

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

In the Matter of:)
)
TCI CABLEVISION OF ARCADIA/)
SIERRA MADRE)
)
Appeal of the Local Rate Order for)
the City of Arcadia, California)

ORDER

Adopted: September 5, 1996

Released: September 12, 1996

By the Chief, Cable Services Bureau:

INTRODUCTION

1. On July 20, 1995, TCI Cablevision of Arcadia/Sierra Madre ("TCI"), the franchisee in the above matter, filed an appeal of a local rate order adopted on June 19, 1995 by its local franchising authority, the City of Arcadia, California ("the City"). The rate order establishes a new regulated rate schedule for TCI's basic service tier and associated equipment and installations.¹ In its order, the City reduced certain equipment rates proposed by TCI in its Form 1205. The City filed an opposition to TCI's appeal on August 3, 1995.

2. In its local order, the City found that TCI had incorrectly included in its rate calculations certain costs described by the operator as overhead expenses for converter units.² TCI defined these costs as: material costs (cable jumpers, fittings, etc.); labor costs associated with the installation of converters; labor costs to retrieve converters from customers; and operating costs to manage the converter population, i.e., inventory management costs.³ The City found that TCI had erroneously capitalized these costs, enumerating them in Schedule C, Capital Costs of Leased Customer Equipment of Form 1205. TCI's inclusion of its overhead expenses for converter units in Schedule C increased the operator's equipment rates. In its review of TCI's

¹Under the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act") and the Commission's implementing regulations, local franchising authorities may regulate rates for basic cable service and associated equipment. See Cable Television Consumer Protection and Competition Act, Pub. L. No. 102-385, 106 Stat. 1460 (1992); Communications Act of 1934 § 623(b), 47 U.S.C. § 543(b).

²See TCI's Petition for Review of Rate Order at Exhibit 1.

³*Id.*

Form 1205, the City excluded all of these costs, thereby reducing TCI's rates to subscribers for addressable and non-addressable converters by \$0.28 and \$0.27 per month, respectively.

3. TCI seeks review of the local rate order with respect to two issues. TCI states that the local order violates federal law and Commission rules (1) by treating both the labor costs of installing and retrieving converters and the operating costs of managing converter inventory as installation costs, and consequently prohibiting them from inclusion on Schedule C; (2) by misclassifying material costs for converters as drop costs, and consequently prohibiting them from inclusion on Schedule C.

4. Under our rules, rate orders made by local franchising authorities may be appealed to the Commission.⁴ In ruling on appeals of local rate orders, the Commission will not conduct a *de novo* review, but instead will sustain the franchising authority's decision as long as there is a reasonable basis for that decision.⁵ Therefore, the Commission will reverse a franchising authority's decision only if it determines that the franchising authority acted unreasonably in applying the Commission's rules in rendering its local rate order.⁶ If the Commission reverses a franchising authority's decision, it will not substitute its own decision but instead will remand the issue to the franchising authority with instructions to resolve the case consistent with the Commission's decision on appeal.⁷

DISCUSSION

5. The two issues raised by TCI on appeal involve preparation of FCC Form 1205. The portions of Form 1205 that are relevant to TCI's appeal are Schedule B, Annual Operating Expenses of Service Installation and Maintenance of Equipment and Plant, and Schedule C, Capital Costs of Leased Customer Equipment. Form 1205 is the official form used by regulators to determine whether an operator's regulated rates for equipment and installations are reasonable under the revised benchmark rules which apply to operators beginning May 15, 1994.⁸ Pursuant to the 1992 Cable Act, the Commission has established standards for setting, on the basis of actual cost, the rates for installation and lease of equipment used by subscribers to receive the

⁴See 47 C.F.R. § 76.944.

⁵See Report and Order and Further Notice of Proposed Rulemaking in MM Docket 92-266, 8 FCC Rcd 5631, 5731(1993) ("*Report and Order*"); Third Order on Reconsideration in MM Docket 92-266, FCC Rcd 4316, 4346 (1994) ("*Third Recon. Order*").

⁶*Id.*

⁷*Id.*

⁸See Second Order on Reconsideration, Fourth Report and Order, Fifth Notice of Proposed Rulemaking in MM Docket 92-266, 9 FCC Rcd 4119 (1994) ("*Second Recon. Order*").

basic service tier.⁹ Equipment rates are derived from total capital and maintenance costs per unit of equipment. Installation rates are derived from a calculation of an hourly service charge and an application of that charge to different types of installations.¹⁰ The maximum permitted rates for installation and lease of equipment calculated pursuant to these Commission regulations as determined on Form 1205 are deemed to be reasonable, and are, therefore, lawful under the 1992 Cable Act.¹¹ Under Commission rules, cable operators have the burden of proof in demonstrating the reasonableness of existing or proposed rates for their basic service tier and associated equipment.¹²

