[151] Thus, we have no constitutional duty to ensure full recovery of these acquisition costs, we must only ensure that the end result of our ratemaking decisions here is reasonable.[152]

54. We continue to believe that the ratebase should not include costs resulting from any expectation of monopoly profits or expectation of a return on emerging and unregulated services, which we believe the presumptive exclusion of such acquisition costs ensures. However, upon further reflection and based upon our review of cost of service filings, we believe this presumption can be modified, without sacrificing this conclusion.

55. Therefore, we will adopt a new rule, applicable to systems conyeyed prior to the effective date of the interim cost rules, with respect to the treatment of intangible assets. We find the model proposed by Continental, pursuant to which 34% of the purchase price of a system is presumed to be attributable to monopoly expectations, to be the one best suited to these goals. For explanatory purposes, we will recast this model as follows, using hypothetical figures. Assume a purchaser with monopoly expectations buys a cable system for $1,000, based on a system valuation of ten times cash flow.[153] This means that the operator anticipates an annual cash flow of $100 and annual revenues of $200 based on an assumption of a 2:1 ratio between revenues and cash flow. According to our benchmark survey, 17% of annual revenues, or $34, reflects the system's monopoly revenues. Because expenses should remain the same before and after rate regulation, this $34 must be removed from the cash flow side of the revenue stream. Thus, had there been effective competition, the same system would be expected to generate only $66 in annual cash flow.[154] If, as we have assumed, the purchase price is ten times cash flow, we can conclude that the system would have been purchased for $660 in a competitive environment, not the $1,000 paid based on its monopoly status. Therefore, $340 of the actual purchase price, or 34%, is attributable to monopoly expectations.

56. The two major variables in this analysis are the 17% competitive differential and the 2:1 revenue-to-cash flow multiple. We have confidence in the reliability

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[151] *Id.* at 601. *See also Illinois Bell v. FCC*, 988 F.2d 1254, 1262 (D.C. Cir. 1993) ("the FCC has no obligation to maintain the current market value of investors' property").

[152] *Duquesne Light Company v. Barasch*, 488 U.S. 299 (1989); *Hope*, 320 U.S. 591 (1943).

[153] For purposes of this approach, the particular ratio of purchase price-to-cash flows does not affect the analysis. We have used a 10:1 ratio solely for convenience.

[154] In other words, the presence of effective competition would have forced the operator to reduce rates to this extent. The full $17 in monopoly rents is attributable to cash flow, since by definition it is being exacted solely because of the system's monopoly status, not to cover system expenses.

of the competitive differential, as it is the basis for our primary regulatory scheme and has been found reasonable upon judicial review.[155] The 2:1 multiple is a generalization, but rules of broad applicability often depend upon such approximations and there is clearly support in the record for this particular estimate.[156] The multiple of cash flow that a purchaser would use to value a system depends upon whether the system is subject to effective competition, given the impact of competition on revenues. That is, if the purchaser in our example paid 10 times cash flow for the monopoly system, it might be expected to pay a reduced multiple (times lower cash flows) if the system were subject to effective competition. Our analysis assumes lower cash flows because of competition, but not a reduced multiple. However, we do not have sufficient evidence to conclude that the multiple would be significantly affected by a 17% reduction in revenues[157]. Based on the limited information available at this time, we conclude that the effect would be minimal. Therefore, we do not believe any adjustment to the multiple is necessary.

57. We find the mechanism proposed by Continental to be more persuasive than simply disallowing 10% of intangibles as proposed by Viacom. The Continental proposal is based on a reasonable model of the incentives that might have motivated an operator to pay more for a particular system rather than a simple admission that some portion of the "excess acquisition cost" resulted from an expectation of monopoly profits. Furthermore, Continental's proposal follows from our previous finding that systems able to exercise monopoly power charge rates which exceed the rates charged by competitive systems by 17%.[158] We also find, however, that Continental's proposal should be refined somewhat. Because we are only concerned with expectations of monopoly profits which are derived from regulated services, we believe that this adjustment should only be applied to that portion of the purchase price that can be allocated to services which are now rate regulated.

58. Therefore, our final rule will presume, rebuttably, that 34% of the purchase price associated with regulated services of systems purchased prior to regulation represents monopoly expectations and must be removed from the regulated ratebase. Put differently, the ratebase presumptively shall not exceed 66% of that portion of the system price allocable to assets used to provide regulated services. The 34% adjustment must be applied to the entire purchase price associated with regulated services, not just the portion of the price allocable to intangibles, because cable operators derive revenues, including monopoly revenues, from the employment of both tangible and intangible assets. Applying the 34% adjustment to all assets associated with regulated services, rather than only to the

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[155] *Time Warner Entertainment Co., L.P. v. FCC*, 56 F.3d 151, 164-71 (D.C. Cir. 1995).

[156] *See, e.g.* Paul Kagan and Associates *Cable TV Financial Databook*, at 9 and 92, July 1995.

[157] Between 1991 and 1994, the revenue-to-cash flow multiple varied only 6.43%. *Id.*

[158] *See supra* at ¶ 3.

associated intangibles, should remove all expectations of monopoly profits.

59. As noted, we recognize that this approach necessarily involves the use of industry-wide averages with respect to certain variables that, while reasonable, will not always reflect with perfect accuracy the circumstances of particular operators. To the extent the 34% adjustment is inexact for certain operators, we are particularly concerned that this adjustment could be used to raise rates unreasonably, given our statutory mandate to guard against unreasonable rates. Therefore, we will allow use of the 34% adjustment only for the purpose of justifying rates in effect as of the effective date of these rules. We believe that this represents a reasonable compromise between the overall integrity of the analysis used to arrive at the 34% adjustment and the concern we have that in some cases this adjustment could prove overly generous to operators. Accordingly, in cost of service cases to which the 34% adjustment is applicable, the operator may include in the ratebase up to 66% of the purchase price allocable to assets used to provide regulated services, but only to the extent necessary to justify rates in effect as of the effective date of these rules. If the current rate can be justified by including in the ratebase less than the 66% amount, then in no event shall the operator seek to use a higher percentage for purposes of any cost of service showing. Given our refined approach to allowing these acquisition costs into the rate base, as well as the alternative ratemaking methodologies available to operators (such as hardship relief), we are convinced that exclusion of some acquisition costs will not result in unreasonable rates.

60. This adjustment shall be applied only to the purchase price of systems sold prior to May 15, 1994, the effective date of the *Cost Order*. The interim rule is made permanent with respect to systems sold after this date. Operators who acquired systems after May 15, 1994 were aware of the interim rule strictly limiting the ability to recover the cost of intangible assets. Thus, to the extent such operators recorded substantial intangibles, we presume those intangibles are associated with investment in unregulated services. As such, they cannot be included in the regulated ratebase.

