DOCKET FILE COPY ORIGINAL

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection And Competition Act of 1992	)	MM Docket 92-266
	)	
Rate Regulation	)	
	)	
	)	
In the Matter of	)	CS Docket 96-157
	)	
Cable Pricing Flexibility	)	
	)	
	)	
	)	

MEMORANDUM OPINION AND ORDER AND NOTICE OF PROPOSED RULEMAKING

Adopted: July 25, 1996 Released: August 15, 1996

By the Commission:

Comment Date: October 6, 1996
Reply Comment Date: November 8, 1996

Table of Contents

Paragraph

I. INTRODUCTION
- A. Background 2
- B. Summary 6

II. ORDER 8

III. NOTICE OF PROPOSED RULEMAKING
- A. Background 13
- B. Discussion 14

IV. REGULATORY FLEXIBILITY ANALYSIS 26
V. INITIAL PAPERWORK REDUCTION ACT OF 1995 ANALYSIS 50
VI. PROCEDURAL PROVISIONS 51
VII. ORDERING CLAUSES 53

Appendix A: Rule Changes

I. INTRODUCTION

1. In this Memorandum Opinion and Order and Notice of Proposed Rulemaking ("*Order*" or "*Notice*"), we combine two proceedings to address issues related to the pricing of different tiers of regulated service relative to other tiers of regulated service offered on the same system. In the *Order*, we address the requirement that operators use the same ratemaking methodology for all tiers of service. In the *Notice*, we propose to allow a rate-regulated operator increased flexibility with respect to the pricing of tiers, once the maximum combined rate for all tiers has been established in accordance with our existing rules.

A. Background

2. Under the Cable Television Consumer Protection and Competition Act of 1992 (the "1992 Cable Act"),[1] the Commission is required to ensure that rates charged for regulated cable services are not unreasonable.[2] Our rate regulations apply only to cable systems that do not face effective competition in their franchise area.[3] A regulated system must comply with our rules governing the rates for programming offered on the basic service tier ("BST") or on the cable programming services tier ("CPST").[4] The BST, which all subscribers must purchase in order to have access to any other tier of programming, consists generally of all of the local broadcast television stations carried by the system as well as all public, educational, and governmental ("PEG") access channels that the system is required to provide to

---

[1] 1992 Cable Act, Pub. L. No. 102-385, 106 Stat. 1460 (1992). The 1992 Cable Act amends Title 6 of the Communications Act, as amended, 47 U.S.C. § 521 et seq. ("Communications Act").

[2] Communications Act, §§ 623 (a),(b)(c), 47 U.S.C. §§ 543(a),(b),(c).

[3] Communications Act, § 623(a)(2), 47 U.S.C. § 543(a)(2). In 1996, Congress amended the 1992 Cable Act to exempt small cable operators from rate regulation with respect to the cable programming service tier ("CPST"), and with respect to the basic service tier ("BST") if the BST was the only service tier subject to rate regulation as of December 31, 1994, in franchise areas where a small cable operator serves fewer than 50,000 subscribers. This exemption applies even if the cable system is not subject to effective competition. A small cable operator is defined as an operator that, directly or through an affiliate, serves in the aggregate fewer than one percent of all subscribers in the United States and is not affiliated with any entity or entities with aggregate gross annual revenues in excess of $250,000,000. Telecommunications Act of 1996 ("1996 Act"), Pub. L. No. 104-104, 110 Stat. 56 (1996), Section 302(c), 47 U.S.C. § 543(m).

[4] Communications Act, §§ 623 (a),(b),(c), 47 U.S.C. §§ 543(a),(b),(c).

subscribers under the terms of its local franchise.[5] In addition, a cable operator may add additional channels of programming to the BST.[6] The CPST includes any tier of programming other than the BST.[7] An operator is not required to offer a CPST, or it can create multiple CPSTs if it desires. Programming offered on a per channel or per program basis is not rate-regulated.[8]

3. Congress imposed rate regulation on cable systems not subject to effective competition based upon its findings that rates for cable service had risen significantly between 1984 and 1992.[9] Although directing the Commission to protect consumer interests,[10] Congress sought to "rely on the marketplace, to the maximum extent feasible . . . ."[11] The Commission has adhered to these policies in the course of developing regulations.[12] Under our rules, most regulated systems establish rates using one of two methodologies. Our primary approach to rate regulation is known as the benchmark method. Under this method an operator establishes its rates in accordance with our analysis of the differences in rates, prior to rate regulation, between systems facing competition and those not facing competition.[13] Alternatively, an operator may seek to establish rates based on an individualized cost-of-service showing.[14] The cost-of-service rules permit an operator to set rates based on the actual cost of providing regulated cable service and are intended primarily for high-cost systems that may not be able to charge compensatory rates using the benchmark approach. Using either method, the cable operator calculates a permitted per channel charge that is multiplied by the number of

---

[5] Communications Act, § 623(b)(7)(A), 47 U.S.C. § 543(b)(7)(A).

[6] Communications Act, § 623(b)(7)(B), 47 U.S.C. § 543(b)(7)(B).

[7] Communications Act, § 623(l)(2), 47 U.S.C. § 543(l)(2).

[8] *Id.*; Communications Act, § 623(a)(2), 47 U.S.C. § 543(a)(2).

[9] 1992 Cable Act, § 2(a)(1).

[10] *Id.*, § 2(b)(4).

[11] *Id.*, § 2(b)(2).

