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

In the Matter of	)	
	)	
Implementation of Sections of the	)	
Cable Television Consumer Protection	)	MM Docket No. 92-266
and Competition Act of 1992:	)	
Rate Regulation	)	
	)	
Low-Price Systems	)	

**REPORT AND ORDER**

**Adopted: March 13, 1997**

**Released: March 14, 1997**

By the Commission:

**I. INTRODUCTION**

1. In this *Report and Order*, we terminate the transition status of low-price systems and establish final rules for low-price system rate regulation pursuant to the provisions of the Cable Television Competition and Consumer Protection Act of 1992 ("1992 Cable Act").<sup>1</sup> We rely on the results of our cost survey in particular, to determine whether low-price systems should be required to reduce their rates by the full competitive differential or any lesser amount.

**II. BACKGROUND**

2. In the *Report and Order and Further Notice of Proposed Rulemaking* in MM Docket No. 92-266<sup>2</sup> ("*Rate Order*"), the Commission found that "our initial effort to regulate rates for cable service should provide for reductions from current rates of regulated cable systems with rates above competitive levels."<sup>3</sup> In order to simulate the rates that would be charged by

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<sup>1</sup>Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992), 47 U.S.C. § 521 *et seq.* (1992). The 1992 Cable Act amends Title 6 of the Communications Act of 1934, as amended, 47 U.S.C. § 521 *et seq.*

<sup>2</sup>8 FCC Rcd 5631 (1993).

<sup>3</sup>8 FCC Rcd at 5644.

comparable cable systems subject to effective competition, we adopted a "benchmark" approach to regulate the basic service tier and the cable programming services tier of systems not subject to effective competition.<sup>4</sup> The initial benchmark formula was primarily derived by examining cable operator's revenues.<sup>5</sup> The formula reflected an implicit assumption that all cable operators faced similar cost conditions,<sup>6</sup> but it took into account variations in rates due to certain other economic and demographic factors. Our initial analysis revealed that the "rates of systems not subject to effective competition [were], on average, approximately 10 percent higher than rates of comparable systems subject to effective competition."<sup>7</sup> This 10% competitive differential was incorporated into the benchmark system, and noncompetitive systems whose rates exceeded the benchmark were deemed to be charging unreasonable rates. These systems were thus required to reduce their rates, at most by the full 10% competitive differential, but not below the benchmark.<sup>8</sup>

3. In the *Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking* in MM Docket No. 92-266<sup>9</sup> ("*Second Order on Reconsideration*"), the Commission adopted a 17% competitive differential based on a revised analysis of its early competitive survey of the cable industry; it concluded that the 17% differential determined by the revised model more accurately estimated the difference between effectively competitive and noncompetitive cable rates than the ten percent differential established in the *Rate Order*.<sup>10</sup> The Commission recognized, however, that the rates developed under this revised benchmark approach might not be appropriate for all cable systems.<sup>11</sup> The competitive survey used to establish the new benchmark approach included several cost-related variables,<sup>12</sup>

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<sup>4</sup>*Id.* at 5755, 5881. We also permitted cable operators to exceed the rates that would be established under the benchmark formula if they elected to make cost showings particular to their systems that justified higher rates. *Id.* at 5794.

<sup>5</sup>See *id.* at 5766-67. See also *Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking*, in MM Docket No. 92-266, 9 FCC Rcd 4119, 4166 (1994).

<sup>6</sup>See *Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking*, in MM Docket No. 92-266, 9 FCC Rcd 4119, 4166 (1994).

<sup>7</sup>See *Rate Order*, 8 FCC Rcd at 5644.

<sup>8</sup>*Id.* at 5772, 5882. Cable systems with rates below the benchmark were not required to reduce their rates. *Id.* at 5771, 5882-83.

<sup>9</sup>9 FCC Rcd 4119 (1994). The notice portion of the *Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking*, is referred to below as the "*Fifth Notice of Proposed Rulemaking*."

<sup>10</sup>*Second Order on Reconsideration*, 9 FCC Rcd at 4150-66.

<sup>11</sup>*Id.* at 4168.

<sup>12</sup>*Id.* at 4158-59.

but we remained concerned that our analysis may have failed to identify unusual cost influences that might indicate whether a system was charging unreasonable rates.<sup>13</sup> In particular, the Commission identified two types of systems, small systems and low-price systems, that appeared to exhibit significantly different prices and costs from most other cable systems based on the initial data gathered.<sup>14</sup> The Commission granted transition relief to small systems and low-price systems finding that these systems would not be required to use the new benchmark approach until the Commission gathered further data regarding their particular price/cost profiles.<sup>15</sup> We defined low-price systems as "(i) systems whose March 31, 1994 rates are at [or] below the revised benchmark and (ii) systems whose March 31, 1994 rates are above the benchmark but whose permitted rates are at or below the benchmark."<sup>16</sup> Pending this determination, low-price systems were placed in a "transition" status and were subject to "transition relief" as "transition systems."