61. Generally, operators using the cost of service to justify current rates for the first time, will be able to do so using the 34% adjustment. In some rare cases, however, this adjustment may not be adequate. For instance, if an operator acquired a system with tangible assets equal to 70% of the purchase price, obviously allowing a ratebase equal to 66% of the purchase price may not allow the operator to recover reasonably incurred costs. Similarly, if the tangible assets represent 64% of the purchase price, the remaining 2% may not adequately compensate the operator for reasonably incurred intangible assets. Therefore, where the tangible assets approach 66% of the purchase price, the operator may justify rates using 100% of the tangible assets and such intangible assets as are permissible using the interim rules.

62. We further believe it appropriate to adjust our interim rule concerning deferred income taxes. Deferred income taxes represent the tax benefit enjoyed by regulated entities that depreciate ratebase assets on an accelerated basis, but that establish rates based on the regulatory presumption that they use a straight-line depreciation method. As compared to

accelerated depreciation, the straight-line method produces a lower amount of expenses to offset against revenues and thus a higher tax liability which is passed through to subscribers. The operator using straight-line asset depreciation for rate regulation purposes, as our rules presume, but using accelerated depreciation for tax purposes, receives revenues from subscribers today for tax liability it will not incur until some later date, i.e., when the asset is more fully depreciated. Because it may earn a return on those revenues until it actually incurs the tax liability, we require that this amount, the deferred tax liability, be deducted from the ratebase so as to preclude a double recovery by the operator. As noted, however, this deduction is premised on the regulatory presumption that rates reflect the operator's use of straight-line depreciation. Obviously, such a presumption could not have existed in the absence of rate regulation. Therefore, we will require operators to deduct deferred income taxes from the ratebase only to the extent that amount was accrued after the date the operator became subject to rate regulation.

63. Finally, we reject Continental's assertion that the excluded intangibles should be amortized since our analysis is based on the reasonable assumption that these excluded intangibles derive from an expectation of monopoly profits from regulated services. Thus, these costs should not be recovered from regulated rates.

V. RATEBASE-START-UP LOSSES

A. Background

64. In the course of starting a business, losses can be reasonably expected before the business begins to show a profit. These losses can be considered to be part of the necessary cost of providing cable service to subscribers and as such should be recoverable by the cable operator. To the extent that such losses can be considered used and useful, they can legitimately be included in the ratebase. Financial Accounting Standards Board Statement No. 51 ("FASB 51") allows that certain expenditures, which are normally expensed, may be subsequently capitalized when incurred during a prematurity period which is generally expected to be no more than two years.[159]

65. In the *Cost Order*, we concluded that some accumulated start-up losses, to the extent that they reflect operating losses in the early years of the system, should be included in the ratebase.[160] Our current cost of service rules permit cable operators to include accumulated start-up losses occurring during a prematurity period as defined by FASB 51.[161] Such losses derive exclusively from the original franchisee (also often referred to as a "build

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[159] Statement of Financial Accounting Standards No. 51, Financial Reporting by Cable Television Companies ("FASB 51").

[160] *Cost Order*, 9 FCC Rcd at 4563.

[161] *Id.* at 4563-65.

and hold system"). The FASB 51 standard is a rebuttable presumption and cable operators are free to demonstrate that a longer start-up period is appropriate. Cable operators may rebut the presumption of the two year prematurity phase by demonstrating that losses beyond this period were reasonably necessary to develop the cable system and provide cable service and thus benefitted current subscribers.[162]

B. Comments

66. Continental argues that operators should be allowed an "accumulated return deficiency" which includes start-up losses and accumulated "low earnings," i.e., earnings below a reasonable level.[163] FASB 51 should not artificially limit the amount of start-up losses included in the ratebase, according to Continental.[164] Continental states that losses and low earnings should be allowed commensurate with amounts necessary to provide incentives for operators to build systems.[165] According to Continental, investors in cable systems assume long periods of losses or low returns before obtaining higher returns in later years. Thus, Continental maintains that we should allow the total amount of losses and "low earnings" in the early years of the system's life into the ratebase. Under this scenario, low earnings would be earnings below a "reasonable" level, perhaps returns below 11.25%, the Commission's prescribed rate of return. Eventually, when earnings exceed this "reasonable level," the excess is credited against the ratebase amount attributable to losses and low earnings of prior years. Continental argues that we should discard all presumptive limits on start-up losses because a system seller will always regard such losses as part of his total investment and seek recovery from an acquiring entity.[166]

67. TCI asserts that FASB 51 allows more than two years of start-up losses.[167] TCI states that two years is a general guideline for the prematurity period, but FASB 51 itself recognizes that a longer period may be justifiable in major urban markets.[168] TCI also notes that FASB 51 only concerns itself with particular accounting issues; it does not

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[162] *Id.* at 4564, n. 131.

[163] Continental Comments at 7-11.

[164] *Id.*

[165] *Id.*

[166] *Id.* at 11.

[167] TCI Comments at 32-33.

[168] *Id.*

address all the various costs that give rise to start-up losses.[169] Accordingly, TCI argues that the cost of service methodology must take cognizance of start-up losses beyond two years.[170]

68. NCTA maintains that all start-up losses in the early years of a system should be allowed in the ratebase.[171] According to NCTA, FASB 51 is an insufficient basis to limit start-up loss inclusion since it does not address itself to a cost of service regulatory system.[172]

69. Media General argues that all reasonably incurred start-up losses should be allowed in the ratebase.[173] According to Media General, FASB 51 was not intended to serve as a vehicle for cost of service regulation. Media General asserts that it sustained losses well beyond two years for a variety of legitimate reasons, including fidelity to its franchise agreement, unexpected costs incurred to build 1,100 more plant miles than originally planned, and rate pressure from local franchise officials. Media General argues that such losses should be allowed without a 2-year presumptive limit.[174]

C. Discussion

70. Based upon many of the actual cost of service showings submitted in rate complaint proceedings before the Commission and the comments and petitions for reconsideration that have been filed in this proceeding, we are persuaded that the treatment of prior year losses in the *Cost Order* should be amended. Cable operators have made a convincing case that they experience a wide range of prematurity periods and that start-up losses will vary widely depending upon the particular circumstances in each cable system.[175] For example, Media General cites a number of factors particular to its situation, including a significant miscalculation of the extent of plant needed to serve the franchise area in the County's pre-bid representation, that illustrate how specific franchise history can differ widely

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[169] *Id.*

[170] *Id.*

[171] NCTA Comments at 34-35.

