Transfer Report:
Adelphia Communications Corporation
to Time Warner Cable:

Analysis and Recommendations Regarding Time Warner Cable's Request to Acquire the Cable Television Systems Owned and Operated by Adelphia Communications Corporation in Nash County, North Carolina

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Recommendation Regarding Time Warner Cable's Request to Purchase Adelphia Cable System

Summary:
Around June 16, 2005, most of you received a Form 394 from Time Warner Cable ("TWC") requesting your approval for the Company to buy the bankrupt Adelphia system serving unincorporated *Nash County* and the *Nash County Communities*.[1] We have carefully reviewed this form and sent Time Warner Cable two sets of followup questions; the first set on July 9 and the second set on August 19, 2005. A financial analyst was retained to evaluate the financial statements of both Time Warner Cable and its parent in addition to the Form 394s and various filings made at the FCC. Time Warner Cable responded to these inquiries on July 22, 2005 and September 20, 2005, but failed to provide sufficient information for a complete assessment of the Company's financial, technical, legal, and character qualifications to purchase your local cable system. As such, the 120 day period within which the local franchising authority must act has been stayed, but out of an abundance of caution we are asking that you act on this recommendation within the original time frame. Inaction by October 13, 2005 could otherwise be viewed as approving the transaction.

During various cable-related needs assessment implemented in a number of your communities over the last few years, a number of issues came to light. Overall, residents believe cable rates are too high. They want access to cable modem service which is currently not offered by Adelphia, a wider array of programming and improved customer and technical service. Many residents are still deprived of cable service entirely, with some communities reporting that Adelphia has failed to meet its household density requirements. In essence, residents want access to an upgraded cable system, more services, improved customer service and lower rates.

Six categories of qualifications were evaluated as part of our assessment which were ultimately reduced to four. Because the New Franchisee, TWNY, will be 100% controlled by Time Warner Cable and ultimately by its parent, Time Warner, we examined the qualifications of these companies as well. We found that while TWNY is legally qualified to purchase the Adelphia systems, the character qualifications of its parents are far from untarnished. Although Time Warner Cable has been qualified to deploy technologically advanced systems in the past, our assessment is that it is not financially qualified to purchase the system without engaging in business practices that will have a significant detrimental impact on local subscribers.

Especially in light of the community needs identified above, we must seriously caution each community on what we believe will be the impact of this sale: higher cable rates, minimal likelihood of cable system upgrade and reduced customer and technical service due to the need for the New Franchisee to pay down significant debt, and produce revenues for shareholders. The Company will face enormous strain as its financial imperatives give it no choice but to reduce large expense items, such as employees, employee benefits and capital infrastructure costs at the same that it must

[1]Bailey, Castalia, Dortches, Momeyer, Middlesex, Red Oak, Spring Hope, Whittakers

increase these resources and facilities to grow its new phone business and integrate millions of new Adelphia customers.

In essence, in the face of inevitable rate increases, we would advise against approving this sale unless it can be conditioned on the promise of a cable system upgrade within a reasonable time frame. (Cable modem service is now intricately linked to a community's future economic development.) In all documentation received to date, Time Warner Cable has refused to commit to such an upgrade or to in anyway change the status-quo operation and structure of the system. This analysis is detailed below.

STUDY

Background on Communities

Although all nine communities are served by Adelphia (the "Adelphia Communities"or "Nash County Adelphia Communities"), renewal of the Adelphia franchise is pertinent to only six of the nine communities associated with this transfer: Momeyer, Nash County (2 expired), Bailey, Dortches, Middlesex, Whitaker (4 in the 36 month window). Future cable-related community needs identified as part of those renewal processes include a significant need for the cable system to be upgraded, access to cable modem service and a larger number of channels,[2] a need for the Company to build out to its full home-density requirements, the allocation of a minimum of three PEG channels, the interconnection of the system serving the communities for the sharing of PEG programming, and improved customer and technical service.

Background of Adelphia Buyout

Adelphia declared Chapter 11 bankruptcy on June 25, 2002. On April 20, 2005, Comcast and Time Warner, the Country's first and second largest cable companies, reached agreements to acquire all the U.S. assets of Adelphia for $12.7 billion in cash and 16% of the common stock of Time Warner Cable. Under the terms of the transaction, approved by the boards of directors of all three cable operators, Time Warner will pay Adelphia's stakeholders $9.2 billion in cash and 16% of TWC's common equity. (A new public publicly traded company will emerge at the end of the transactions as a result of the 16% being identified for public offering).[3] In addition, Comcast will pay Adelphia $3.5 billion in cash. The initiative to buy Adelphia stemmed in large part from an interest in "super-clustering."