4. The Commission established an alternate approach to rate regulation for transition systems pending completion of our price/cost analysis. During the transition period, low-price systems having March 31, 1994 rates below the new benchmark were not required to reduce their rates at all.<sup>17</sup> Low-price systems having March 31, 1994 rates above the new benchmark but having permitted rates at or below the new benchmark were only required to reduce their rates to the new benchmark.<sup>18</sup> We imposed a modified price cap on these transition rates that allowed systems subject to such relief to increase their rates "to reflect increases in external costs and increases caused by channel changes that accrue after March 31, 1994."<sup>19</sup> A transition system was not, however, allowed to increase its transition rate due to increases in inflation until its transition rate was equal to the rate that would have resulted from a full 17% rate reduction under our revised benchmark approach (*i.e.*, their full reduction rate increased by permitted inflation, and increases due to external costs and channel changes).<sup>20</sup> In this way, the transition rates of transition systems would eventually become equal to the full reduction rates these systems would have been required to charge under our new benchmark approach.<sup>21</sup> The Commission reasoned

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<sup>13</sup>*Id.* at 4172-78.

<sup>14</sup>*Id.* at 4172-73, 4176.

<sup>15</sup>*Id.* at 4166-69.

<sup>16</sup>*Second Order on Reconsideration*, 9 FCC Rcd at 4168. We note that this definition does not include new systems that may establish low rates after March 31, 1994. *See also* 47 C.F.R. § 76.922(b)(4)(ii)(A).

<sup>17</sup>*Id.* at 4178.

<sup>18</sup>*Id.* at 4178-79.

<sup>19</sup>*Id.* at 4181-82.

<sup>20</sup>*Id.* at 4182.

<sup>21</sup>*Id.*

that a system's full reduction rate might eventually exceed its transition rate because the full reduction rate would increase with inflation as well as external costs and channel changes.<sup>22</sup> The Commission stated that transition treatment would terminate at the completion of our price/cost analysis, and that systems that had been provided transition relief would be required to apply the 17% competitive differential upon termination of transition treatment unless our analysis revealed that application of the 17% competitive differential to these systems would be inappropriate.<sup>23</sup>

5. Specifically, we said that we needed to further study whether below-benchmark rates are more likely to be reasonable than above-benchmark rates, because they are comparatively lower, and that in light of this inquiry, it would not be appropriate, at the time, to require regulated systems to reduce their rates below the benchmark level.<sup>24</sup> In addition, we stated that "requiring any systems whose rates are currently slightly above the benchmark to reduce their rate levels to the full reduction levels, but not requiring below-benchmark systems to reduce their rates at all, would result in inequitable treatment of systems that may be fairly similarly situated."<sup>25</sup> Therefore, we stated that upon completion of our collection and analysis of low price system prices and costs "the regulated rates of such systems [would] be set to reflect the full 17 percent differential if our analysis [did] not show that the resulting rates would be unreasonably low -- that is, the rates would be lower than they would be if set by competitive pressures as determined by cost comparisons between noncompetitive systems and systems subject to effective competition."<sup>26</sup>

6. The Commission subsequently made adjustments to the transition relief initiated in the *Second Order on Reconsideration*. In the *Ninth Order on Reconsideration* in MM Docket No. 92-266,<sup>27</sup> the Commission allowed all systems subject to transition relief to further adjust their rates based on inflation. In the *Sixth Report and Order and Eleventh Order on Reconsideration* in MM Docket Nos. 92-266 and 93-215,<sup>28</sup> ("*Small System Order*") we initiated "the gradual termination of transition relief for all but low-price systems," by limiting transition relief for small systems to two years from the effective date of the new rule.<sup>29</sup> Consistent with our statements in the *Second Order on Reconsideration*, however, we have continued transition

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<sup>22</sup>*Id.*

<sup>23</sup>*Id.* at 4168-69, 4178.

<sup>24</sup>*Id.* at 4179.

<sup>25</sup>*Id.*

<sup>26</sup>*Id.* at 4124-25.

<sup>27</sup>10 FCC Rcd 5198 (1995).

<sup>28</sup>10 FCC Rcd 7393 (1995).