[12] Our pricing methods are described in a series of orders. *See, e.g.*, Report and Order and Further Notice of Proposed Rulemaking in MM Docket No. 92-266, FCC 93-177, 8 FCC Rcd 5631 (1993) ("*Rate Order*"); Second Order on Reconsideration, Fourth Report and Order and Fifth Notice of Proposed Rulemaking in MM Docket No. 92-266, FCC 94-38, 9 FCC Rcd 4119 (1994) ("*Second Reconsideration Order*"); Report and Order and Further Notice of Proposed Rulemaking in MM Docket No. 93-215 and CS Docket No. 94-28, FCC 94-39, 9 FCC Rcd 4527 (1994) ("*Interim Cost Order*"); and Second Report and Order, First Order on Reconsideration, and Further Notice of Proposed Rulemaking in MM Docket No. 93-215 and CS Docket No. 94-28, FCC 95-502 (rel. January 26, 1996) ("*Final Cost Order*").

[13] *See Second Reconsideration Order*, 9 FCC Rcd at 4160-69.

[14] *See, generally, Final Cost Order.*

channels on the tier to establish the maximum permitted charge for that tier.[15] After establishing initial rates for regulated services, operators may adjust those rates to account for changes attributable to inflation, channel additions and deletions, and other circumstances affecting the operator's cost of providing regulated cable service.[16]

4. In the Third Report and Order in MM Docket No. 92-266, FCC 93-519 ("*Third Report and Order*") we determined that operators must use the same rate-setting method for all tiers.[17] This requirement applies for one year from the date an operator first becomes subject to rate regulation on either the BST or a CPST. We established this requirement because, in some circumstances, using the benchmark approach for one tier and the cost-of-service approach for another tier could result in a double recovery of costs by the cable operator.[18]

5. The regulatory review process for BST rates is separate from the review process for CPST rates. Regulation of rates for BSTs is the responsibility of certified local franchising authorities ("LFAs"), pursuant to standards and procedures established by the Commission.[19] An operator may appeal an LFA's rate decision to the Commission.[20] CPST rates are regulated directly by the Commission upon receipt by the Commission of a valid complaint from an LFA.[21]

B. Summary

---

[15] 47 C.F.R. § 76.922(a).

[16] *See* Sixth Order on Reconsideration, Fifth Report and Order, and Seventh Notice of Proposed Rulemaking in MM Docket Nos. 92-266 and 93-215, FCC 94-286, 10 FCC Rcd 1226 (1994) ("*Going Forward Order*"). The preceding paragraphs summarize our standard approaches to cable rate regulation. We have established separate rate-setting methodologies for certain smaller systems which, because of their size, face proportionately higher costs of providing cable service. *See* Sixth Report and Order and Eleventh Order on Reconsideration in MM Docket Nos. 92-266 and 93-215, FCC 95-196, 10 FCC Rcd 7393 (1995). As noted, under the 1996 Act certain smaller systems are now deregulated with respect to their CPST and, in some instances, with respect to their BST. 1996 Act, Section 302(c), 47 U.S.C. § 623(m). *See* Order and Notice of Proposed Rulemaking in CS Docket No. 96-85, FCC 96-154 (rel. April 9, 1996).

[17] 8 FCC Rcd 8444, 8446 (1993).

[18] *Id.* at 8446.

[19] 47 U.S.C. 543(a)(2)(A). Under certain circumstances, the Commission will regulate BST rates directly. 47 C.F.R. § 76.913.

[20] 47 C.F.R. § 76.944(a).

[21] 47 U.S.C. 543(c)(1)(B). Previous to the 1996 Act, the Commission received CPST complaints directly from subscribers, and other state and local entities, as well as from LFAs.

6. In the *Order*, we revisit our decision in the *Third Report and Order* to require cable operators to use the same method of initial rate regulation, either benchmark or cost-of-service, for both the BST and the CPSTs. This requirement applies for one year from the date that the operator first becomes subject to regulation on any tier. The *Third Report and Order* sought to remove incentives to engage in retiering strategies during the initial rate setting process that would result in operators receiving more than compensatory rates. We indicated that we would review the requirement after 18 months.[22] Upon review of the record before us, we modify the requirement set forth in the *Third Report and Order* so that consistent rate methodologies must be used for the entire period in which an operator is subject to rate regulation on both the BST and CPST(s).

7. In the *Notice*, we seek comment on a new proposal to modify our current ratemaking rules in order to allow operators greater flexibility in pricing their regulated tiers of cable service while continuing to protect subscribers from unreasonable rates. Specifically, we propose to permit a cable operator that has established rates for its regulated service tiers to decrease the rate for its BST, and then take a corresponding increase in the rate for its CPSTs, as long as the combined rate for the two tiers does not generate revenues for the operator that exceed what would otherwise be permitted under our rules. We tentatively conclude that this proposal would remove an unnecessary restriction on an operator's pricing strategy, while maintaining effective constraints on the overall rates paid by subscribers, thus resulting in pricing which more nearly simulates that of a competitive market.

II. ORDER

8. On November 30, 1993, we issued the *Third Report and Order* in response to several parties that had pointed out that the *Rate Order* did not explicitly state that an operator would be required to use the same method of initial rate regulation for all regulated tiers. In the *Rate Order*, we established the benchmark formula as the primary means of setting rates for cable services. Cost of service showings were permitted as an alternative way to justify rates if actual costs would result in a rate above the benchmark formula rate.

9. As we explained in the *Third Report and Order*, without the tier consistency requirement:

> an operator could retier its services and place its most expensive programming on the tier regulated by a cost-of-service determination. The operator would then be allowed to charge a per channel rate for the low cost tier based on the benchmark (which is an averaged rate) that actually exceeds its cost for that tier (and, thus, the rate it would be able to charge under a cost-

[22] Continental Cablevision, Inc. has withdrawn its petition for reconsideration of the Third Report and Order (received July 8, 1996).