Time Warner and Comcast system super-clustering will occur in four separate steps. In step one, Time Warner will buy Adelphia systems in about 29 states for $9.2 billion in cash and by offering "Adelphia stakeholders"16% of what will be emerge as a new publicly traded company. Comcast

[2]Whitakers, for example, reports having only 33 cable channels.

[3]Recent trade journals report that corporate raider Carl Icahn is pressing Time Warner (the parent of Time Warner Cable) to increase the amount of shares sold in an IPO or to sell off Time Warner Cable entirely, among other directions he believes will increase the share price of the parent company.

will purchase Adelphia systems in seven states for $3.2 billion cash. In the second step, Time Warner and Comcast will then swap a number of systems, which will include some of the newly-purchased Adelphia systems and some currently owned, non-Adelphia systems. The third step is an unwinding of Comcast from its 21% ownership of Time Warner Entertainment, a subsidiary of Time Warner Cable, Inc. This will consist of Time Warner Cable, Inc. paying Comcast ~$1.9 billion in cash for Comcast's 17.9% ownership in Time Warner Cable's "subsidiary" Time Warner Entertainment, and giving Comcast cable systems in Florida, Tennessee and Minneapolis. Time Warner Entertainment will then pay $1.33 million for Comcast's 4.7% holding in Time Warner Entertainment and give Comcast some of its cable systems in Louisiana and Mississippi. The fourth and final step will consist of Time Warner becoming into a new publicly traded company, over which it will exercise 91% voting control, and own 84% of the stock, with the remaining 16% owned by "Adelphia Stockholders."

At the end of these transactions Time Warner will have obtained greater geographic scope by enhancing the size of its clusters in 5 key areas including western New York, Maine, the Carolinas, Texas and Southern California (including Los Angeles) while maintaining its cable systems in Wisconsin and owning all the cable systems in Hawaii. It will enhance its overall cable subscribership by about 32%, from 10.882 million to 14.4 million. Comcast will also obtain enhanced size and greater regionalization, while taking on significantly less debt than Time Warner. It will increase its cable subscribership by about 8%, from 24.9 million to 26.67 million, serve 45%[4] of cable homes in the country as the largest cable operator and control access to 70% of the subscribers in the top 20 advertising markets.

The transaction is subject to approval by the U.S. Bankruptcy Court for the Southern District of New York, the Security Exchange Commission, the Federal Trade Commission, the Federal Communications Commission for anti-trust purposes (Hart-Scott-Rodino) and media consolidation, and by state and/or local franchising authorities through the FCC Form 394 transfer form and terms of the respective local franchises.

On or about June 16, 2005, all but three of the Adelphia Communities received a copy of Time Warner Cable's Form 394 which described the company's interest, as the parent of Time Warner NY Cable LLC ("TWNY"), in purchasing the local Adelphia cable system.[5] On July 9, 2005, on behalf of the Adelphia Communities, Action Audits informed Time Warner Cable that the Company's Form 394s were not "complete," this staying the 120-day deadline for local franchising authority approval, and provided the Company with further questions. On July 22, 2005, TWC submitted responses to these questions. On or about August 19, 2005, Action Audits informed Time Warner that these answers were again insufficient, that the Form 394s remained incomplete, that the stay on

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[4]30% of all Multichannel Video Program Distributor homes.

[5]Time Warner has refused to send a Form 394 to Castalia and Red Oak, claiming the franchises in these two communities do not require the municipality's approval for the transfer of ownership. The Company's position has been challenged through a series of Action Audits August and September 2005 letters.

the 120-day deadline remained in effect, and provided the Company further instruction on the types of answers necessary for the local franchising authority to properly complete its transfer of ownership assessment. TWC was asked to provide responses by September 2, 2005. On September 20, 2005, TWC responded to these questions, again providing insufficient information for a complete assessment. Out of an abundance of caution, this final assessment is being completed within the original 120-day period without waiving the local franchising authority's claim that the 120 day period has not yet begun, or their right to continue the process until sufficient information has been collected for a truly complete assessment.