[172] *Id.*

[173] Media General Petition for Reconsideration at 5.

[174] *Id.* at 5-8. Continental endorses Media General's position, arguing that FASB 51 is an accounting rule that does not address a cable investor's expectations of earnings over time from an investment in a cable system. Continental Comments at 10.

[175] Media General Petition for Reconsideration at 5-7.

from the FASB 51 Standard.[176] We find therefore that we should not prescribe a specific prematurity phase, rather we find that we should define the prematurity phase as the actual period during which expenses exceed revenues. Although we find that the interim rule should be modified, for the reasons stated in the *Cost Order*, we continue to reject the claims of commenters who argue that the wholesale inclusion of start-up losses in the ratebase is warranted. We also reject Continental's assertion that we should allow deferred earnings into ratebase. To do so would artificially inflate the ratebase.

71. Thus, we find it appropriate to redefine our current definition of prematurity so as to account for the specific circumstances experienced by individual operators rather than continuing to use the FASB 51 standard. We are persuaded by the arguments that limitations on start-up losses should be governed by the history of individual operators. For capitalized start-up losses, build and hold operators should be permitted to recover reasonably incurred cumulative net losses, plus any unrecovered interest expenses connected to funding the regulated ratebase, over the unexpired life of the longest lived asset in the regulated ratebase, commencing with the end of the loss accumulation phase. In most cases acquired systems will have recorded accumulated start-up losses as goodwill or as some other form of intangibles. To the extent that purchased systems can demonstrate that start-up losses have been recorded as goodwill or some other category of intangibles, these losses shall be allowed just as if they had been recorded as start-up losses and the system must itemize its assets instead of using the 66 % purchase price allowance methodology described above. In allowing this however, we must emphasize this should not be interpreted as authority for the wholesale inclusion of goodwill. The burden remains on the operator to demonstrate that any portion of a class of assets is derived from start-up losses.

72. The end of the accumulation phase (i.e., the prematurity phase) will vary from system to system, depending upon the experience of the particular system at issue. By allowing the recovery to occur over the unexpired life of the longest lived asset in the regulated rate base rather than the remainder of the franchise life, the amortization period for purchased systems will realistically reflect the expected period during which the operating losses can be recovered.

VI. RATEBASE - TANGIBLES

A. Background

73. In the *Cost Order*, the Commission concluded that operators should use

[176] *Id.* at 6-7. Because of these factors Media General reports that its operation in Fairfax County did not reach the breakeven point until 1991 or eight years after initiation of construction. *Id.*

original cost to determine the value of plant in service that may be included in the ratebase.[177] Original cost was defined as the "actual money cost (or the money value of any consideration other than money) of property at the time it was first used to provide cable service."[178] The Commission decided against other valuation approaches, including methods based on market value, replacement cost, or reproduction cost, because they may be difficult to apply and could include excess acquisition costs.[179] The Commission chose original cost because it is the traditional method used for public utility valuation and because it produces reliable and fair valuations of plant in service.[180] Unlike the other valuation approaches, original cost does not require estimates of current values, which may be speculative or subjective.[181] Consistent with the dictates of the 1992 Cable Act, an original cost approach reduces administrative burdens because it relies on cost information that is constant, verifiable, and in most cases, readily available.[182] If adequate records do not exist, operators may estimate original cost, provided the basis for the estimate is supported by accompanying documentation.[183] In such cases, if an operator can show that book value approximates original cost, the operator may value tangible plant in service at the book value recorded by the operator at the time of acquisition.[184]

B. Comments

74. Several commenters argued for an approach based on market value instead of original cost. Viacom believes that an operator's ratebase should be valued at its market value minus any putative monopoly rents.[185] Viacom claims that an original cost approach "would disserve the public interest by frustrating the Congressional intent that cable rates be set at the same levels that would exist in a competitive environment."[186] Viacom

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[177] *Cost Order*, 9 FCC Rcd at 4554-55.

[178] *Id.* at 4555.

[179] *Id.* at 4557-59.

[180] *Id.* at 4554-55.

[181] *Id.* at 4555.

[182] *Id.* at 4556.

[183] *Id.* at 4559.

[184] *Id.*

[185] Viacom Comments at 6.

[186] *Id.* at 5.

argues that prices in competitive markets are not related to historical book values but instead reflect inflation, technological changes, relative productivity, and potential opportunities.[187] Since historical costs are not affected by such factors, Viacom concludes that they cannot be used to derive competitive rates.[188] Similarly, NCTA supports a valuation approach based on what the market value of the assets would be if the cable system were subject to competition.[189] Arguing that the Commission's method ignores intangible assets, NCTA suggests an approach which involves computing a competitive cash flow based on the Commission's 17% competitive differential and applying it to the historical cash-flow-to-market-value multiple in the cable industry.[190] Finally, Continental contends that, regardless of whether the cable system was acquired or constructed and notwithstanding the availability of original cost data, operators should be able to include in their ratebases the actual amounts they paid for their tangible assets, without having to prove that the value approximates original cost.[191] Continental avers that the fair market value of acquired tangible assets, purchased at arms-length, is more accurate than the book value listed by the seller, since depreciation rates are subject to "a fair degree of variability."[192]

C. Discussion

75. We continue to believe that original cost is a reliable and fair measure of the value of tangible assets. In addition to eliminating monopoly profits, it is a method that is both practical and familiar. However, our review of cost of service filings reveals that in many instances it could be difficult, if not impossible, to determine the original cost of a tangible asset. To accomodate this reality, for cable systems constructed before May 15, 1994, we will allow operators to use the book value that was recorded as of May 15, 1994, regardless of whether the system was built or acquired by the current operator. Although in balancing consumers' and operators' interests, we continue to believe original cost reaches the better balance, we recognize that the pragmatic adjustment we are allowing is equally reasonable. We will continue to require that original cost be used for cable systems constructed after May 15, 1994. Also, an operator that acquires individual cable assets, such as converters or remotes, at arms' length after May 15, 1994 may use its original cost for those items, rather than its seller's original cost.

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[187] *Id.* at 6.

[188] *Id.* at 6-7.

[189] NCTA Comments at 25.

[190] *Id.* at 27-28.

[191] Continental Comments at 22-23.

[192] *Id.* at 22.

76. An exception may apply to the original cost rule in the case of assets acquired in an arms-length transaction and without subscribership. In such instances, assets may be recorded at fair market value. Thus, where a cable operator sells converters, for example, to an unaffiliated operator to be used in a different franchise location, it is acceptable for the acquiring operator to record such converters at fair market value, that is, at the price the acquiring operator paid for them.