<sup>29</sup>*Small System Order*, 10 FCC Rcd at 7413-14.

relief for low-price systems until the completion of our collection and analysis of necessary cost data.<sup>30</sup>

7. When the *Second Order on Reconsideration* was adopted, the Commission noted that we lacked sufficient data regarding the costs faced by low-price systems to establish whether these systems were charging reasonable rates despite the fact that they were charging relatively low rates as compared to the rates of other noncompetitive cable systems.<sup>31</sup> Therefore, the Commission delegated authority to the Chief, Cable Services Bureau to conduct general cost studies of the cable industry.<sup>32</sup> A cable industry cost survey was commenced pursuant to this authority in the Fall of 1995.<sup>33</sup> This *Report and Order* analyzes data from our cost survey, and compares the cost and revenue data of noncompetitive low-price systems with the cost and revenue data received for non-low-price systems that are already regulated by the Commission under the revised benchmark approach.

### III. DISCUSSION

#### A. Data

8. The cost survey we initiated in September of 1995 was based upon a random sample of cable systems. Specifically, the survey was mailed to cable operators owning 660 of the total 2,271 non-small cable systems in the U.S. Small systems were not included in our survey because their treatment was previously determined in the *Small System Order*.<sup>34</sup> The Commission received 359 usable questionnaires from the cable operators surveyed. Of these 359 questionnaires, 40 were received for low-price systems ("low-price group") and 38 were received for systems regulated by the Commission under the revised benchmark approach ("non-low-price group"). Of the remaining 281 usable questionnaires, two were received for systems facing effective competition as defined in the 1992 Cable Act, and the remaining 279 were received for several categories of cable systems including those regulated only at the local level, those for which a cost-of-service showing was filed, those unregulated, and those subject to social contracts.

9. Data provided in response to the cost survey included information regarding system plant and equipment costs, intangible assets, operating revenues and expenses, and capital

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<sup>30</sup>*Second Order on Reconsideration*, 9 FCC Rcd at 4168-69, 4178.

<sup>31</sup>*Id.* at 4176.

<sup>32</sup>*Report and Order and Further Notice of Proposed Rulemaking*, in MM Docket No. 93-215 and CS Docket No. 94-28, 9 FCC Rcd 4527, 4692-93 (1994).

<sup>33</sup>*See Order*, in MM Docket No. 92-266, 11 FCC Rcd 4003 (rel. September 29, 1995).

<sup>34</sup>*See Small System Order*, 10 FCC Rcd 7393 (1995).

structure as of year end 1992 and year end 1994. We also received information regarding system characteristics.

### B. Analysis

10. The data received from our cost survey was analyzed to determine the relative profitability of the low-price group compared with the non-low-price group. In our analysis, we used a standard measure of "accounting" profitability as a means of determining the relative profitability of these two groups. Specifically, we used cash flow ratios, which are commonly used in financial analyses of the cable industry. One of the more frequently used cash flow measures is income before interest, taxes, depreciation and amortization ("IBITDA"). We applied this measure in the form of the following ratio: operating revenues minus operating expenses before interest, taxes, depreciation, and amortization divided by operating revenues.

11. We compared the average cash flow ratio of our low-price group with the average cash flow ratio of our non-low-price group. We found that the average cash flow ratio of our low-price group was 36.5% and the average cash flow ratio of our non-low-price group was 39.7%.<sup>35</sup> These findings indicate that, on average, the operators of systems in our low-price group received lower profit margins for their low-price systems than the operators of systems in our non-low-price group received for their non-low-price systems. Based on these findings, we believe that the operators of low-price systems generally receive lower profit margins for their low-price systems than the operators of systems already regulated under the Commission's revised benchmark approach. Under these conditions we believe that rates charged by low-price systems are reasonable. We therefore find it unnecessary for the operators of these systems to reduce the rates on these systems by the full competitive differential or by any lesser amount.

12. We believe that the transition relief afforded low-price systems was appropriate, however, we see no need to maintain the transition status of low-price systems now that we have completed an analysis of the necessary cost data particular to these systems. Therefore, we make that relief permanent. We will allow low-price systems to continue charging the rates they established under transition relief and making appropriate rate increases in accordance with our current rules.<sup>36</sup>

## IV. FINAL REGULATORY FLEXIBILITY CERTIFICATION

13. As required by the Regulatory Flexibility Act, 5 U.S.C. § 603 (RFA), an Initial Regulatory Flexibility Analysis (IRFA) for the *Fifth Notice of Proposed Rulemaking* was incorporated in the *Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking* in MM Docket 92-266. The Commission therein provided notice of its

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<sup>35</sup>See Appendix A for derivation of these percentages.