Factors for Evaluating the Transaction

Based on the terms of each local franchise, Action Audits focused on the following various factors in making its recommendation on whether to approve or deny the transaction, including:

1. Legal and character qualifications of Time Warner Cable;
2. Technical Ability of Time Warner Cable and its operational staff;
3. Financial stability and qualifications of Time Warner Cable, and the impact of the Transaction on service and rates;
4. Future managerial qualifications of Time Warner Cable;
5. Impact on cable service competition;
6. Other appropriate public interest factors, including those required by local law, such as the impact on the LFAs' cable franchise renewal rights.

I. LEGAL & CHARACTER QUALIFICATIONS

The legal qualifications standard relates primarily to the analysis of whether Time Warner NY Cable LLC ("TWNY") is duly organized and authorized to own the cable system and the franchise via the transfer transaction. It also involves an analysis of whether the overall transaction complies with federal, state and local law. The ownership of the franchise will, in the end, rest with the ultimate parent of the franchise holder, so the name, control and nature of this company must be determined. The primary purpose of evaluating a transfer applicant's character qualifications are to ascertain whether it is likely that the applicant, through its officers and directors, will defraud local cable subscribers, the local franchising authority, or renege on its franchise obligations.

Analysis:

Overall, while Time Warner Cable and its parent appear legally qualified to purchase the Adelphia system, the Company's character qualifications are far from untarnished. If the communities approve this transaction, they will be served by a cable operator who is controlled by a company, Time Warner, Inc., whose tolerance for questionable accounting and security practices has led to historical billion dollar settlements with the U.S. Department of Justice, the Security and Exchange Commission, and over 50 class action lawsuits. It will be served by a company whose direct parent, Time Warner Cable, engaged in business practices which led to class action lawsuits by mistreated cable subscribers, who has ignored federal law regarding transfers of ownership and who sued, or was sued, due to an intolerance of local laws.

Legal Qualifications
Under the buy-out offer, the New Franchisee for the Adelphia Communities will be Time Warner NY Cable LLC ("TWNY"), a Delaware company qualified to do business in North Carolina. TWNY is currently 100% owned by Time Warner Cable, a company owned, through subsidiaries, by Time Warner Inc. (82.1%) and Comcast (17.9%). While TWNY will continue to be 100% controlled by Time Warner Cable, this ownership will become indirect after the sale.[6] In addition, after the Adelphia transaction, the parent companies, who ultimately control the operations of Time Warner Cable and TWNY, will change. Time Warner Cable will be controlled by Time Warner Inc. (84%)[7] and "Adelphia stakeholders" (minimum of 16%)[8].

In its July 22, 2005 response, Time Warner Cable notes that it is aware that it will be buying systems with "expired" franchises in a number of the Adelphia Communities, (namely Nash County, Momeyer and Whitaker) but fails to accept that these franchises have expired.[9]

Character Qualifications
Character qualifications address whether there are indications that the New Franchisee (or its parents or affiliates) will defraud subscribers or a local franchising authority, or renege on its franchise obligations. Toward this end, Time Warner Cable is currently named as a defendant in two class action lawsuits for the allegedly tying the purchase of cable modem service to the lease of cable modems and for the unauthorized selling of subscribers' personally identifiable information.[10] The Company's history also includes ignoring federal law and taking control of or selling cable systems where the franchising authority has denied the transfer of ownership.[11] It also is challenging local law as it is currently engaged in a legal proceedings against one community who denied it a franchise renewal,[12] and was sued by another for the Company's unauthorized conversion of public access channels to commercial channels.[13]

Time Warner Inc, who controls TWC and TWNY, made the news recently for its historical (~$500

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[6] 100% Time Warner Cable control but divided nonvoting control through a Time Warner Cable Holding company (88% non-voting common stock) and ATC (12% non-voting common stock), a subsidiary 100% controlled by Time Warner Inc.

[7] 90.5% voting control

[8] 9.5%voting

[9] TWC July 22, 2005 Response at page 3.

[10] Form 394 at Exhibit 5.

[11] Cary, N.C., Daytona Beach, FL - Form 394 Exhibit 4.

[12] Mecklenburg County, NC - TWC July 22, 2005 Response at page 4.

[13] City of Minneapolis, MN - *Id.* at page 5.

million) settlement of Department of Justice and SEC investigations into the Company's alleged securities law violations and improper accounting practices. TWC reported that TWX is named in more than 50 shareholder class action lawsuits and three ERISA class action lawsuits. TWX recently agreed to pay $2.5 billion to settle some of its securities fraud litigation [14]

As part of this proceeding, TWC refused to list whether any of its parent, subsidiaries, or principals who had been charged in the last seven years with 11 varied forms of business malfeasance, such as antitrust behavior, fraud or tax evasion. The Company stated it was unaware of any criminal charges ever being brought against it, nor had it been subject to a "adverse finding" by any court in a civil or criminal proceeding for a number of named offenses.