A. Costs of Installing and Retrieving Converters and Managing Converter Inventory

6. The first issue raised in TCI's appeal involves the treatment in Form 1205 of the labor costs of installing and retrieving converters and the operating costs of managing converter inventory. Citing Commission regulations that require equipment rates to be based on actual costs, TCI contends that it must be permitted to recover the costs of installing and retrieving converters, and the costs of managing converter inventory.¹³ Moreover, TCI argues that these costs should be capitalized, and thus included in Schedule C of Form 1205.¹⁴ TCI maintains that even though certain types of labor costs should be included in Schedule B as part of installation rates, the labor costs of installing and retrieving converters and the operating costs of managing converter inventory should be accounted for in Schedule C rather than in Schedule B.¹⁵ TCI contends that placement of these costs in Schedule C enables the operator to comply most effectively with the Commission's instructions to base its rates on actual costs. TCI claims that the actual cost of installing and retrieving converters and managing converter inventory cannot

⁹Communications Act, § 623(b)(3), 47 U.S.C. § 543 (b)(3).

¹⁰To calculate the hourly service charge ("HSC"), an operator adds its expenses for equipment necessary for the maintenance of customer equipment and for the installation of basic tier service to its annual capital costs, excluding the capital costs of customer equipment. The operator then divides the total by the total number of person-hours spent in those activities over the past year. The HSC is used as a factor in developing charges for installation and monthly lease of individual pieces of equipment. *See* Form 1205 at 14.

¹¹*See* Communications Act, § 623(b), 47 U.S.C. § 543 (b).

¹²47 C.F.R. § 76.937.

¹³*See* TCI's Petition for Review of Rate Order at 3.

¹⁴*Id.* at 4.

¹⁵*See* TCI's Petition for Review of Local Rate Order at 3. According to TCI, the operating costs of managing inventory include the time and materials required to: place converter orders with a qualified vendor; receive and record converter shipments; test converters prior to their installation; close out converter work orders and key in converter serial numbers for customers' accounts in the billing system; pay vendors for tracking converters; and program addressable converters. *Id.* at 6.

be recouped through one-time charges.¹⁶ In its opposition to TCI's appeal, the City asserts that the labor costs of installing and retrieving converters and the operating costs of managing converter inventory are properly considered as costs of installation and cannot be included in Schedule C of Form 1205.¹⁷

7. The Commission rule defining the "equipment basket" states that the basket shall include all "direct and indirect material and labor costs of providing, leasing, installing, repairing, and servicing customer equipment."¹⁸ Pursuant to the 1992 Cable Act, material and labor costs included in the equipment basket must be recoverable by the operator.¹⁹ The costs of installing and retrieving converters and the operating costs of managing the converter inventory are clearly related to providing and installing equipment, and are properly classified as part of the equipment basket. Thus, TCI must be permitted to recover the labor costs of installing and retrieving converters and the operating costs of managing converter inventory.

8. TCI does not justify adequately its reasons for treating the labor costs of installing and retrieving converters costs as capital costs and including them in Schedule C. Indeed, the operator does not clearly distinguish these costs from the operating expenses and labor costs that are ordinarily included in Schedule B. Instead, TCI argues that it should include these costs in Schedule C because it has not listed them elsewhere in Form 1205. The Commission's instructions for completing Schedule B ask operators to provide "all annual operating expenses . . . for installation and maintenance of all cable facilities."²⁰ Moreover, operating expenses incurred specifically to maintain and install customer equipment are referenced expressly.²¹ Schedule C is used only to "compute the annual capital costs of equipment leased to customers."²² The Commission's instructions for Form 1205 clearly indicate that TCI should

¹⁶See TCI's Petition for Review of Rate Order at 6-7.

¹⁷See City of Arcadia's Appeal Letter at 2.

¹⁸47 C.F.R. § 76.923.

¹⁹See Communications Act, § 623(b), 47 U.S.C. § 543(b). Section 623(b)(3) of the Communications Act requires that rates for equipment and installation reflect their actual costs. See also First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking in MM Docket 92-266, 9 FCC Rcd 1164, 1190-1201 (1993) ("*First Recon. Order*").

²⁰FCC Form 1205 at 11.

²¹*Id.*

²²*Id.* at 12.

include the labor costs of installing and retrieving converters in Schedule B rather than in Schedule C.²³

9. TCI's decision to capitalize the costs of managing converter inventory is reasonable. Commission rules require operators to adhere to generally accepted accounting principles ("GAAP") when completing Form 1205.²⁴ According to GAAP, it is proper to capitalize costs incurred in storing or handling goods before they are sold. Thus, TCI's decision to capitalize its inventory management conforms with GAAP. TCI must be allowed to recover its equipment costs. Thus, TCI should be permitted to recalculate its Form 1205 to include the labor costs of installing and retrieving converters in Schedule B, and the operating costs of managing inventory in Schedule C. Accordingly, we are remanding this issue to the local franchising authority for further consideration consistent with this Order.