<sup>36</sup>47 C.F.R. § 76.922; See also *Ninth Order on Reconsideration*, in MM Docket No. 92-266, 10 FCC Rcd 5198, 5202-04 (1995).

intent to establish further requirements concerning the rates permitted for systems subject to transition treatment, and sought written public comments on the IRFA. 9 FCC Rcd 4119, 4247, 4250 (1994). Comments regarding the treatment of "small" transition systems were received by the Commission and addressed in a previous order. 10 FCC Rcd 7393 (1995).<sup>37</sup> No comments, however, were received regarding the matter of "low-price" transition cable systems.

14. Although we performed an IRFA in the *Fifth Notice of Proposed Rulemaking*, we received no comments in response to the IRFA with respect to "low-price" transition systems and upon further consideration we now believe that we can certify that no regulatory flexibility analysis is necessary. This certification conforms to the RFA, as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).<sup>38</sup>

15. We do not believe that the amendments to the rules adopted in this *Report and Order* will have a significant economic impact on a substantial number of small entities as defined by statute, by our rules, or by the Small Business Administration (SBA).<sup>39</sup> 5 U.S.C. § 605(b).

16. Our rules for regulating the rates of small systems owned by small cable companies were established in a previous order, so this *Report and Order* only concerns the permitted rates for low-price systems. Based on the rule changes adopted here, low-price systems will be permitted to maintain the rates originally established pursuant to their status as systems subject to transition relief. Further, the rules adopted in this *Report and Order* will allow low-price systems to increase their rates in the same manner as our previous transition rules for low-price systems. The rules adopted herein do not alter the method by which low-price cable system rates currently are regulated, and for this reason these amendments will not have a significant economic impact on a substantial number of small cable operators, and will not change the treatment of low-price systems.

17. The Commission will send a copy of this certification, 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), and to the Chief Counsel for Advocacy of the Small Business Association, 5 U.S.C. § 605(b). A copy of this certification will also be published in the Federal Register. *Id.*

## V. ORDERING CLAUSES

18. Accordingly, **IT IS ORDERED** that, pursuant to Sections 4(i), 4(j), 303(r), and

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<sup>37</sup>No further comments were received regarding this matter.

<sup>38</sup>SBREFA is Title II of the Contract with America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847, 857 (1996), codified at 5 U.S.C. § 601 *et seq.*

<sup>39</sup>See 47 U.S.C. § 543(m)(2); 47 C.F.R. § 76.901(e); 13 C.F.R. § 121.201 (SIC 4841).

623 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 303(r), and 543, the rules, requirements and policies discussed in this *Report and Order* **ARE ADOPTED** and Section 76.922 of the Commission's rules, 47 C.F.R. Section 76.922, **IS AMENDED** as set forth in Appendix B.

19. **IT IS FURTHER ORDERED** that the Secretary shall send a copy of this *Report and Order*, including the Final 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).

20. **IT IS FURTHER ORDERED** that the requirements and regulations established in this decision shall become effective thirty (30) days after publication of this *Report and Order* in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION

  
William F. Caton  
Acting Secretary

**APPENDIX A****Cash Flow Ratios**

<b>Category</b>	<b>Average operating revenues</b>	<b>Average operating expenses before interest, taxes, depreciation and amortization</b>	<b>Income before interest, taxes, depreciation and amortization (IBITDA)</b>	<b>Cash flow ratios*</b>
	<b>(A)</b>	<b>(B)</b>	<b>(A-B)</b>	
Low-price group (40 systems)	\$15.1 million	\$9.6 million	\$5.5 million	36.5%
Non-low-price group (38 systems)	\$12.5 million	\$7.5 million	\$5 million	39.7%
Competitive group (2 systems)	\$76.4 million	\$46.2 million	\$30.2 million	39.5%
All other** (279 systems)	\$8.3 million	\$5.3 million	\$3 million	36.7%

\* Calculated on totals for each group prior to averaging (i.e., cash flow ratios equal total operating revenues minus total operating expenses before interest, taxes, depreciation and amortization divided by total operating revenues).

\*\* Includes systems for which a cost-of-service showing was filed, systems regulated only at the local level, unregulated systems, and systems subject to social contracts.

**APPENDIX B**

**Revised Rules**

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. Secs. 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 is amended by revising paragraph (b)(4)(ii) to read as follows:

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

\* \* \* \* \*

(b)(4) \* \* \*

(ii) Low-price systems. Low-price systems shall be eligible to establish a transition rate for a tier.

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