II. TECHNICAL ABILITY OF TIME WARNER CABLE AND ITS OPERATIONAL STAFF

A technical ability focused on the technical expertise and experience of the parent company(s) of the "New Franchisee," since it (they) will likely direct and control investment in the day-to-day operations of the local system.

Technical issues involve whether local technical staff with whom the County is familiar will continue to serve the local community, or whether the new company will introduce its own and regional technical resources, affecting the new Company's historical understanding of the system and ability to maintain and update the local cable plant or improve customer service, such as telephone answering response times. Technical issues for the County also include whether the new company will resolve the ongoing technical problems which characterize the cable system in the Adelphia Communities and when the new company will upgrade and introduce cable-modem service into this system.

Analysis

While TWC has been technically qualified to deploy advanced cable services in the past, TWC has refused to make any commitment to upgrade the Adelphia Communities' cable systems and has given every indication that the current operation of the Adelphia cable systems will not change under its control in the foreseeable future. This includes a refusal to commit to the use of regional TWC facilities that could relatively easily be extended to the Adelphia Communities. As such, the Communities have no assurance of gaining any benefits by approving the transfer, but should expect higher cable rates and diminished customer and technical service, as detailed under the Financial Qualifications section below.

The technical qualifications of the new owner of the cable systems serving the Adelphia Communities is of critical importance to the Adelphia Communities. Access to high speed cable

[14] *Id*. The settlement is among the top five securities fraud class-action settlements in history and is the second largest in history paid by the issuer of a security and its auditor. The Government probe involves charges that AOL had inflated its advertising revenues and inflated internet subscriber numbers. The result of the settlement was TWX reporting its first quarterly loss since late 2002. See **"Time Warner in $2.5B fraud settlement"** August 3, 2005 at money.cnn.com/2005/08/03/news/fortune500/timewarner_settlement/?cnn=yes.

modem service is now tied to local economic development. Through this transfer process, Adelphia Communities informed TWC that the are currently served by an outdated and unreliable cable system which is sorely in need of an upgrade and proper technical maintenance. Cable modem service is not offered. Time Warner Cable states in both its cover letter and within the body of its Form 394 that it has a reputation for introducing highly advanced technologies into local communities. Trade press coverage of this national buy-out describe how the new super-clustering of its systems will allow Time Warner Cable "greater geographic scope, regional efficiencies and an ability to more effectively compete with Incumbent Local Exchange Carriers" (although these LECs have expressed no interest in providing the Nash County Adelphia Communities any triple play of services). Such statements indicate a clear interest on the part of Time Warner Cable to further regionalize its customer service and technical maintenance resources. Yet in answering specific questions regarding staffing, the upgrade of the system or the use of regional resources, Time Warner Cable was unforthcoming.

Staffing: TWC failed to provide any specific plans on the staffing of local operations. When asked if it planned to assume all existing staff positions to maintain a seamless transition and familiarity with the local cable systems, the Company responded that it is "premature to develop precise plans"[15] until it has acquired the system. While TWC reported there were certain employees to whom TWNY is obligated to "make offers," it provided no specifics.[16] While the Company assured that it will not make any "management, operational, or technical changes that would adversely affect the conditions of service and operations of the system,[17] what each community might consider adverse, might not be considered adverse by a Company seeking to maximize profit and reduce Adelphia transaction debt.

Regionalization: TWC made no commitment, and claims to have no plans, to utilize regional facilities and resources in service provisioning to the Nash County Adelphia Communities. Despite numerous national presentations of the Company's intention to create super-clusters and gain efficiencies through the regionalization its resources,[18] TWC responded that it is "premature to develop precise plans" regarding its intention to regionalize the technical and customer service operations which serve or will serve the Adelphia Communities.[19] This response was repeated when the Company was asked to describe plans to interconnect the Adelphia Communities' cable systems,

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[15]TWC July 22, 2005 response at page 6.

[16]TWC September 20, 2005 response at page 5.