VII. RATE OF RETURN

A. Background

77. In the *Cost Order*, we established a single overall rate of return for cable cost of service proceedings. The presumptive rate was set at 11.25% after taxes. Operators are not foreclosed from justifying different rates of return, however, if they believe their circumstances warrant such a filing. We noted that an operator seeking a higher rate of return bears a heavy burden in attempting to justify the higher rate and that local franchising authorities can counter the operator's request with evidence that the justifiable rate of return is lower than the presumptive 11.25% rate.[193] In choosing a single rate, the Commission determined that individualized rates of return would impose significant administrative burdens on franchising authorities, operators and the Commission.[194]

B. Comments

78. In its reconsideration petition, Comcast argues for the elimination of the 11.25% presumptive rate of return. Comcast contends that operators must be free to justify higher rates of return and that the presumptive 11.25% rate does not adequately reflect the risks of providing cable service. The 11.25% rate mirrors the rate of return for telephone companies subject to cost of service regulation, according to Comcast, who suggests cable operators deserve a higher rate because they present a higher investment risk than telephone companies. According to Comcast, the lower risk associated with telephone companies is manifested by their historic profitability, their routine payment of dividends to shareholders, and their issuance of investment grade bonds. Moreover, Comcast argues, telephone service is an essential utility while cable service is not.[195] Comcast points out that cable penetration is 65% while telephone penetration is approximately 95% of all households. Cable also faces competition from direct broadcast satellite ("DBS") and multichannel multipoint distribution services ("MMDS").[196] Cablevision Industries, Inc. ("Cablevision") in its petition, also argues

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[193] *Id.* at 4616, n.327.

[194] *Id.* at 4615.

[195] Comcast Petition at 19-20; Avenue TV Cable Reply Comments at 3.

[196] Comcast Comments at 4-5.

that telephone companies face lower risks and are nevertheless eligible for rates of return three percentage points above the 11.25% rate under price cap regulation.[197] NCTA asserts a unitary rate of return is inappropriate for the cable industry because cable operators face significantly higher business risks that are not represented in a unitary rate.[198] Comcast and Cablevision Industries reject suggestions that common rates of return for telephone companies and cable operators are needed to ensure regulatory parity. They argue business realties in the cable industry should control the rate of return calculation.[199]

79. TCI challenges the propriety of an industry average unitary rate of return. It argues that the rate of return cannot be based on industry averages because cost of service filings, as a general matter, are initiated by companies with costs above average, rendering cost of service regulation the appropriate alternative to the benchmark approach. In addition, TCI argues, the cable industry consists of companies of varying risk profiles which makes unitary treatment untenable. Unitary rates may make sense in the telephone context, but the cable industry is too diverse to justify uniform treatment, according to TCI. Telephone companies, on the other hand, possess similar capital structures, operating assets, credit ratings and management heritage, TCI contends.[200] As an example of unworkable unitary rates, TCI cites the experience of the Federal Energy Regulatory Commission which abandoned a mandatory unitary rate approach for electric utilities because regulated entities were not sufficiently homogenous.

80. Telephone companies argue that the business risks of the cable industry do not exceed the risk of providing telephone service. Bell Atlantic asserts that competition in the local telephone service market is increasing as competitive access providers, interexchange carriers and wireless companies enter the local services market. Moreover, universal service obligations force telephone companies to overprice services to their best customers, leaving this customer base particularly vulnerable to offerings from competitors, according to Bell Atlantic.[201] GTE argues that a unitary 11.25% rate for cable operators is appropriate to ensure regulatory parity between cable operators and telephone companies.[202]

C. Discussion

81. We continue to believe that an 11.25% rate of return for the provision of regulated cable service is within the zone of reasonableness and we are supported in that

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[197] Cablevision Petition at 13, n.11.

[198] NCTA Reply Comments at 14.

[199] Comcast Reply Comments at 8-9.

[200] TCI Comments at 36-38.

[201] Bell Atlantic Comments at 3-4; USTA Comments at 5-6.

[202] GTE Comments at 8.

conclusion by the fact that in individual cost of service filings a large number of operators did not attempt to overcome the presumptive reasonableness of that rate. The presumptive unitary rate sets a rate of return in a manner that minimizes the administrative burdens of determining the various components of the rate of return calculation for individualized operators. In light of these significant administrative benefits and the Commission's institutional experience with the presumptive 11.25% rate, we will retain the 11.25% figure as an option that operators may use in recovering capital costs. If the operator believes that this rate fails to provide adequate compensation for genuine capital costs, the operator may seek to overcome the presumption consistent with the approach set forth in the initial *Cost Order*.

82. We recognize, however, that reliance on a unitary rate of return does not offer a precise estimation of capital costs for every operator making a cost of service filings. For this reason, we are adopting in this item a Further Notice of Proposed Rulemaking to explore alternatives to a unitary rate of return. As set forth in the Further Notice of Proposed Rulemaking, *infra* at para. 194, the Commission, in an effort to design a rate of return formula that adjusts more accurately to the individual capital market circumstances of various operators, proposes to establish an alternative methodology for setting an operator's rate of return. This alternative approach stems from comments that have argued that the appropriate return for individual operators will vary from the 11.25% rate. We will therefore address the comments in the context of the proposal set forth in the further notice of proposed rulemaking in Section XVII, *infra*. Although some commenters have provided documentation to support alternative methods of setting the rate of return, we will nevertheless seek additional comment to solicit a broader range of input and to address additional questions that arise when alternative methodologies are considered.

VIII. DEPRECIATION

A. Background

83. In adopting the interim rules, we declined to prescribe any specific depreciation rates or schedules to be used in determining a cable operator's allowable ratebase.[203] Instead, we decided that the reasonableness of depreciation rates claimed by operators would be subject to case-by-case review.[204] At the time, we observed that there was no record evidence that "operators' use of depreciation methodologies or rates has been abusive or even questionable."[205] Thus, we concluded that the imposition of a specific depreciation methodology "would impose unjustified burdens without providing a balancing

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[203] *Cost Order*, 9 FCC Rcd at 4603.

[204] *Id.* at 4603-04.

