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

In the Matter of	)	
	)	
InterMedia Partners	)	CUID No. AZ0018 (City of Sierra Vista)
	)	
Cost of Service Showing to Support	)	
Cable Programming Service Rate	)	

ORDER

Adopted: June 19, 1996 **Released: June 20, 1996**

By the Chief, Cable Services Bureau:

I. INTRODUCTION

1. On August 15, 1994, InterMedia Partners ("InterMedia") filed a cost of service submission with the Federal Communications Commission ("Commission") in response to a complaint that alleges that InterMedia's cable programming service ("CPS") rate in the above-referenced franchise is excessive.[1] On October 30, 1995, and November 15, 1995, InterMedia supplemented and amended its filing in response to Cable Services Bureau staff's requests for additional information.[2]

2. InterMedia's cost of service filing seeks to establish that its CPS rate of $12.90, is justified based on its cost of providing CPS. InterMedia's FCC Form 1220 filing indicates that it provides 13 channels on its CPS tier which serves approximately 8,421 CPS subscribers. Our review of the record indicates that InterMedia's rate of $12.90 per month, as established in its Form 1220 is cost justified under the Commission's most current rules.[3]

[1] The Commission received one valid complaint in the franchise area set forth above. The complaint was filed initially on February 25, 1994, returned by the Commission on March 18, 1994, and properly re-submitted to the Commission on April 12, 1994.

[2] This supplemental information was provided in response to Requests for Additional Information submitted to InterMedia by staff of the Cable Services Bureau on October 4, and October 24, 1995.

[3] This Order does not make any findings or rulings regarding InterMedia's rates for basic service and equipment, or premium services. Regulation of rates for basic service and equipment is generally the responsibility of the local franchising authorities, and premium services are unregulated. Data for these services were reviewed only to the extent needed for our evaluation of the reasonableness of the operator's CPS rates (e.g., allocations).

3. In this review process, pursuant to the Cable Television Consumer Protection and Competition Act of 1992 (the "1992 Cable Act"),[4] we are analyzing rates for past periods to ensure that rates charged were not unreasonable, and if so, to determine the associated refund liability.[5] In reviewing and evaluating InterMedia's cost of service filing, we are applying the Commission's Second Report and Order, First Order on Reconsideration, and Further Notice of Proposed Rulemaking, MM Docket No. 93-215 and CS Docket No. 94-28 (*"Final Cost Order"*).[6]

II. BACKGROUND

4. On May 3, 1993, the Commission released its Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket No. 92-266, Report and Order and Further Notice of Proposed Rulemaking (*"Rate Order"*)[7] establishing rules to implement the cable television rate regulation provisions of the 1992 Cable Act. In the *Rate Order*, the Commission determined that a benchmark and price cap approach should serve as the primary method for regulating basic service and CPS rates. The Commission also concluded that because the benchmark methodology might not produce fully compensatory rates in all cases, it was appropriate to permit operators, as an alternative, to justify rates based on costs, using individual cost of service showings.[8] The cost of service approach was intended to be used only if an operator believed that the maximum rate permitted under the benchmark formula would not enable the operator to recover costs reasonably incurred in providing rate regulated cable services. Under traditional cost of service regulation, rates are set at a level to provide a company with recovery of its costs and a reasonable opportunity to earn a fair return on its invested capital.[9]

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4 Cable Television Consumer Protection and Competition Act, Pub. L. No. 102-385, 106 Stat. 1460 (1992) amended by Telecommunications Act of 1996, Pub. L. 104-104, 110 Stat. 56 (1996).

5 *See* Communications Act of 1934, as amended by the Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992), at Section 623(c)(1)(C). The 1992 Cable Act authorizes the Commission to order that the operator refund to subscribers that portion of rates that subscribers have paid after the filing of a valid complaint, that are then found to be unreasonable. *See* Communications Act, Section 623(c)(3), 47 U.S.C. Section 543(c)(3).

6 *See* FCC 95-502, (released January 26, 1996).

7 *See* 8 FCC Rcd 5631, 5637 (1993).

8 *Rate Order*, 8 FCC Rcd at 5794-95; *see also*, 47 C.F.R. Section 76.922.