B. Capitalization of Material Costs

10. The second issue raised by TCI in this case concerns capitalization of certain material costs associated with TCI's converters (cable jumpers, fittings, etc.). TCI included those costs in Schedule C of Form 1205. The City characterized the costs as drop costs and deleted them from Schedule C.²⁵

11. The instructions for Schedule C direct an operator to include as capital costs all equipment for which it has established or is going to establish a separate charge. The instructions also provide that such costs may only be capitalized in Schedule C if they are not drop costs. The instructions state:

Subscriber drops may not be included on this Schedule. The demarcation point for cable home wiring in single unit dwellings is 12 inches outside of the point where the cable wire enters the outside wall of the subscriber's premises. For multi-dwelling units, the demarcation point is 12 inches outside of the point where the cable enters the outside wall of the subscriber's individual dwelling unit. Therefore, subscriber drops are considered network

²³The issue raised in this case is analogous to one discussed in *ML Media Partners L.P., trading as Multivision Cable TV* (Fairfield, CA), 11 FCC Rcd 1017 (1995) ("*Multivision*"), where the operator sought to capitalize the labor costs associated with inside wiring in its preparation of FCC Form 393. In *Multivision*, we held that, "Cable operators may not capitalize labor costs associated with inside wiring . . . [Such costs] are properly included in the charges for the installation of inside wiring." *Multivision* at 1024.

²⁴See FCC Form 1205 at 3.

²⁵The subscriber drop is that final section of the distribution plant of the cable system which connects the cable system to the premises of a single subscriber, or to a group of subscribers in a multi-dwelling unit. See *Meredith/New Heritage Strategic Partners, L.P.*, 10 FCC Rcd 13406 (1995).

equipment and may not be included as customer equipment on Schedule C.²⁶

12. TCI contends that the material costs for converters cannot be considered drop costs because all of the materials at issue are utilized inside a subscriber's home. TCI has attached to its appeal diagrams of converter installation configurations, which it argues demonstrate that the material costs at issue are used inside a subscriber's home.²⁷ In its opposition to the appeal, the City simply states that the material costs are drop costs. The City does not offer any further explanation, nor does it refute the validity of the diagrams presented by TCI.²⁸

13. If the material costs at issue are simply those presented in TCI's diagrams, they do not constitute drop costs. However, it is not clear from the record whether these materials should be accounted for in Schedule C, Capital Costs of Leased Customer Equipment, or in Schedule B, Annual Operating Expenses for Service Installation and Maintenance of Equipment and Plant. The instructions to Schedule C ask operators to, "list all customer equipment for which there is a separate charge, including . . . different types of converter boxes, and other equipment (splitters and amplifiers)."²⁹ Operators are asked to account for "supplies" for which there are no separate charges in Schedule B.³⁰ While the record is not clear whether the material costs in this case represent customer equipment with separate charges or supplies with no separate charges, they appear to be the latter. As we noted in *Multivision*, "[w]ith respect to the cost of materials associated with inside wiring, cable operators have the option of capitalizing those costs"³¹ for which they have established a separate lease charge. If the material costs at issue in this case do not constitute drop costs and are customer equipment for which the operator has established a separate charge, the costs should be included in Schedule C of Form 1205. If the costs are simply supplies for which no separate charge has been established, the operator should include the costs in Schedule B. Accordingly, this issue is remanded to the local franchising authority for further proceedings consistent with this order.

²⁶FCC Form 1205 at 12.

²⁷See TCI's Petition for Review of Rate Order at Exhibit 2.

²⁸See City of Arcadia's Appeal Letter at 2.

²⁹FCC Form 1205 at 12.

³⁰FCC Form 1205 at 3.

³¹ML Media Partners L.P., trading as Multivision Cable TV, (Fairfield, CA), 11 FCC Rcd 1017 (1995).

ORDERING CLAUSES

14. Accordingly, **IT IS ORDERED** that the appeal by TCI Cablevision of Arcadia/Sierra Madre of the local rate order of the City of Arcadia with respect to the capitalization of the labor costs of installing and retrieving converters and the operating costs of managing converter inventory **IS REMANDED** to the local authority for further consideration consistent with this opinion.

15. **IT IS FURTHER ORDERED** that the appeal by TCI Cablevision of Arcadia/Sierra Madre with respect to the capitalization of material costs **IS REMANDED** to the local authority for further consideration consistent with this opinion.

16. This action is taken by the Chief, Cable Services Bureau, pursuant to authority delegated by § 0.321 of the Commission's rules, 47 C.F.R. § 0.321.

FEDERAL COMMUNICATIONS COMMISSION

Meredith J. Jones
Chief, Cable Services Bureau