DOCKET FILE COPY ORIGINAL

ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Telecommunications Services Inside Wiring	)	CS Docket No. 95-184
	)	
Customer Premises Equipment	)	

SURREPLY OF OPTEL, INC.

Pursuant to the order extending the time period for filing reply comments in the above-referenced proceeding, released January 16, 1998, OpTel, Inc. ("OpTel"), submits this brief surreply to the reply comments filed March 2, 1998.

DISCUSSION

Over a year ago, OpTel submitted an ex parte filing in this docket in which it attached several spreadsheets and system diagrams to illustrate the costs of MDU installations under various scenarios (*e.g.*, when cable home run wire is transferred from the previous provider versus the installation of an entirely new cable plant).[1] A few months later, to demonstrate the value of exclusive contracts to new entrants, OpTel submitted a study done by its Treasurer, Richard Alden (the "Alden Study").[2] In the latest set of comments and reply comments, both of these documents have been challenged by other parties.

One party criticized the Alden Study as being premised on unrealistic cost estimates and cash flow expectations.[3] Mr. Alden has prepared a brief response (attached as Exhibit A hereto) regarding the basis for the cost and revenue figures used in his original study. At a more basic level, however, the very foundation upon which the criticism of the Alden Study is based is flawed; *i.e.*, that "OpTel feels that the purpose of this proceeding is for the Commission to protect inefficient market participants."[4] To the contrary, OpTel's position in this proceeding from the start has been that the Commission

1 See *Ex parte* Letter from Henry Goldberg, CS Docket No. 95-184 (Feb. 7, 1997).
2 See *Ex parte* Letter from Henry Goldberg, CS Docket No. 95-184 (July 22, 1997).
3 See Reply Comments of CableVision Communications, Inc., et al., (filed Mar. 2, 1998) at 4-6.
4 Id. at 6.

No. of Copies rec'd 049
List ABCDE

should not interfere with the workings of the market now that companies such as OpTel are waiting to compete with CableVision and the other MSOs, which so long have held a monopoly over local video distribution service. Only in the case of perpetual contracts, which for the most part are the product of the former MSO monopoly, should the Commission act to correct the market failure.

With respect to the earlier OpTel installation spreadsheets, one well-intentioned party has relied on a single set of figures in those spreadsheets to attack the need for exclusivity in general.[5] Two points need to be made in this regard.

First, by focusing on a single set of numbers (the ones representing the least cost scenario for providing service to an MDU), MAP has missed the larger point — a functioning market will demand that MVPDs provide superior services to subscribers at the lowest cost. The trade off, however, that new entrants such as OpTel obtain in the market for providing more channels and specialized services at lower costs, is an assurance from the subscribers or the subscribers' agents that the sunk investment in the enhanced system can be recovered along with an investment-sustaining profit.

If MAP seeks to ensure that new entrants have no incentive to do anything more than plug into the existing cable plant on an MDU property and provide plain old vanilla cable service, a limit on the term of exclusivity will serve that purpose well. The spreadsheets provided by OpTel last year, on the other hand, demonstrate that as a new entrant's investment in an MDU increases, so must the length of its term of exclusivity to support that investment.

Second, there has been some disagreement about the import of the numbers used in the spreadsheets (*i.e.*, whether the cost recovery factors discounted for the time value of money include a built-in profit, or the extent to which "inside wiring," costs, as discussed in the text of the February 7, 1997, *ex parte* include related capital expenditures as reflected in the attached spreadsheets). Generally, the earlier *ex parte* letter speaks for itself on these points. Nonetheless, the lowest-cost MDU installation for a single MVPD (OpTel) should not be used to establish a limit on exclusivity for an entire industry.

The bottom-line is that installation costs may vary widely in MDUs depending upon a variety of factors. The Commission simply is not in a position to determine whether the costs of a particular MDU installation are reasonable; nor can it possibly

---

5 See Comments of MAP (filed Dec. 23, 1997) at 3-4; Reply Comments of MAP (filed Mar. 2, 1998) at 6.

determine the cost of capital for each MVPD. Thus, any effort to establish a limit on parties' free bargaining power in the market will only serve to limit competition. If the Commission seeks a competitive market, it must allow competitors to compete.

Respectfully submitted,

OPTEL, INC.

/s/W. Kenneth Ferree

W. Kenneth Ferree

GOLDBERG, GODLES, WIENER & WRIGHT
1229 Nineteenth Street, NW
Washington, DC 20036
(202) 429-4900

Its Attorneys

Counsel:

Michael E. Katzenstein
Vice-President and General Counsel
OpTel, Inc.
1111 W. Mockingbird Lane
Dallas, TX 75247

March 16, 1998

Exhibit A

RESPONSE OF RICHARD ALDEN

1. **Introduction**

1.1 This document is written in response to the reply comments of CableVision Communications, Inc., Comcast Cable Communications, Inc. and Tele-Media Corporation of Delaware (together "the Pleaders") on the Second Further Notice of Proposed Rulemaking in CS Docket No. 95-184. It is intended solely to address specifically those comments made by the Pleaders in response to the financial analysis prepared by OpTel in support of its Comments on proposals to restrict exclusive service agreements between Multi-channel Video Programming Distributors ("MVPDs") and the MDUs that they serve.

1.2 The Pleaders contend that the OpTel financial analysis should be disregarded because it has been prepared by OpTel's Treasurer and, as a result, they contend, it is inherently biased due to lack of independence, relies substantially on exaggerated assumptions, and utilizes faulty reasoning.