> of-service showing). At the same time, the operator may be able to charge a higher-than-benchmark rate for the other tier through a cost-of-service showing, based on its higher costs for that tier. The end result would be rates that exceed the reasonableness standard set forth in the 1992 Cable Act.[23]

10. We uphold the requirement of the *Third Report and Order* that the same methodology for determining rates on all regulated tiers shall be used in the initial rate setting process. The Commission has no reason to conclude that the concerns referred to in the preceding paragraph have dissipated. In addition, because these concerns do not dissipate one year after an operator initially becomes subject to regulation, on our own motion, we remove the provision that limits the required use of consistent methodologies to the one year period beginning on the date an operator initially becomes subject to rate regulation, and thereby extend the requirement so that consistent methodologies must be used whenever an operator has more than one tier subject to rate regulation.[24] This requirement will remain effective until such time as the Commission finds that the use of the same rate regulatory method on all rate regulated tiers is not necessary to prevent operators from charging rates above that which our rate regulations contemplate.[25] This provision effectuates our statutory mandate to protect consumers from unreasonable rates.

11. Use of the same rate regulatory method for all rate regulated tiers does not hamper an operator's ability to charge fully compensatory rates. We provide a cost of service option as an alternative to the benchmark formula for operators that believe the benchmark would not enable them to recover costs reasonably incurred in the provision of regulated cable service. As of the effective date of this Order, operators must use consistent rate regulatory methods on all rate regulated tiers whenever the operator is required to justify its rates on any rate regulated tier.

III. NOTICE OF PROPOSED RULEMAKING

A. Background

---

[23] *Third Report and Order*, 8 FCC Rcd at 8446.

[24] In light of pending petitions for reconsideration in MM Docket 92-266, the Commission retains jurisdiction to grant reconsideration on its own motion. *See* 47 U.S.C. § 405; 47 C.F.R. § 1.108; *Central Florida Enterprises v. FCC*, 598 F. 2d 37, 48, n. 51 (D.C. Cir. 1978), cert. dismissed, 441 U.S. 957 (1979); *Rebecca Radio of Marco*, 5 FCC Rcd 2913, 2914, n. 8 (1990); *see e.g. First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking*, MM Docket No. 92-266, FCC 93-372, 9 FCC Rcd 1164 (1993).

[25] We note that, under the 1996 Act, CPSTs will not be subject to rate regulation as of March 31, 1999 (1996 Act, Section 301(a)(4)).

12. As we have developed and refined our rules governing regulated cable rates, the market for video services has experienced an increase in competition from alternative providers of video programming.[26] The 1996 Act should stimulate competition further by lifting restrictions on local telephone companies providing video programming in their telephone service areas.[27] Given the increased competition faced by the cable industry, we here propose a change in our rules that would provide cable system operators with more flexibility to compete with alternative providers of video programming. In this *Notice*, we examine the current rule that prohibits a rate-regulated cable operator from justifying an increase in its CPST rate on the basis of a corresponding decrease in the BST rate. For the reasons set forth below, we tentatively conclude that eliminating this aspect of our current rules would give cable operators greater pricing flexibility to respond to their growing competition while continuing to protect consumers.

B. Discussion

13. We propose to permit an operator, once it has set its initial or adjusted rates in accordance with existing regulations, to decrease its BST rate and increase the CPST rate to offset the lost revenue on the BST. An operator wishing to use the proposed pricing methodology first would establish rates for its regulated service tiers using the same methodology for both tiers. The resulting rate for the BST would be the cap for that tier. The operator then would determine the amount by which it was willing to decrease the BST rate and calculate the total revenue loss derived from the reduction. The operator would then divide this amount by the total number of CPST subscribers in order to calculate the rate increase for the CPST.

14. The BST rate decrease would be reflected on the cable bill of every subscriber because subscription to the BST is required in order to have access to any other tier of service.[28] Because subscription to CPSTs is optional, the pool of CPST subscribers is usually smaller than the BST subscriber pool. The total loss in BST revenue, therefore, when spread over the smaller CPST subscriber base, would generate a CPST rate increase that exceeded the amount of the BST rate decrease. As a result, BST-CPST subscribers (i.e., all CPST subscribers) would see a net increase in rates. This increase should be minimal if the operator has a high penetration rate on the CPST.[29] Industry data available to us indicate that, for the

---

[26] *See* Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, CS Docket No. 94-48 (rel. December 11, 1995).

[27] 1996 Act, § 302(b)(1) (repealing former Communications Act § 613(b), 47 U.S.C. § 533(b)).

[28] *See supra* at para. 2 and n. 5.

[29] For any particular tier, the "penetration rate" refers to the percentage of eligible customers that actually subscribe to the tier. Thus, to calculate the penetration rate of the BST, the number of BST subscribers is divided by the total number of households to which the operator offers service (the number of "homes passed") in the franchise area. To calculate the penetration rate for a CPST, the number of CPST subscribers is divided by the

most highly penetrated CPST on a system, the average penetration rate approaches or exceeds 90% and the median penetration rate exceeds 95%. We seek comment on these estimates and, more generally, on the likely impact on CPST rates if the proposal is implemented.

15. We believe that individual consumers would be either substantially better off, or subject to only minor rate increases, were we to adopt the proposal. BST-only subscribers would be better off because their rates would decrease with no diminution in service. Although CPST subscribers could experience a minor rate increase, all CPST subscribers are also BST subscribers for whom the increase in CPST rates would be substantially offset by the decrease in BST rates. However, because we seek to ensure that increases to CPST subscribers be minimized, we seek comment on whether to limit the amount of increase a CPST subscriber must pay or to otherwise limit the amount by which the BST and CPST rates may be adjusted. As noted, any increase to CPST subscribers would be minimal because of the high penetration rate of CPSTs.