[205] *Id.* at 4603, n. 282.

benefit to subscribers."[206] We left open the possibility of revisiting the issue after having had an opportunity to monitor industry practices,[207] and sought comment on whether to adopt the interim treatment of depreciation as part of our final cost rules.[208]

B. Comments

84. Most of the comments we received concerning depreciation schedules come from telephone companies. However, these commenters do not oppose the interim depreciation rule adopted for cable operators; rather, they argue that in a separate docket the Commission should eliminate the specific depreciation schedules that are currently applicable to telephone companies.[209] BellSouth argues that depreciation "is an area where regulatory parity between cable television and telephone companies is critical."[210] Bell Atlantic suggests that maintenance of such schedules in either the telephone or cable context "departs from the economically correct result," yet urges us to impose such schedules upon cable operators if they continue to be a part of our common carrier rules.[211]

85. The comments of cable interests are largely silent on the specific issue of depreciation schedules, although cable operators generally urge the Commission not to pursue the goal of "regulatory parity." Fred Williamson & Associates ("Williamson") urge the adoption of deprecation schedules to prevent abuses and suggest that a range of useful life periods should provide flexibility needed to address the circumstances of individual operators.[212]

C. Discussion

86. The telephone companies do not argue that regulatory parity is of particular importance when it comes to depreciation. They offer no specific suggestions as to the depreciation methods that should be employed if we decide to adopt some type of depreciation scheme. Rather, the telephone companies simply include depreciation as one of the general areas in which, they contend, parity is required. By the same token, the cable

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[206] *Id.* at 4603.

[207] *Id.*

[208] *Id.* at 4681.

[209] Bell Atlantic Petition at 4-5; GTE Comments at 3-4; BellSouth Comments at 8-9.

[210] BellSouth Comments at 9.

[211] Bell Atlantic Petition at 5.

[212] Williamson Comments, Attachment A at 2.

industry is largely silent concerning depreciation, except to argue that the idea of parity, by itself, does not justify the adoption of depreciation schedules. For example, cable operators offer no analysis of the impact of adopting depreciation schedules and provide no basis on which we can conclude that one method of depreciation is superior to another.

87. The applicability of specific regulatory schemes and policies to telephone companies does not compel their application to cable operators. We indicated in the *Further Notice* that industry practices with respect to depreciation would shape our ultimate resolution of the issue. Since release of the *Further Notice*, we have had the opportunity to review numerous cost of service filings. As described below, these filings demonstrate that some operators often do not follow any industry standards or other specific guidelines in establishing the useful lives of their assets for purposes of depreciation, or with respect to other aspects of their cost of service filings. As a result, the claimed useful life of a particular asset category can vary significantly among cable operators, even though they all use the same type of equipment and hence should be claiming roughly the same useful life in most instances. Some variation in the claimed useful lives is to be expected since, for example, management plans to replace equipment affect its useful life and will vary among operators. Thus, when we adopted the interim rules with respect to depreciation, we expressly provided for case-by-case review of filings. However, we neither intended nor expected the substantial variations that the Form 1220s reveal. Our experience since adoption of the *Cost Order* now convinces us that the benefits of standardizing the useful lives of assets underlying depreciation rates outweigh any resulting burdens.

88. The absence of specific standards or guidelines with respect to useful lives creates uncertainty for operators and regulators alike and, at the local level, creates the risk of inconsistent treatment of similarly situated operators, given the varying practices of the operators and the discretion given to franchising authorities. These factors necessitate heightened scrutiny of cost of service cases before the Commission, as our staff endeavors to ensure that the rates charged for regulated services are the product of reasonable estimations of useful lives. To provide for consistent treatment of these issues and to ease burdens on operators and regulators, we believe it prudent to establish some certainty and uniformity with respect to several issues.

89. *Depreciation schedules*. A staff survey of cost of service filings reveals significant disparities in the useful lives claimed by cable operators with respect to specific assets.[213] Although for each particular asset category there are a substantial number of filers claiming useful lives within a relatively small range, there are also a significant number of outliers whose claimed useful lives appear to be inappropriate. With respect to headends, for example, 22% of filers claimed a useful life of between seven and nine years while 18% claimed between 15 and 16 years. For transmission facilities, 33% of filers set the useful life at five to six years, while 23% claimed lives of between 15 and 16 years. Numerous

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[213] *See* Appendix B.

additional examples of such disparities are set forth in Appendix B.

90. The variations in the useful lives of various assets, as claimed by cable operators, are due in part to the absence of depreciation schedules in the interim cost rules, which forces operators to establish the useful lives of their assets on some other basis. Thus, it appears that operators do not have a great deal of specific guidance from any source in this regard, resulting in the variations described above and in Appendix B.

91. Local franchising authorities face a similar lack of guidance when they attempt to determine the reasonableness of the useful lives that their cable operators claim. And the Commission staff that reviews the cost of service filings, in an effort to ensure equal treatment of similarly situated cable operators, must attempt to reconcile the substantial differences reflected in the individual filings.

92. To eliminate the uncertainty described above, and to facilitate more uniform depreciation practice for use in computing rates for regulated cable services, we will adopt a flexible range of useful lives for use by cable operators seeking to justify depreciation rates in cost of service filings. Appendix B describes the method by which the depreciation schedules have been calculated. In general, we have used the data available from these filings to develop a range of years defining the useful life of each of the relevant asset categories identified in Section C, Item 9 of Form 1220, as follows:

Category	Useful life (years)
a. Headend	8-13
b. Transmission Facilities and Equipment	6-14
c. Distribution Facilities	10-15
d. Circuit Equipment	7-14
e. Maintenance Facilities	17-35
f. Maintenance Vehicles and Equipment	3-7
g. Buildings	18-33
h. Office Furniture and Equipment	9-11

93. As described more particularly in Appendix B, these figures are derived from 600 cost of service filings. Such filings, including the depreciation data, are required to be made in accordance with generally accepted accounting principles ("GAAP"). GAAP does not dictate specific useful lives, but rather provides general guidelines. Thus, the useful lives

reported on the cost-of service filings reflect, to some extent, the subjective judgments of the operators making the filings. To the extent certain aspects of particular filings raise concerns, we have made adjustments accordingly, as described in Appendix B. For example, we excluded from the observation pool as facially unreasonable the filings of a number of systems that claimed a useful life of one year for all of their assets.

94. Having made such adjustments, staff arrived at an average useful life for each asset category.[214] Staff then established a range, by taking one standard deviation from the average useful life for each asset category. Each end of the range was then rounded to the nearest whole number. We have chosen a range of years, rather than dictating the use of a unitary figure, to provide operators with flexibility in determining depreciation rates for their particular systems, although still within reasonable bounds. By prescribing a range of years, we will permit operators to take into account factors that reflect characteristics of their individual systems. For example, the useful life of a cable distribution system might vary depending upon the presence and nature of a competing multichannel video programming distributor ("MVPD"). Depending upon whether the competing MVPD offers interactivity and other advanced features, the cable operator reasonably might determine that these factors will alter the obsolescence, and hence change the depreciation period, of the operator's assets that do have such features. Thus, while the ranges we have prescribed will provide for more consistent depreciation practices between cable operators, we do not believe it is necessary or prudent to deprive cable operators of all discretion to judge the appropriate useful life of their own property. However, operators seeking to establish useful lives that fall outside the prescribed ranges will have to justify such claims on a case-by-case basis.