[17]*Id.*

[18]See, for example, TWC May 18, 2005 submission to the FCC documenting the public interest benefits of transferring Adelphia licenses to TWC and Comcast as part of the buy-out transaction. TWC describes super-clustering as "geographic rationalization" which will "promote efficiencies" which will "redound to the benefit of cable subscribers" and states that it will save $200 million as a result of this rationalization. (pages 49-50 and page 59).

[19]TWC July 22, 2005 response at page 6.

and to describe any regional facilities and resources of Time Warner Cable which TWNY will utilize in providing service to the communities. TWC repeated its "confidence" in its "proven ability to consolidate..operations" and that it "anticipate[d]" bringing its "exemplary record of customer service and technical performance" to each local community, while unequivocally stating it "has not formulated plans for operations changes in the system"[20] and that its inability to be more specific "is not a result of any...absence of planning."[21] A natural conclusion is that the Company's plan is for no operational changes to the status quo.

Upgrading the System: TWC failed to commit to upgrading the cable systems serving the Adelphia Communities, and likened the Communities' inquiry on whether the Company planned to "add[] any new services" to "being held to unreasonable...expectations to foretell future events."[22] Despite the fact that these questions described the Adelphia Community systems as in need of an upgrade and "suffer[ing] from consistent outages," "without cable modem service" and "severely limited" in choice in programming,"[23] TWC responded that it had "set aside" $600 million to upgrade "technologically inferior" Adelphia systems, but had not allocated the money "to particular systems" and could not be more specific for legal reasons.[24] TWC further claimed it is "legally constrained" from making "operational changes prior to closing."[25]

It is unreasonable to expect the Adelphia Communities to accept the premise that TWC would engage in a multi-billion dollar buy-out and have no specific plans on which systems it will upgrade, a critical component to all future revenue generation. The identification of "technologically inferior" cable systems would be an expected element of any due diligence exercised prior to making a buy-out offer of this magnitude, and plans to allocate such monies do not require operational changes prior to closing. TWC has stated to the Nash County Adelphia communities that it has "no current plans to change the existing channel line-up in the short term."[26] Again it appears that the Company will maintain the status quo.

III. FINANCIAL STABILITY AND OTHER FINANCIAL ISSUES

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[20] TWC September 20, 2005 response at page 7.

[21] *Id.*at page 5. TWC also suggest it would "expect that the existing headend would remain in place for the foreseeable future" but "might be consolidated" with nearby TWC facilities when it deems it necessary. TWC also stated it would "maintain a customer service office to serve local customers" but fails to specify if that will be a location in the community served. *Id* at page 8.

[22] *Id.* at page 7.

[23] See TWC September 20, 2005 Response at page 6.

[24] TWC September 20, 2005 Response at page 6.

[25] *Id.,* at page 5, and by reference at page 6.

[26] *Id*. at page 7.

An evaluation of financial stability includes whether TWNY, more specifically, the parents who control its operations, have the financial resources available or committed, now and in the future, to enable the operation of the local system in accordance with applicable laws, standards, franchises ordinances and agreements. Financial stability also pertains to whether the transfer, as presented, is reasonable and economically viable. Other financial issues to be considered are the transaction's impact on rates and services, including (but not limited to) the availability of programming services, the quality of customer service and maintenance and repair practices. This evaluation includes whether Time Warner will have sufficient cash flow after the transfer to meet local franchise obligations, including franchise fee payments and PEG support payments.

For this analysis, Action Audits hired a financial consultant who evaluated TWC's Form 394s, its responses to Action Audits financial inquiries, Time Warner, Inc. and Time Warner Cable, Inc. financial statements for the year ended December 31, 2004 as well as the Time Warner, Inc. June 30, 2005 10Q and various other documents. TWC failed to provide Time Warner Cable, Inc.'s quarterly financial statements for 2005. This financial analysis is attached at Exhibit 1, and referred to herein as the Racine Analysis.[27]

Analysis

The Racine Financial Analysis ("Racine Analysis") concludes that Time Warner Cable's purchase of the Adelphia systems will likely have a detrimental impact of cable subscribers in the Nash County Adelphia Communities. This impact includes a high likelihood of increased cable rates, a minimal likelihood of local cable system upgrades and diminished customer and technical services. The Racine Analysis also cautions how material financial uncertainties associated with the transaction and questionable business practices engaged in by the New Franchisee's parent companies oppugn the Company's long term ability to meet future franchise obligations.