16. In addition to lowering rates for current BST-only subscribers, this proposal should make the BST more affordable for some consumers who currently do not subscribe to cable at all. We believe that our proposal presents other benefits as well. This proposal would provide cable operators with a rate structure flexibility enjoyed by providers of video services that are, or soon will be, attempting to compete with traditional cable operators in the video marketplace, including providers of direct broadcast satellite ("DBS") service, multichannel multipoint distribution service, and open video systems. These video competitors offer, or will offer, consumers an alternative to conventional cable service. Because these competitors are not subject to the type of rate regulation imposed upon cable operators by the Communications Act, they have greater flexibility to restructure their pricing as well as the services they offer consumers. We tentatively conclude that the proposed rate adjustment mechanism may enhance a cable operator's ability to compete with these alternative providers. For example, while currently a cable operator can attempt to become more competitive by simply dropping the rate of its BST, this proposal gives the operator an additional incentive to do so in that BST revenues that otherwise would be lost due to the rate decrease can be recovered on the CPST, even though no subscriber would see a significant rate increase.

17. We further conclude that a less expensive BST service might assist system operators in increasing customer access and penetration, in preparation for the developing marketplace in which access to nonvideo services, such as telephony or enhanced services, is becoming increasingly important. An example of such a BST service is the "LocaLink" service offered by Cox Cable Communications ("Cox") in Omaha, Nebraska. We understand that Cox has created this service in Omaha to increase its penetration.[30] In announcing its

number of BST subscribers.

[30] Cox's LocaLink service consists of a free basic service tier that subscribers can receive by paying only a one time installation or downgrade fee (MultiChannel News, September 4, 1995).

proposal, Cox noted that it is developing other communications services in the market and that it intends to combine them into a "one-stop-shopping" approach.[31]

18. To ensure that these goals can be accomplished while continuing to protect consumers, we believe that the proposed mechanism must be subject to several conditions. As we have stated, an operator electing this approach first would set rates for its regulated tiers in accordance with our existing rules. After lowering its BST rate and increasing its CPST rate in the manner described, the operator would have a continuing obligation to keep track of what its maximum permitted rate would be for each tier had it not made the adjustment. An operator would continue to maintain records of these "underlying rates" so that an LFA, or the Commission, could verify that the operator had made the adjustment properly. In particular, the LFA must be able to ensure that the operator prices its BST rate at no more than what our rules otherwise permit. We invite comment on this aspect of our proposal.

19. Further, we propose that systems offering more than one CPST would be able to allocate the amount deducted from the BST rate among the CPSTs in any manner, so long as the combined rate increases for the CPSTs is revenue neutral to the cable operator. As noted above, to ensure that any CPST rate increase is minimized, we seek comment on whether to limit the amount of such increase.

20. With respect to timing issues, we believe that an operator should be permitted to use the proposed adjustment mechanism only when it has the opportunity to adjust rates under our existing rules. Thus, if an operator has chosen to adjust rates on annual basis,[32] it would be able to implement the adjustment mechanism proposed herein only at the time of, and as part of, an annual rate adjustment. This restriction would ensure that our proposal does not increase the number of times subscribers experience rate adjustments. We do not intend to require that the operator make a standard rate adjustment at the time it uses the proposed mechanism (unless it is otherwise required to do so), only that it have the choice to make such an adjustment

21. For LFAs, this proposal should generate no additional burdens. An LFA will engage in the same rate review process as before. We seek comment on how to simplify further the rate review process.

22. The proposal would add another step to the Commission's review of a CPST complaint. This is because an operator that elects the proposed option may have a CPST rate that exceeds what normally would be permitted by our rules. To determine whether the CPST rate is nonetheless reasonable, the Commission will have to consider not just the CPST rate, but also the combined BST-CPST rate. Our consideration of the combined BST-CPST

---

[31] *Communications Daily*, August 30, 1995, at 1.

[32] Thirteenth Report and Order on Reconsideration in MM Docket No. 92-266, FCC 95-397, 11 FCC Rcd 388 (1995).

rate under this proposal will be for the sole purpose of determining whether the CPST rate is reasonable. BST rate review will remain the province of LFAs. We invite comment as to the interaction of this extra step in the Commission's review of CPST rates and the Commission's statutory mandate to ensure that CPST rates are not unreasonable.

23. We also seek comment regarding how this proposed adjustment should work in cases where the cable operator is subject only to CPST rate regulation, such as where the LFA has not exercised authority to regulate the BST. Upon submission of a complaint invoking its jurisdiction, the Commission is obligated to determine whether the new CPST rate is not unreasonable. One option in this circumstance would be to analyze the operator's rates as if its BST were regulated and to permit the operator to increase its CPST rate by the amount necessary to recover revenue lost due to a rate decrease on the unregulated BST. We seek comment on the extent of these circumstances and the merits of this suggestion, and invite commenters to recommend means by which a rate review should be conducted. In addition, we solicit comment on an operator's ability to rescind a recently implemented rate adjustment, and whether this would cause subscriber confusion, particularly if reversing the adjustment reflects rates the operator intended to charge absent this alternative.