95. Given the number of filings, the requirements of GAAP, the ability of operators to adjust for their individual circumstances, and the refinements and adjustments made by the staff, we are confident that the survey captures a representative sampling of data and produces a fair and reasonable range of years for each asset category.

96. For any asset category, we will presume the reasonableness of the useful life claimed by an operator if it falls within the range prescribed above. An operator may seek to depreciate assets over a period of time other than that which we have prescribed, but in that case the operator will have the burden of establishing the reasonableness of the period it has chosen. Thus, while furthering the goals of certainty and uniformity in the area of depreciation rates, our approach will be flexible enough to account for those unique circumstances in which an operator can demonstrate the reasonableness of a rate that falls outside of the prescribed range.

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[214] This averaging process included the claims of some operators reporting useful lives that, while not facially unreasonable, were at the extremes. However, the impact of these outlier claims is, at it should be, minimal, given the substantial number of operators claiming a useful life within a relatively small range for each asset category.

97. In addition, we will require the operator to depreciate its assets in accordance with the straight-line methodology. Our review of the Form 1220s on file with the Commission suggests that some operators are using accelerated depreciation methodologies to increase the amount of their depreciation expense and thus to increase rates. While there are contexts in which accelerated deprecation is a legitimate practice, we have been presented with insufficient justification to show that it would be appropriate for purposes of establishing rates under our cable cost of service rules.

98. *Test-year data.* Our cost of service rules establish a maximum permitted rate based on the operator's costs and ratebase as established during the test year, which is the operator's most recent fiscal year.[215] In some instances, an operator will be able to time the filing of its 1220 such that the test year will be one in which unusually high depreciation write-offs were taken. Higher depreciation expenses translate into higher permitted rates, since rates must cover expenses. Thus, to the extent the operator can control the timing of its filing, it can justify rates that are higher than would be permitted were the operator to use data from a more representative 12 month period. The staff review of the Form 1220s suggests that some operators are pursuing precisely this strategy and thus artificially inflating rates.

99. Our new rules prescribing depreciation schedules and requiring straight-line depreciation should help to curb this practice. Where it nevertheless appears that the test-year data include unreasonably high depreciation write-offs, the operator should determine the extent to which the depreciation claimed for the test year exceeds normal depreciation and exclude the excess from the ratebase.

100. *Relevance of Franchise Life in Defining Useful Life of Assets.* The cost of service filings indicate that operators often claim that the useful life of cable system assets cannot exceed the term of the cable franchise, based on the proposition that the termination of the franchise renders the assets useless. However, this presumes that operators generally are unsuccessful at renewing the franchise, a premise for which there is no evidence and which conflicts with the general experience of the industry. Even in the event of a non-renewal, the operator might sell its asset to the new cable franchisee and thereby realize the value associated with its actual remaining life. For these reasons, we will presume that the term of the franchise is not relevant for purposes of determining the useful life of cable system assets, again subject to rebuttal by the operator if it can show, for example, some threat that its franchise will not be renewed and that in the event of non-renewal the operator will not be able to recover the value of its assets.

IX. TAXES

A. Background

[215] 47 C.F.R. § 76.922(g).

101. In the *Cost Order*, we provided for the recovery of income taxes as an expense incurred by operators as a consequence of providing regulated cable services. We provided that Chapter C corporations would be allowed to include as an annual expense all taxes on the provision of regulated services. For other entities such as Subchapter S corporations, partnerships and sole proprietors, we allowed an expense for taxes after an adjustment for amounts distributed by such entities to the individual owners of the operating enterprises. This approach comports with the principle that taxes related to the provision of regulated service may be recovered from subscribers, but taxes on dividends paid to owners may not be recovered from subscribers.[216]

B. Comments

102. Continental argues that, consistent with traditional utility ratemaking theory, the capital structure used to calculate the amount of the tax gross up should be consistent with the structure assumed in the calculation of the allowed rate of return. If, for example, a 50% hypothetical capital structure is used to set the rate of return, a similar structure should be presumed in estimating the equity portion subject to the tax gross up. In the alternative, Continental would support calculation of the tax allowance based on system-specific capital structures and define equity as the actual equity infusions received by the operators over the course of their operations.[217]

103. Continental also challenges the *Cost Order's* approach to the calculation of the income base subject to the gross up. Continental argues that the Commission should not adjust the income base by distributions to owners because such distributions cannot be presumed as corporate income. A portion, if not all, of the distribution, for example, may be devoted to tax liabilities of the owner.[218] In any event, Continental challenges the presumption that a distribution to the owner of a non-Chapter C corporation is a distribution of income earned by the operating entity.

C. Discussion

104. We agree that use of an actual capital structure is the appropriate method of estimating the equity portion subject to tax recovery if actual capital structure is used to establish the rate of return. Reliance on the actual capital structure in such cases would ensure that the method of calculating an operator's tax liability is consistent with capital structure assumptions used to estimate the allowed rate of return. Accordingly, if we adopt the proposed alternative to use actual capital structures when calculating the rate of return, we will rely on actual capital structures derived from the rate of return analysis to

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[216] *Cost Order*, 9 FCC Rcd at 4607, n. 296.

[217] Continental Comments at 36-37.

[218] Continental Comments at 41-42.

determine the amount of tax recovery for operators using the alternative to the presumptive 11.25 percent rate. When hypothetical capital structures are used to set the rate of return, however, we will employ the same capital structures to determine the equity portion of total capital subject to income tax recovery. Because the presumptive rate of return relies on a hypothetical debt range of 40 to 70 percent of capital, we will use the average of that range, or 55 percent, as the hypothetical debt proportion. This approach also ensures consistency between the method of calculating return on equity and the tax obligations flowing from that calculation.

105. With respect to distributions to individual owners of non-Chapter C entities, we will continue to adjust the income calculation for estimating allowed taxes. We recognize that entities other than Chapter C corporations may pass through income directly to the individual owners and that this income may have been derived from the provision of regulated cable services. Nevertheless, we will adhere to the traditional principle of adjusting the income tax amount to ensure that ratepayers do not pay the taxes of individuals who are structurally separate from the entity providing the regulated service. Because income and deductions from cable operations would be combined with income and deductions for activities unrelated to cable operations, the tax recovery built into cable rates may bear little if any relationship to actual tax liabilities incurred by the owner of the non-Chapter C operator. Rather than engage in a review of the tax impact of other non-cable businesses conducted by the owner of the non-Chapter C entity, we will limit recovery of taxes in such cases by the adjustment mechanism described above.