1.3 In response to the first two of these points, OpTel is one of the leading private cable operators in the United States, providing service to over 314,000 homes in MDUs in nine large cities. OpTel, therefore considers that its knowledge of this marketplace is sufficiently detailed (and the data that the Company has assembled sufficiently representative) to be able to provide meaningful input to this debate. Throughout the financial analysis, the Company has relied entirely on its own experience and has not sought to inflate, modify or exaggerate any of the assumptions used. In their reply comments the Pleaders make reference to certain assumptions and also refer to, so called, faulty reasoning. Each of these references is examined further below.

2. **Initial Investment**

2.1 The Pleaders contend that the numbers used in the calculation of initial investment required to service a typical MDU of 300 units is "grossly exaggerated." In fact, the numbers used represent the low point of the averages of OpTel's actual experience. The Pleaders make specific reference to wiring and distribution costs typically ranging from a low of $50 to a high of $150. OpTel concurs with these figures for wiring alone. However, OpTel's analysis attributed a cost of $250 to **Wiring and Distribution**. Distribution costs include the equipment costs and the costs of linking properties which form part of the same MDU complex (typically in a "Garden Style" arrangement). This linking of buildings avoids the need for (and therefore the cost of) separate microwave receiving equipment at each individual building within the same complex. In OpTel's experience, the distribution cost for a typical MDU ranges from $130 to $200. At the top end of this range this cost can be further segregated between equipment (pedestals, connectors, taps, line extenders and conduit) costing an average of $80 per unit, and labor, costing an average of $120 per unit, for a total cost of $200 per unit. Where distribution cost are lower, the same relative split of equipment and labor is generally observed. In the aggregate, therefore, the typical unit cost to OpTel of wiring and distribution is between $180 and $350. The figure of $250 per unit used by OpTel is slightly below the average of this range, but is entirely dependable and consistent with actual experience.

2.2 The Pleaders also state that the costs used by OpTel for other items are "likely inflated as costs are provided by OpTel in support of its position without any supporting details." Each of these figures are taken from OpTel's confidential internal cost reporting data and are consistent with, or even marginally below, OpTel's actual experience. Further, given the experience of the Pleaders, they should quickly be able to determine that the figures are genuine estimates of the costs that would be incurred by new market entrants (without the bulk buying power that the Pleaders enjoy). The cost of converter boxes, interdiction technology, microwave receivers and typical headends are either well known, or can be verified with only limited market experience.

2.3 As an additional example, OpTel's total investment at August 31, 1997 (its last financial year end) amounted to $147 million (after deducting telephone investment and computer equipment), for a total number of units passed, at that date, of 254,032. This represents a cost per passing of $616 which is in line with the figure of $623 ($187,000/300 units) identified by OpTel in its financial analysis.

3. **Other assumptions**

3.1 The Pleaders contend that a 60% penetration rate (used by OpTel in its financial analysis) is too low. In fact, this figure is quite close to the average penetration rate experienced by OpTel across 314,000 passings in nine large US cities. Indeed, this figure is in excess of the actual rate experienced by several other private cable operators who make public such information.

4. **Misleading emphasis on unimportant assumptions or methodologies**

4.1 The Pleaders refer to the terminal multiple of 7 times used in the OpTel financial analysis. It is unclear from the Pleader's reply comments whether they consider this multiple to be too low or too high. They rightly point out that hardwire systems rely on terminal multiples of between 9 - 11, although they also point out that OpTel is not considered a hardwire system. There is a distinction of multiples to be used by franchise operators versus private operators; the later should be lower. However, included with the OpTel financial analysis was a table indicating the sensitivity of its conclusions to this assumption. This analysis indicates that the potential returns from the business are largely insensitive to changes in this multiple. For example, each increase of 1 in the terminal multiple (for example from 7 to 8) has the approximate effect of increasing the implied return from the business by 1%. Therefore a multiple of 10 would increase the implied return (with a 75% probability of contract renewal and minimum life of 10 years) to 10.2%. To spend time ridiculing such a small part of the OpTel financial analysis only reveals the complete lack of substance to the Pleaders' criticisms.

4.2 The Pleaders claim that the use of post and pre-tax rates of return by OpTel is a reason to ignore the analysis. However, OpTel only introduced this complexity into its reasoning in an attempt to indicate that investors are satisfied with differing levels of return. It was not an attempt to compare apples and oranges, but rather to compare expectations and reality. If, as explained above, the best possible return that can be obtained for the OpTel cable business is 10.2%, it is somewhat academic to discuss whether a typical investor's required rate of return is post, or pre-tax. Because any new market entrant carries a degree of risk, it should not be surprising that a normal investor would expect to generate a return of more than 10.2% from an investment in such a company. Attacking the use of post and pre-tax returns is intended to detract from this most basic of observations. In fact, OpTel expects to generate returns somewhat higher than this level because its average contracts are for a period in excess of ten years, and because it is permitted to offer products other than cable that share the same operating cost infrastructure (but note - not the same capital cost infrastructure, and therefore it is not relevant to consider those incremental returns here).

4.3 The Pleaders reference to OpTel's use of "the time value of money" also is misleading and confusing. Indeed, OpTel refers to the time value of money once, in paragraph 6.3 of the original financial analysis. This paragraph 6.3 is wholly separate from any of the calculations relating to financial return (which forms the basis of most of the paper) and is used to demonstrate that it takes more than nine years to payback the capital required to service an individual unit. Thus, a limit on the exclusivity period below nine years would not even allow capital to be returned. The reference to the "time value of money" was intended to point out that even nine years is too short of a period of exclusivity because there is a need to earn a profit from the capital invested, and that this cannot be accomplished until well after the nine-year period has elapsed.

Richard Alden /s/

Richard Alden