24. As indicated above, when we initially proposed approaches to rate regulation under the 1992 Cable Act, we considered a pricing mechanism somewhat similar to that which we propose here, the object of which was to encourage or require a low-cost "bare bones" BST.[33] In the *Rate Order*, we rejected this idea and adopted the "tier neutrality" requirement.[34] We determined that the public interest would best be served by basing rates for all rate-regulated channels of cable services on common principles, rather than forcing BST rates down through a rate-setting approach applicable only to that tier.[35] We were concerned that suppressing BST rates in this manner would result in operators simply moving channels off the BST to other tiers that would generate more revenues.[36] We concluded that it was preferable to adopt a framework that resulted in a slightly higher-cost BST that had more programming. In addition, we determined that applying a single methodology to all regulated tiers reduced administrative burdens and confusion for operators, LFAs, and the Commission.[37]

25. The current proposal differs from the proposal we rejected in the *Rate Order* in two fundamental respects. First, the current proposal is not a forced reduction in the price of

---

[33] Notice of Proposed Rulemaking in MM Docket No. 92-266, FCC 92-544, 8 FCC Rcd 510, 518-19 (1992).

[34] *Rate Order*, 8 FCC Rcd at 5759.

[35] *Id.*

[36] *Id.*

[37] *See supra* at para. 4.

the BST. Rather, it simply permits operators to reduce the price of the BST as part of an overall marketing strategy. Second, it does not require any reduction in the number of channels on the BST. The current proposal preserves the benefits of the tier neutrality approach since the operator can make the adjustment proposed above only after establishing rates for its tiers in accordance with the tier neutrality principle. The current proposal also preserves the ability of the operator to move channels in order to accommodate market changes. We believe this adjustment is consistent with our approach to modify and improve the existing rules continually as the market changes and more information becomes available, while protecting consumers from more than a minimal rate increase.

IV. REGULATORY FLEXIBILITY ANALYSIS

A. Final Regulatory Flexibility Analysis for the *Order*:

26. As required by Section 603 of the Regulatory Flexibility Act, 5 U.S.C. § 603 (RFA), an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in the *Report and Order and Further Notice of Proposed Rulemaking* in MM Docket 92-266 ("*Report and Order*"). The Commission sought written public comments on the proposals in the *Report and Order* including comments on the IRFA, and addressed these responses in the *Third Report and Order*. No IRFA was attached to the *Third Report and Order* because the *Third Report and Order* only adopted final regulations and did not propose regulations. This FRFA thus addresses the impact of regulations on small entities only as adopted or modified in this action and not as adopted or modified in earlier stages of this rulemaking proceeding. The Commission's Final Regulatory Flexibility Analysis (FRFA) conforms to the RFA, as amended by the Contract with America Advancement Act of 1996 (CWAAA), Pub. L. No. 104-121, 110 Stat. 847.[38]

27. *Need and Purpose for Action*: This action is being taken in accordance with the Commission's decision, as set forth in the *Third Report and Order*, to revisit the issues discussed herein, and to carry out the Commission's statutory mandate to insure that cable rates are reasonable.

28. *Summary of Issues Raised by the Public Comments in Response to the Initial Regulatory Flexibility Analysis*: There were no comments received in response to the Initial Regulatory Flexibility Analysis. A single commenter petitioned the Commission for reconsideration of the requirements contained in the *Third Report and Order*, but this petition was ultimately withdrawn. The petitioner was not a small entity, and no reply comments to the petition were received.

[38]Subtitle II of the CWAAA is The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), codified at 5 U.S.C. § 610 *et seq.* (1996).

29. *Certification of No Significant Economic Impact on a Substantial number of Small Entities*: We do not believe that the final rule adopted in the *Order* will have a significant impact on small entities as defined by the Small Business Administration (SBA), by statute, or by our rules. The Communications Act at 47 U.S.C. 543 (m) (2) defines a small cable operator as "a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1 percent of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed $250,000,000." Under the Communications Act, at 47 U.S.C. 543 (m) (1), a small cable operator is not subject to the rate regulation requirements of Sections 543 (a), (b) and (c) on cable programming service tiers ("CPSTs") in any franchise area in which it serves 50,000 or fewer subscribers. The rule adopted in this *Order* requires that the same rate regulatory methodology be used across the basic service tier ("BST") and CPSTs. Thus, the rule adopted in this *Order* only applies to operators that are rate regulated on both the BST and CPST, and would therefore not apply to a small cable operator in any franchise area in which it serves 50,000 or fewer subscribers.

30. Section 623(i) of the Communications Act, 47 U.S.C. § 543(i), requires that the Commission design rate regulations in such a way as to reduce the administrative burdens and the cost of compliance for cable systems with 1,000 or fewer subscribers. The Commission introduced a form of rate regulation known as the small system cost-of-service methodology. This approach is more streamlined than the standard cost-of-service methodology available to cable operators that are not small cable systems owned by small cable companies. In addition, the small system rules include substantive differences from the standard cost-of-service rules to take account of the proportionately higher costs of providing service faced by small systems. This rate adjustment methodology is an alternative to the standard rate adjustment methodologies which are the subject of this *Order*. In designing this alternative methodology, the Commission extended the small system relief required by Section 623(i) of the Communications Act to cable systems with 15,000 or fewer subscribers owned by cable companies serving 400,000 or fewer subscribers over all of their cable systems. Because of the utilization of this alternative rate adjustment methodology by small cable operators, we do not believe that this *Order*, which does not concern this alternative methodology, will have any significant economic impact on a substantial number of small cable companies as defined by the Commission's rules.