X. COST ALLOCATION

A. Background

106. In the *Rate Order*, we established cost allocation rules which apply to regulated cable operators that elect cost of service regulation, as well as to operators that seek to adjust their rates to reflect changes in external costs. In general, the rules require operators that aggregate their expenses and revenues at a level other than at the franchise level (e.g., system or regional) to allocate expenses and revenues to the franchise level.[219] The cost allocation to the franchise level is to be calculated using the ratio of the total number of subscribers served in the franchise area to the total number of subscribers served in the larger area.[220] At the franchise level, the rules generally require that costs identified at or allocated to the franchise level must be allocated amongst the BST and each CPST using the ratio of channels on each tier to the total number of channels offered in the franchise area.[221]

[219] *See Rate Order*, 8 FCC Rcd at 5973-76.

[220] *Rate Order*, 8 FCC Rcd at 4645.

[221] *Id.* at 4646.

107. The rules established by the *Rate Order* also require direct allocation of programming and retransmission consent fees to the tier upon which the programming is offered.[222] Franchise fee costs must be allocated among program service tiers in a manner that is most consistent with the methodology of assessment of franchise fees by local franchising authorities.[223] In addition, costs associated with public, educational and governmental ("PEG") access must be directly assigned to the basic tier whenever possible.[224]

108. Finally, the *Rate Order* required common costs that are not directly assigned to be allocated based on direct analysis of the origin of the costs.[225] When direct analysis was not possible, common costs were to be allocated to service cost categories based on an indirect, cost-causative linkage to other costs that are directly assigned or allocated to the service cost category.[226] When neither direct or indirect measures of cost allocation could be found, costs are to be allocated to each service cost category based on the ratio of all other costs directly assigned and attributed to the category over the total of all costs directly assigned and allocated by direct analysis and by indirect linkage.[227]

109. In the *Cost Notice*, we proposed five service cost categories that cable operators would be required to use when allocating costs: BST activities, CPST activities, other cable programming services activities, other cable activities, and non-cable activities.[228] We proposed that all costs be directly assigned whenever possible. The *Cost Notice* also sought comment on whether different cost allocation rules should be adopted for cost allocation between regulated cable service and unregulated activities.[229]

110. In the *Cost Order*, we determined that allocation of costs to non-regulated service categories is necessary to ensure that allocations to regulated services are fair

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222 *See* 47 C.F.R. § 76.924(f)(2).

223 *See* 47 C.F.R. § 76.924(f)(3).

224 *See* 47 C.F.R. § 76.924(f)(4). Furthermore, 47 C.F.R. § 76.924(f)(5) requires Commission regulatory fees to be directly assigned to the BST. *See Fourth Order on Reconsideration*, MM Docket 92-266, FCC 94-254, 9 FCC Rcd 5795 (1994).

225 *See Rate Order* at 5976.

226 *Id.*

227 *Id.*

228 *Notice*, Appendix A at 4-6.

229 *Id.* at ¶ 59.

and reasonable.[230] Accordingly, the *Cost Order* amended the rules to require that in addition to the BST and each CPST, costs must also be allocated to non-regulated programming service activities, other cable activities, and non-cable activities.[231] As proposed in the *Notice*, the *Cost Order* established five service cost categories that cable operators are required to use when allocating costs for cost of service showings and for allocating external costs: BST activities, CPST activities, other cable activities, and non-cable activities.[232] These cost allocations take place after revenues and costs are initially identified at the appropriate organizational level. The *Cost Order* requires that the BST and CPST cost categories include only the allowable costs as defined under Section 76.922(g) through (k) of our rules.[233]

111. The *Cost Order* also mandates that, to the extent possible, all costs must be directly assigned amongst the equipment basket and service cost categories.[234] In so doing, we found that direct assignment was preferable to a standard allocator because direct assignment more accurately reflects cost causality. For costs that cannot be directly assigned, the *Cost Order* requires operators to assign such costs amongst the service cost categories and the equipment basket using methodologies consistent with Section 76.924(f)(7) of our rules.[235] These rules require the operator to first attempt to allocate such costs through direct analysis of the origin of the costs. In addition, the *Cost Order* requires that where such direct analysis is not possible, operators must attempt to establish cost causative linkage to other costs directly assigned or allocated by direct analysis.[236] Where no direct or indirect linkage can be made, the *Cost Order* requires operators to allocate on the basis of the totals of all costs directly assigned and allocated using direct analysis or indirect linkage.[237] The Commission declined to adopt specific allocators or rigid allocation schemes, stating that local franchising authorities and the Commission would review the allocators proposed by cable operators on a case-by-case basis.[238]

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[230] *Cost Order* at 4650.

[231] *Cost Order* at 4650; 47 C.F.R. § 76.924(e).

[232] *Id.*

[233] *Id.* at 4652.

[234] *Id.* at 4653.

[235] *Id.* at 4653-54.

[236] *Id.* at n. 476.

[237] *Id.*

[238] *Id.* at 4654.

112. After costs have been directly assigned to and allocated among the service cost categories and the equipment basket, the *Cost Order* amended the rules to specify the particular procedures for allocations to the franchise level for operators who aggregate costs at a higher level.[239] Recoverable costs that have been aggregated at the highest organizational level at which costs have been identified shall be allocated to the next lowest organizational level at which recoverable costs have been identified on the basis of the ratio of the total number of subscribers served at the lower level to the total number of subscribers served at the higher level.[240] The *Cost Order* requires this procedure to be repeated at every organizational level at which recoverable costs have been identified until all costs have been allocated to the franchise level.[241]

B. Comments

113. Time Warner argues that the cost allocation rules should not be applied to cable operators seeking external cost adjustments under the benchmark system.[242] Time Warner claims that the import of these rules in the context of the limited external cost category is very unclear and will create controversy and expensive litigation.[243] Time Warner recommends that the Commission clarify that all external costs are to be directly assigned and otherwise abandon cost allocation rules beyond the requirements of GAAP.[244]

114. Time Warner claims that the Commission does not have jurisdiction to require cable operators to allocate costs for pay-per-channel and pay-per-program offerings, billing and collection services, studio and nonregulated equipment engineering and rental services and sale and maintenance of nonregulated equipment to the three nonregulated service cost categories: other cable programming activities, other cable activities and non-cable activities.[245] Time Warner states that it is neither necessary nor lawful to allocate nonregulated costs to various nonregulated service categories in order to ensure that allocation of costs to regulated services is fair and reasonable in relation to the allocation of costs to

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239 *Id.*

240 *Id*; *see also* 47 C.F.R. § 76.922(g)(1).