The Racine Analysis draws these conclusions from an assessment that <u>TWC is currently a highly leveraged company with low liquidity who will be required to double its long term debt to buy the Adelphia systems</u> and engage in the Comcast swaps and redemptions for the benefit of super-clustering. For this advantage, TWC is paying an above market price of about $5,400 per cable subscriber. TWC in turn will need to return its investment in the Adelphia transactions and to increase annual revenues to shareholders within this framework of increased debt. This means the Company will be required to raise service rates, and reduce expenses, particularly in its largest cash outflow areas: Cost of Revenues (video programming and employee costs), SG& A (Selling, General and Administrative expenses such as merit-based salary increases and employee benefits) and capital expenditures (cable system upgrades.)

<u>Highly Leveraged - Poor Liquidity</u>

The Racine Analysis reminds us that despite TWC's presentation of itself as "financially stable," TWC is entering into these significant Adelphia financial transactions highly leveraged with poor

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[27] "Financial Impact of the Pending Adelphia/Time Warner Cable Transfer of Ownership, by Racine Financial Consulting, Cary, NC, September 28, 2005. [Racine Analysis]

short term liquidity. While TWC is not as leveraged as bankrupt Adelphia, it has a high level of debt relative to its equity and assets.[28] Although TWC's parent, Time Warner Inc. (TWX) total debt to total equity is 95% (a percentage which has declined since 2003), TWC's debt is 1.3 times its equity, has increased since 2003, and will increase to 1.59 after the Adelphia purchase.[29] While TWX's total liabilities represent roughly 40% of its total assets, TWC has liabilities equaling 56% of its total assets. This makes TWC a higher risk to creditors than TWX.[30]

TWC represents a significant portion (22-44%) of the assets, liabilities, equity, income and interest expense of its parent, TWX. Yet TWC provides only 4% of Time Warner's (TWX's) Quick Assets, indicating a relatively low liquidity level for TWC.[31] TWC's current assets are only 30% of its current liabilities, putting TWC in a questionable position of being able to pay short term liabilities. In fact, the Racine Analysis reports that all of TWC's liquidity ratios reflect a potential problem with liquidity. TWC is even less liquid now than bankrupt Adelphia was at year-end 2003. With a defensive interval of 33 days, TWC could continue business one month in the absence of external cash flows.[32] This means TWC will be able to meet short term obligations as long as its predicted revenues are not interrupted. Any absence of or decrease in revenues would put TWC in danger of not being able to meet even short term bills, much less longer term debt.[33]

The Racine Analysis notes that the Adelphia transactions and future acquisitions will further increase TWC's debt and reduce its liquidity.

<u>Considerable New Debt in Exchange for Significant Clustering</u>

In order to effect these Adelphia transactions, TWC plans to assume $8.9 billion in new debt and to issue publicly traded stock in TWC. Doing so will more than double TWC's long-term debt and will increase its debt to equity ratio from 1.28 in December of 2004 to an estimated 1.59 after the Adelphia transactions are complete.[34]

Time Warner Cable will gain 3.5 million subscribers when all Adelphia transactions are complete. The total cash required by TWC for these Adelphia transactions is roughly $11.2 billion. The Racine Analysis calculates that TWC will effectively pay over $19 billion for the 3.5 million

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[28] *Racine Analysis* at page 2.

[29] *Id. at page 2.*

[30] *Id.*

[31] *Id.* at page 1.

[32] *Id.*

[33] *Id.*, pages 1-2.

[34] *Id.,* at page 1.

Adelphia/Comcast subscribers, resulting in an effective cost per subscriber of over $5400.[35] TWC is willing to pay such a premium for the Adelphia transactions in order (1) to achieve over 30% subscriber growth and (2) to benefit from significant clustering; over 85% of TWC subscribers will reside in the top five markets.[36]

Rate Increases

The Racine Analysis notes the high likelihood of cable rate hikes in communities where TWC purchases the Adelphia cable systems. This conclusion is supported by industry trends, TWC's rate history and TWC's need to return its investment in the Adelphia transactions. The Racine Analysis details how the GAO has reported annual rate increases by the cable industry that have outpaced inflation, and overall higher cable rates in clustered cable systems (a sought-after outcome of TWC's Adelphia transactions).[37] TWC also has a history of raising rates to produce annual increases in revenues, and admits it will continue to do so to "grow their video revenues in a maturing market."[38] Finally, the Racine Analysis details that if TWC were not to increase rates and not to reduce expenses after the buy-out, it would take the Company 57 years to return its investment in Adelphia.[39]