31. The SBA, at 13 CFR Part 121.201 (as of July 25, 1996), defines a small cable business concern as a cable business, including its affiliates, that has $11 million or less in annual receipts. The Commission, in defining a small system as a cable system with 15,000 or fewer subscribers owned by a cable company serving 400,000 or fewer subscribers, stated that $100 million in annual regulated revenues equates to approximately 400,000 subscribers. We therefore believe that many cable operators that are within this SBA definition will also be within the Commission's definition of small cable operator, and will not experience significant economic impact for the reasons described in the preceding paragraph. If, however, a cable operator has $11 million or less in annual receipts, but does not fall within the class of small cable companies entities to small system rate relief under the Commissions

rules, we believe that such a company would fall under the Communications Act at 47 U.S.C. 543 (m) (1), which states that a small cable operator is not subject to the rate regulation requirements of Sections 543 (a), (b) and (c) on CPSTs in any franchise area in which it serves 50,000 or fewer subscribers. If $100 million in annual regulated revenues equates to approximately 400,000 subscribers, then 50,000 subscribers, expressed in terms of dollars, should meet or exceed the $11 million in annual receipts from the SBA definition of a small cable business concern. Using this same approach, we likewise believe that the SBA definition of a cable business concern will fall within the one percent of United States subscribers from the Communications Act definition of a small cable operator, because the Commission has determined that there are approximately 61,700,000 subscribers in the United States. We believe that small cable business concerns as defined by the SBA will fall within the Communication Act's definition of a small cable operator and the Act's provision of CPST rate deregulation for small cable operators that serve 50,000 or fewer subscribers. As explained above, the rule adopted in this *Order* is inapplicable to operators that are not subject to CPST rate regulation.

32. The SBA, at 5 U.S.C. Section 601 (Vol. 5), states that small governmental jurisdictions are "[g]overnments of cities, counties, towns, townships, villages, school districts or special districts with populations of less than 50,000." Under the Commissions current rules, if a local governmental has elected to rate regulate the BST, a cable operator must submit rate justifications to the local government on FCC Forms. We do not believe that a substantial number of small governmental jurisdictions will face a significant economic impact due to this *Order* for the following reasons. First, we do not know of any cable operators that are currently using inconsistent rate setting methods on their rate regulated tiers, and that would therefore have to switch to consistent methods as a result of this *Order*. If such an operator did exist, the operator would not be required to use consistent rate regulatory methods until the next time the operator was required to justify rates on a rate regulated tier. Thus, the requirement would not generate an increased number of rate reviews by a local franchising authority. Even in this instance, an operator may elect to change its CPST ratemaking methodology in order to conform to the rule as opposed to its BST ratemaking methodology. Such a change would not affect small governmental jurisdictions because the CPST rate is regulated by the Commission, and not by small governmental jurisdictions.

33. The Commission shall send a copy of this Final Regulatory Flexibility Analysis, along with this Report and Order, in a report to Congress pursuant to the Small Business Regulatory Enforcement Fairness Act of 1996, 5 U.S.C. § 801(a)(1)(A). A copy of this FRFA will also be published in the Federal Register.

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

34. Pursuant to Section 603 of the Regulatory Flexibility Act, the Commission has prepared the following initial regulatory flexibility analysis ("IRFA") of the expected impact of these proposed policies and rules on small entities. Written public comments are requested on the IRFA. These comments must be filed in accordance with the same filing deadlines as

comments on the rest of the *Notice* but they must be have a separate and distinct heading designating them as responses to the regulatory flexibility analysis. The Secretary shall cause a copy of this *Notice* to be sent to the Chief Counsel for Advocacy of the Small Business Administration in accordance with Section 603(a) of the Regulatory Flexibility Act, Pub. L. No. 96-354, 94 Stat. 1164, 5 U.S.C. Section 601 *et seq.* (1981).

35. *Reason for Action and Objectives of the Proposed Rule.* The Commission has determined that our cable rules do not permit cable operators to lower rates for the BST and to then recover lost revenues on the CPST. The proposal contained in this *Notice* will allow operators to offer a better price to BST subscribers while continuing to protect all subscribers from unreasonable rates. The proposal contained in this *Notice*, if adopted, would be an optional step for a cable operator in ratemaking, offering rate regulated operators more flexibility in cable pricing. This proposal will provide a cable operator with the ability to price services in a manner which duplicates market driven rates while continuing to offer consumers protections in the absence of effective competition.

36. *Legal Basis.* The authority for the action as proposed for this rulemaking is contained in Section 623 of the Communications Act of 1934, as amended, 47 U.S.C. § 543, and Section 303(r) of the Communications Act of 1934, as amended, 47 U.S.C. § 303.

37. *Description and Number of Small Entities Affected.*

38. *Small Cable Entities*: The Communications Act contains a definition of a small cable system operator, which is "a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1 percent of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed $250,000,000."[39] The Commission has determined that there are 61,700,000 subscribers in the United States. Therefore, we found that an operator serving fewer than 617,000 subscribers is deemed a small operator, if its annual revenues, when combined with the total annual revenues of all of its affiliates, do not exceed $250 million in the aggregate.[40] Based on available data, we find that the number of cable operators serving 617,000 subscribers or less totals 1,450.[41] Although it seems certain that some of these cable system operators are affiliated with entities whose gross annual revenues exceed $250,000,000, we are unable at this time to estimate with greater precision the number of cable system operators that would qualify as small cable operators under the definition in the Communications Act. We are likewise unable to estimate the number of these small cable operators that serve 50,000 or fewer subscribers in a franchise area.

[39]47 U.S.C. § 543(m)(2).

[40]47 C.F.R. § 76.1403(b).

[41]Paul Kagan Associates, Inc., *Cable TV Investor*, Feb. 29, 1996 (based on figures for Dec. 30, 1995).