241 *Cost Order*, 9 FCC Rcd at 4655; *see also* 47 C.F.R. § 76.924(g).

242 Time Warner Comments at 16-17.

243 *Id.* at 17.

244 *Id.*

245 *Id.* at 17-18.

nonregulated services.[246] According to Time Warner, once costs are found to be nonjurisdictional, the Commission's legal authority to track these costs is extremely limited.[247] Time Warner asserts that the Commission's joint cost rules for telephony separate costs between regulated and nonregulated activities, but do not further disaggregate purely nonregulated costs.[248]

115. Continental recommends that the Commission continue to take a flexible approach to cost allocation issues when permanent rules are adopted, provided that cable operators comply with the key principles set out in the *Cost Order*.[249] Continental also states that it would greatly improve the operator's ability to assess the reasonableness of their rates under cost-of-service principles if the Commission indicated in advance that one or more approaches to allocating costs are reasonable.[250] Continental contends that one key issue is how to allocate the costs of cable plant, and related maintenance and depreciation costs, among service baskets.[251] Continental recommends that the Commission specify that one acceptable method of allocation is "weighted channels," with weighting performed on the basis of the number of households subscribing to the service at issue.[252] According to Continental, this approach represents a fair middle ground between the strict "cost causation" approach and a simplistic capacity-based allocation that takes no account of the usage.[253]

116. Similarly, Avenue TV argues that operator costs should be more heavily weighted toward the BST because (1) BST channels are more valuable and are required under must-carry; (2) CPST service could not be offered without the BST; and (3) most of Avenue TV's costs are necessary to provide BST service.[254]

117. Continental urges that advertising revenues be assigned to the nonregulated "Other Cable Activities" category because (1) cable operators are under no

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[246] *Id.* at 18.

[247] *Id.*

[248] *Id.* at 18-19.

[249] Continental Comments at 26.

[250] *Id.*

[251] *Id.* at 27.

[252] *Id.*

[253] *Id.* at 27-28.

[254] Avenue TV Reply Comments at 14.

obligation to carry advertising of their own (as opposed to advertising contained in broadcast signals obtained from others); (2) cable-specific advertising represents an improved customer service, because advertisers are better able to reflect the likely interests and needs of cable subscribers with cable-specific advertising; and (3) cable operators provide this service to consumers and advertisers because it is profitable to do so (if the sole reason for providing advertising were to lower rates, then operators would have no incentive to continue providing this service).[255]

118. Continental also recommends that revenues received from home shopping services on regulated tiers be allocated to the nonregulated "Other Cable Activities" category because if the effect of using a valuable slot for a home shopping service is to reduce the cable operator's regulated rates from the level that would result if some other service were offered, that would create a regulatory disincentive to carrying home shopping service.[256]

C. Discussion

119. While our current rules require direct assignment of costs, the rules also allow for operator flexibility in determining specific allocators and allocation schemes. Accordingly, we affirm our current cost allocation requirements set forth in the *Cost Order*, as amended, with the exception of our rule which requires cost allocation of non regulated costs to specific non regulated service categories, which we remove by this *Order*.[257] We also take this opportunity to clarify that, within our current cost allocation methods which we affirm today, revenues must be matched with underlying expenses between related lines on FCC Form 1220, and that allocators need to be consistent. For example, advertising expenses on line 33 of FCC Form 1220 and advertising revenues on line 51 of Form 1220 should be allocated similarly. We find that accuracy is sacrificed if operators are not consistent with their use of allocators between related lines on FCC Form 1220 (i.e., differing methods are used between the revenue and expense sides of the same category), and are not consistent with their use of allocators between forms such as the 1205 and 1220.

120. The general propositions upon which we continue to base our cost allocation requirements are as follows: (1) costs shall be directly assigned among the equipment basket and service cost categories whenever possible; (2) costs that cannot be directly assigned and which no allocator has been specified by the Commission are to be allocated based on direct analysis of the origin of the costs, and where allocation based on direct analysis is not possible, operators must attempt to make a cost causative linkage to other costs directly assigned or allocated to the service cost categories and the equipment

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[255] *Id.* at 32-33.

[256] *Id.* at 33-34.

[257] *See* 47 C.F.R. § 76.924(e)(1)(iii),(iv),and (v); § 76.924(e)(2)(iii),(iv),and (v).

basket; and (3) for costs that cannot be directly assigned and for which no indirect measures of cost allocation can be found, such costs shall be allocated to each service cost category based on the ratio of all other costs directly assigned and attributed to a service cost category over total costs directly or indirectly assigned and directly or indirectly attributable.[258]

121. We agree with Time Warner that the Commission should not require cost allocation of non-regulated costs to specific non-regulated service categories. While the requirement may in some limited instances enable us to more readily ascertain the bases for cost allocations to regulated categories, we believe that it would be overly burdensome to continue to include this requirement in our rules. Therefore, we amend our rules to remove the requirement that non-regulated costs must be allocated among the non-regulated programming service categories, other cable activities, and non-cable activities categories, and replace these categories with a single "all other" service cost category.[259] Accordingly, operators electing cost of service regulation and cable operators seeking an adjustment to external costs shall allocate costs among the equipment basket and the following service cost categories: (1) BST, (2) CPST, and (3) all other. The "all other" service cost category shall include all costs not included in the BST or CPST service cost categories. We find that so long as the "all other" service cost category reflects both direct and indirect assignments to regulated categories, we need not require that costs be allocated amongst the non-regulated categories. As with other aspects of our cost rules, however, our rules regarding allocation of costs associated with services not subject to cable rate regulation are likely to be revisited in the near future in light of developing circumstances, including in particular the convergence of the telephone and cable industries.

122. We concur with Time Warner that external costs should continue to be directly assigned to the extent practicable. We disagree that we should otherwise abandon our rules in favor of GAAP, inasmuch as we believe that our current rules are already in conformance with GAAP. Our external cost category consists of retransmission consent fees, programming costs, cable specific taxes, franchise related costs, franchise fees and Commission regulatory fees.[260] Our rules specify that retransmission consent fees and programming costs are to be directly assigned to the tier upon which they are associated.[261] Likewise, Commission regulatory fees are to be directly assigned to the basic tier because these fees are assessed on a per subscriber basis and all subscribers receive the basic tier.[262] Finally, our rules require that PEG related franchise costs be assigned directly to the basic tier

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[258] 47 C.F.R. § 76.924(f).

[259] *See* 47 C.F.R. § 76.924(e).

[260] 47 C.F.R. § 76.924 (f).

[261] *Id.*

[262] *Id.*