Reduced Service Levels: Diminished Customer and Technical Service

The Racine Analysis notes that TWC "will look to its biggest cash outflows: Cost of Revenues: Selling, General and Administrative (SG&A) expenses and capital outflows to cut costs and turn a profit on its Adelphia transactions."[40] Cost of Revenues represented over 70% of TWC's total costs and expenses before depreciation, amortization and goodwill impairment between 2002 and 2004.[41] TWC's biggest contributors to Cost of Revenues include video programming and employee costs. The Company claims it is unable to influence video programming costs. It will therefore aim at reducing employee costs. That means reducing "headcount" which in turn will affect customer and technical service.[42] SG&E represented 28% of TWC's total costs between 2002 and 2004, with 40% of SG&E represented by "employee expenses," such as salary increases and benefits.[43] TWC will

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[35]*Racine Analysis* at page 1.

[36]*Id.*

[37]*Id.,* at page 2.

[38]*Id.*

[39]*Id.* at page 3.

[40]*Id.*

[41]*Racine Analysis* at page 3.

[42]TWC September 20, 2005 Response at page 9. TWC also reports certain one-time employee restructuring costs f $225 million (likely aimed at management levels (TWC September 20, 2005 response at page 9).

[43]*Racine Analysis* at page3.

be required to make cuts in these areas leading to employee dissatisfaction and disaffection, especially in light of the Company's increased pressure to integrate the Adelphia system subscribers. This will lead to diminished customer and technical service.

Reduced Service Levels: Fewer Technology Upgrades

To gain a return on its investment, the Racine Analysis notes that TWC will likely aim to reduce one of its largest cash outflows: capital expenditures. In the past, over 40% of TWC capital expenditures were devoted to customer premise equipment (initial deployment of converters and cable modems).[44] It will be difficult for TWC to reduce these expenses without sacrificing quality, and especially difficult to reduce these expenses in light of a 30% increase in subscriber base from the Adelphia transactions and the Company's newly introduced digital phone product.

Historically, TWC's second largest capital expenditure (34% per year) is scalable infrastructure, line extensions, and upgrades/rebuilds.[45] TWC has earmarked $600 million for upgrading the Adelphia systems which "demonstrate inferior technology," while admitting that it has not allocated these monies to specific cable operations.[46] The Racine Analysis notes that should TWC spend the $600 million on capital expenditures, the Company would have further pressure to reduce Cost of Revenues and SG&A expenses (employee costs), further affecting customer service at a time when the Company will need to be increasing these resources to grow its new digital phone business and integrating the operations of three companies and millions of new cable customers.[47] One logical counterbalance would be for TWC to focus its upgrades on high income markets (Los Angeles), while leaving untouched low income markets less able to afford advanced services and which can generate revenue exclusive of an upgrade. In this light, it is noteworthy that TWC has refused to commit to upgrading the cable system serving the Adelphia Communities and instead simply notes its reputation for deploying advanced technologies.

Additional Financial Uncertainties and Questionable Business Practices

The Racine Analysis points to other areas of financial uncertainty for TWC, and various business practices which throw into question the reasonableness of the Company's business judgement and its long-term financial capabilities.

In recent news, corporate raider Carl Icahn has begun pressuring TWC's parent, Time Warner Cable, to more aggressively pursue its stock buyback plan and sale of its cable operations, to boost the Company suppressed stock value. The implications of such of move range from a higher percentage

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[44] *Racine Analysis* page 4.

[45] *Id.*

[46] TWC September 20, 2005 Response at page 6.

[47] *Racine Analysis* at page 4.

of the TWC taken public, to the Company being sold off completely.[48] Time Warner is also aggressively entering an entirely new business - digital phone service - which requires significant training and the addition of customer service representatives and technicians.[49] These pressures are being introduced in an environment where TWC has announced plans to buy and integrate 3.5 million new Adelphia customers while reducing large expenses, such as employee expenses.