39. The Commission has developed its own definition of a small cable system operator for the purposes of rate regulation. Under the Commission's rules, a "small cable company," is one serving fewer than 400,000 subscribers nationwide.[42] Based on our most recent information, we estimate that there were 1,439 cable operators that qualified as small cable system operators at the end of 1995.[43] Since then, some of those companies may have grown to serve over 400,000 subscribers, and others may have been involved in transactions that caused them to be combined with other cable operators. Consequently, we estimate that there are fewer than 1,439 small entity cable system operators that may be affected by the proposal adopted in this *Notice*. Under the Commission's rules, a small cable system is a cable system with 15,000 or fewer subscribers owned by a cable company serving 400,000 or fewer subscribers over all of its cable systems. We are unable to estimate the number of small cable systems nationwide, and we seek comment on the number of small cable systems.

40. SBA has developed a definition of small entities for cable and other pay television services, which includes all such companies generating less than $11 million in revenue annually. This definition includes cable systems operators, closed circuit television services, direct broadcast satellite services, multipoint distribution systems, satellite master antenna systems and subscription television services. According to the Census Bureau, there were 1,323 such cable and other pay television services generating less than $11 million in revenue that were in operation for at least one year at the end of 1992.[44]

41. *Municipalities*: The term "small governmental jurisdiction" is defined as "governments of . . . districts, with a population of less than fifty thousand."[45] Based on most recent census data, there are 85,006 governmental entities in the United States.[46] This number includes such entities as states, counties, cities, utility districts and school districts. We note that any official actions with respect to cable operators' BST will typically be undertaken by LFAs, which primarily consist of counties, cities and towns. Of the 85,006 governmental entities, 38,978 are counties, cities and towns. The remainder are primarily utility districts, school districts, and states, which typically are not LFAs. Of the 38,978 counties, cities and towns, 37,566 or 96%, have populations of fewer than 50,000.

42. *Steps taken to Minimize Significant Economic Impact on Small Entities and Significant Alternatives Rejected.*

---

[42]47 C.F.R. § 76.901(e). The Commission developed this definition based on its determinations that a small cable system operator is one with annual revenues of $100 million or less. *Implementation of Sections of the 1992 Cable Act: Rate Regulation*, Sixth Report and Order and Eleventh Order on Reconsideration, 10 FCC Rcd 7393.

[43]Paul Kagan Associates, Inc., *Cable TV Investor*, Feb. 29, 1996 (based on figures for Dec. 30, 1995).

[44]*1992 Census*, *supra*, at Firm Size 1-123.

[45]5 U.S.C. § 601(5).

[46]United States Dept. of Commerce, Bureau of the Census, *1992 Census of Governments*.

43. *Small Cable Entities*: The Communications Act contains a definition of a small cable system operator, which is "a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1 percent of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed $250,000,000."[47] Under the Communications Act, at 47 U.S.C. 543 (m) (1), a small cable operator is not subject to the rate regulation requirements of Sections 543 (a), (b) and (c) on CPSTs in any franchise area in which it serves 50,000 or fewer subscribers. The proposed rule adopted in this *Notice* would give a rate regulated operator the option to lower rates on its BST and to raise rates on its CPST in order to recover lost revenues from the BST reduction. The CPST rate increase would be reviewed by the Commission. Because this proposed rule would not affect operators that are not rate regulated on CPSTs, there would be no impact on small cable operators that, according to the Communications Act, are not subject to rate regulation on CPSTs.

44. The Commission has developed its own definition of a small cable system operator for the purposes of rate regulation. Under the Commission's rules, a "small cable company," is one serving fewer than 400,000 subscribers nationwide, and a small cable system is a cable system with 15,000 or fewer subscribers owned by a cable company serving 400,000 or fewer subscribers over all of its cable systems.[48] SBA has developed a definition of small entities for cable and other pay television services, which includes all such companies generating less than $11 million in revenue annually.

45. To the extent that any of these operators are rate regulated on CPSTs, we emphasize that the proposal would provide an optional rate adjustment methodology for rate regulated operators in order to provide for greater flexibility in cable pricing, and would not impose a mandatory requirement on cable operators. If we did not modify our rules, a regulated cable operator would not be able to recover, on its CPST, lost revenues for rate decreases to the BST. We believe that allowing for such an adjustment could give operators more flexibility to respond to competition in the marketplace.

46. *Municipalities*: The term "small governmental jurisdiction" is defined as "governments of . . . districts, with a population of less than fifty thousand."[49] We do not believe that the proposal contained in this *Notice* will have a significant economic impact on a substantial number of these small governmental jurisdictions. A small governmental jurisdiction that regulates the BST would continue its current practice of reviewing an operator's maximum permitted per channel rate on the BST. Any rate increase by an operator

[47] 47 U.S.C. § 543(m)(2).

[48] 47 C.F.R. § 76.901(e). The Commission developed this definition based on its determinations that a small cable system operator is one with annual revenues of $100 million or less. *Implementation of Sections of the 1992 Cable Act: Rate Regulation*, Sixth Report and Order and Eleventh Order on Reconsideration, 10 FCC Rcd 7393.

[49] 5 U.S.C. § 601(5).

opting to use the proposal contained in this *Notice* would occur on the CPST and would therefore be reviewed by the Commission.

47. *Reporting, Recordkeeping and other Compliance Requirements.* Our current methodology for calculating maximum permissible rates will need to be amended to account for the additional optional rate calculation step proposed in this *Notice*. The proposed rule is optional, and would not be a requirement for any cable operator that does not want to utilize the proposed option. An operator wishing to use the proposed pricing methodology first would establish rates for its regulated service tiers using the same methodology for both tiers. The resulting rate for the BST would be the cap for that tier. The operator then would determine the amount by which it was willing to decrease the BST rate and calculate the total revenue loss derived from the reduction. The operator would then divide this amount by the total number of CPST subscribers in order to calculate the rate increase for the CPST. After lowering its BST rate and increasing its CPST rate in the manner described, the operator would have a continuing obligation to keep track of what its maximum permitted rate would be for each tier had it not made the adjustment. An operator would continue to maintain records of these "underlying rates" so that an LFA, or the Commission, could verify that the operator had made the adjustment properly. In the *Notice*, we seek comment on the specific method of implementation of the proposal. The rule as proposed would not require any additional special skills beyond any which are already needed in the cable rate regulatory context.

48. *Significant Alternatives to Proposed Rule Which Minimize Significant Economic Impact on Small Entities and Accomplish Stated Objectives.* In the *Notice*, we examine the current rule that prohibits a rate-regulated cable operator from justifying an increase in its CPST rate on the basis of a corresponding decrease in the BST rate. We tentatively conclude that eliminating this aspect of our current rules would give cable operators greater pricing flexibility to respond to their growing competition while continuing to protect consumers. If, in the alternative, we did not modify our rules, a regulated cable operator would not be able to recover, on its CPST, lost revenues for rate decreases to the BST. We believe that allowing for such an adjustment could give operators more flexibility to respond to competition in the marketplace. This is consistent with the issues raised in the body of the *Notice*. As explained above, we do not believe the proposal creates any significant burden for small entities. The proposed rule change would be purely optional for cable operators, and local franchising authorities would not be subject to additional rate regulatory burdens as a result of adoption of the proposal.

49. *Federal Rules which Overlap, Duplicate or Conflict with these Rules.* None.

V. INITIAL PAPERWORK REDUCTION ACT OF 1995 ANALYSIS

50. This *Notice* contains either a proposed or modified information collection. The

Commission, as part of its continuing effort to reduce paperwork burdens, invites the general public and the Office of Management and Budget ("OMB") to comment on the information collections contained in this *Notice*, as required by the Paperwork Reduction Act of 1995, Pub. L. No. 104-13. Public and agency comments are due at the same time as other comments on this *Notice*; OMB comments are due 60 days from date of publication of this *Notice* in the Federal Register. Comments should address: (a) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission's burden estimates; (c) ways to enhance the quality, utility, and clarity of the information collected; and (d) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology

VI. PROCEDURAL PROVISIONS

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

52. Pursuant to applicable procedures set forth in Sections 1.415 and 1.419 of the Commission's rules, interested parties may file comments on or before October 6, 1996, and reply comments on or before November 8, 1996. To file formally in this proceeding, you must file an original plus four copies of all comments, reply comments, and supporting comments. If you would like each Commissioner to receive a personal copy of your comments and reply comments, you must file an original plus nine copies. You should send comments and reply comments to the Office of the Secretary, Federal Communications Commission, 1919 M Street, N.W. Washington, D.C. 20554. Comments and reply comments will be available for public inspection during regular business hours in the FCC Reference Center, Room 239, Federal Communications Commission, 1919 M Street N.W., Washington D.C. 20554.

VII. ORDERING CLAUSES

53. Accordingly, **IT IS ORDERED** that, pursuant to the authority granted in Sections 4(i), 4(j), 303(r) and 623 of the Communications Act of 1934, as amended, 47 U.S.C. Sections 154(i), 154(j), 303(r) and 543, the requirements set forth in the *Third Report and Order* **ARE AMENDED** to provide that the use of the same rate regulatory methodology will be required for all rate regulated tiers for the entire period in which an operator is subject to rate regulation on more than one tier.

54. **IT IS FURTHER ORDERED** that the requirements established in this decision shall become effective 30 days after its publication in the Federal Register.

55. **IT IS FURTHER ORDERED** that, pursuant to Sections 4(i), 4(j), 623(a), 623(b), and 623(c), of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 543(a), 543(b), and 543(c), NOTICE IS HEREBY GIVEN of proposed amendments to Part 76, in accordance with the proposals, discussions, and statement of issues in this Notice of Proposed Rulemaking, and that COMMENT IS SOUGHT regarding such proposals, discussion, and statement of issues.

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

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton
Acting Secretary

Appendix A

Rule Changes

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

PART 76 -- CABLE TELEVISION SERVICE

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

AUTHORITY: 47 U.S.C. 151, 152, 153, 154, 301, 302, 303, 303a, 307, 308, 309, 312, 315, 317, 325, 503, 521, 522, 531, 532, 533, 534, 535, 536, 537, 543, 544, 544a, 545, 548, 552, 554, 556, 558, 560, 561, 571, 572, 573.

2. Section 76.922 (a) is amended to read as follows:

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

(a) Basic and cable programming service tier rates. Basic service tier and cable programming service rates shall be subject to regulation by the Commission and by state and local authorities, as is appropriate, in order to assure that they are in compliance with the requirements of 47 U.S.C. § 543. Rates that are demonstrated, in accordance with these rules, not to exceed the "Initial Permitted Per Channel Charge" or the "Subsequent Permitted Per Channel Charge" as described below, or the equipment charges as specified in § 76.923, will be accepted as in compliance. The maximum monthly charge per subscriber for a tier of regulated programming services offered by a cable system shall consist of a permitted per channel charge multiplied by the number of channels on the tier, plus a charge for franchise fees. The maximum monthly charges for regulated programming services shall not include any charges for equipment or installations. Charges for equipment and installations are to be calculated separately pursuant to § 76.923 of these rules. The same rate-making methodology (either the benchmark methodology found in paragraph (b) of this subsection, or a cost-of-service showing) shall be used to set initial rates on all rate regulated tiers, and shall continue to provide the basis for subsequent permitted charges.

* * * * *