The Racine Analysis notes other TWC questionable business decisions which could influence its financial capabilities. One example is TWC's pending litigation with Urban Cable and its 50,000 subscribers, for which TWC, an already highly leveraged company, will pay a total cost of $169 million and then relinquish ownership to Comcast. Although this trade-off is integrated into the Adelphia transactions, TWC has refused to provide any details on the rationale behind the purchase or the impact of the pending litigation.[50] The Racine Analysis discovered elsewhere that should the sale fail and the swap not occur, TWC will be required to pay Comcast $191 million.[51] In December 2003, TWC also agreed to purchase a subsidiary of its parent for $7.5 million, although the subsidiary had net assets of $7 million and had posted operating losses of $30 million in 2002 and $60 million in 2003.[52] In addition, TWC is been sued for patent infringement regarding the technology used by TWC for its pay per view, video on demand and ad-insertion services. A loss sustained from this litigation could negatively impact an area of business the Company is hoping to grow.[53]

Of critical significance is that the local franchising authorities have received no assurance that TWC has obtained the financing necessary to complete the Adelphia transactions.[54] TWC has refused to provide any detailed information, and simply generalized that the majority of funding could originate with its parent, Time Warner Inc.[55] As noted above, Time Warner itself is suffering under new pressures from corporate raider Carl Icahn to in fact free the parent of the capital intensive demands of its cable subsidiary, while Time Warner, Inc.'s own financial picture is clouded by continuing shareholder lawsuits, and record-breaking payments to the federal government to settle investigations into its AOL operating practices. This investigation has continued to subject Time Warner's Inc's financial statements to review by an independent CPA. (TWC declined to provide its 2005 quarterly

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[48]*Racine Analysis* at page 5.

[49]*Racine Analysis* at pages 5 and 6.

[50]TWC September 20, 2005 Report at page 11.

[51]*Racine Analysis* at page 5.

[52]*Id*. at page 8.

[53]*Id.*

[54]*Id.* at page 2.

[55]TWC September 20, 2005 Response at pages 12-14.

statements which could have revealed the financial impact of this review on its ability to finance the Adelphia transactions.)[56] The uncertainties of the buy-out's financing become more acute when recognizing that some of the stages of the buy-out might not occur. For instance, should the Comcast portion of these Adelphia transactions fall through, TWC has agreed to purchase the entire Adelphia system which would require an additional $3.5 billion.[57]

Finally, as if un-phased by the contradictory burdens of doubling it long term debt in the face of current low-liquidity and high debt-to-equity ratios, increasing revenues and reducing employee-related costs and capital expenditures while upgrading its networks, growing a new phone business and integrating three companies that have previously operated separately,[58] TWC has announced that it will utilize its new IPO position to pursue other cable system acquisitions in the near future.[59] Such future growth poses the same risks and uncertainties brought about by the Adelphia transactions while compounding their potential impacts.

IV. MANAGERIAL QUALIFICATIONS

Managerial qualifications and changes in the organizational structure of the Company who will exercise ultimate ownership and control of the local cable system, can be significant to the local operation. For instance, the local franchising authority should know who is controlling the Company which will hold such a significant media presence in its community. The local franchising authority should also know if the Company serving its community will be controlled by a small handful of individuals or a large group of shareholders. For example, a new Company could be created as part of a transfer, which includes changes in its organizational and management structure which could place control of the Company into the hands of a small group of managers and officers in a manner which makes them less accountable to shareholders, the board of directors, and the local community the Company serves. (Changes such as these were reported as part of Comcast's buy-out of AT&T Broadband).

Analysis:
After the Adelphia Transactions, Time Warner Inc. will continue to have the ability to appoint and remove all members of the TWC Board of Directors, provided, however, that for at least three years after the closing of the transaction, the composition of the TWC Board of Directors must satisfy the requirement of the N.Y. Stock Exchange and at least 50% of the members of the Board of Directors must be independent. No shareholder has the ability to remove TWC senior management and officers. This power will continue to be exercised by the Board of Directors. TWC's July 24, 2005 Second Amended Disclosure Statement, filed with the FCC, discloses that various TWC Board

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[56] *Racine Analysis.* at page 8.

[57] *Id.* at page 5.

[58] *Id.*, at page 7.

[59] *Id.* at page 8.

members are also executive officers of Time Warner, Inc., placing the interests of TWC at risk, notably due to conflicting business interests causing them to favor TWX over TWC[60] This has been recently evidenced by TWX's shareholder Carol Icahn's interest in boosting TWX share values by selling off pieces of what he sees as the capital intensive burdens Time Warner Cable places on TWX, a less capital intensive, information content company. Such TWX Executives, with shares in the parent company, might be inclined to vote against the business interest of TWC if such actions boost the share values of their direct employer.[61]

[60]TWC Second Amended Disclosure statement, June 24, 2005, page 300 of 356.

[61]*Id.*

EXHIBIT 1:

RACINE FINANCIAL ANALYSIS