9 Under the traditional cost of service formulation, a company's revenue requirement is equal to the reasonable expenses of providing service and a fair return on investment: $R = E + (V - d)\ r$, where R is the revenue requirement; E is expenses, including operating expenses, maintenance expenses, depreciation and taxes; V is the value of the rate base, including plant in service and working capital; d is accumulated depreciation; and r is the authorized rate of return, consisting of a weighted average of long term debt, preferred stock, and common stock. *See* Implementation of Sections of the Cable Television Consumer Protection Act of 1992: Rate Regulation, MM Docket No. 93-215, Notice of Proposed Rulemaking, FCC 93-353 (released July 16, 1993), 58 Fed. Reg. 40762 (July

5. The Commission found, however, that the record before it at the time of the adoption of the *Rate Order* did not provide sufficient information on which to develop detailed cost of service rules for the cable industry.[10] Therefore, on July 16, 1993, the Commission issued a Notice of Proposed Rulemaking which proposed requirements to govern cost of service showings submitted by cable operators seeking to justify rates higher than those determined under the benchmark approach.[11] The Commission indicated in the *Notice*, as it did in the *Rate Order*, that general cost of service principles would apply to cost of service filings submitted prior to the adoption of specific rules.[12] InterMedia's cost of service filing under review in this proceeding was submitted during that pre-adoption time period. In February 1994, the Commission adopted an order (the "*Cost Order*") setting forth specific regulatory requirements to govern cost of service filings to justify rates above levels determined under its benchmark requirements. Those rules were to apply to rates charged or to be charged after May 14, 1994. The guidance of the *Cost Order* became known as the "Interim Rules."[13]

6. Subsequently, on December 15, 1995, the Commission adopted the *Final Cost Order* setting forth its final rules to govern cost of service filings. In the *Final Cost Order* the Commission refined the approach it adopted in the *Notice* and *Cost Order* and reaffirmed the use of the cost of service approach for operators for which the benchmark approach might not produce fully compensatory rates in all cases.[14] The Commission also determined that cost of service filings still pending before the Commission can be reviewed in accordance with the *Final Cost Order*, unless the operator notified the Commission by April 8, 1996, that it wished its filing to be reviewed under the Interim Rules of the *Cost Order*.[15]

III. DISCUSSION

7. In this proceeding, InterMedia did not notify the Commission that it elected to have the Interim Rules applied. Therefore, we have analyzed InterMedia's cost of service submission consistent with the *Final Cost Order*. If we found that a certain rate base or expense element was not supported, was excessive, or was unrelated to providing regulated cable service, we

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30, 1993) (*"Notice"*) at 40765 n.18.

[10] *Rate Order*, 8 FCC Rcd at 5798-99.

[11] *Notice*.

[12] *Id.* at 40763; *Rate Order*, 8 FCC Rcd at 5798-99, 5854 n.859.

[13] *See* Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket No. 93-215, Report and Order and Further Notice of Proposed Rulemaking, 9 FCC Rcd 4527 (1994).

[14] *See Final Cost Order* at ¶191.

[15] *Id.*

disallowed that cost in whole or in part.[16] We evaluated rate base and expense items to determine whether InterMedia should be permitted to recover those items in its rates. In some cases, we found costs that are not allowable, and we made appropriate adjustments. Even with our adjustments and disallowances, however, we find that InterMedia's monthly CPS tier rate of $12.90 under review has been justified.

A. Rate Base

8. Rate base represents the amount of used and useful investment the cable company prudently makes in its facilities to provide service to its customers.[17] It is necessary to determine the allowable rate base both to calculate the return component of the revenue requirement and to compute the earned rate of return. In analyzing InterMedia's filing, we have reviewed the components of InterMedia's rate base to determine the investment upon which InterMedia is entitled to earn a return. For purposes of this review, we have made adjustments to the rate base as discussed below.

9. Construction Work in Progress: InterMedia includes an amount for Construction Work in Progress of $196,228. As a general rule, the *Final Cost Order* allows costs associated with plant in the rate base if it is used and useful.[18] As discussed in the *Final Cost Order,* used and useful plant is plant that is actually used to send signals to customers.[19] Plant that is not currently used and useful is excess capacity, and operators may include this excess capacity in the rate base only if it is fully constructed plant that will be used to provide regulated service within 12 months.[20] Based on a review of InterMedia's submissions we did not find that the $196,228 that InterMedia reported as construction work in progress was fully constructed plant expected to provide regulated service within 12 months. Therefore, we removed the amount reported as construction work in progress from the rate base and made appropriate adjustments to the CPS revenue requirement.

10. Asset Valuation: InterMedia's cost of service filing includes both tangible and intangible assets in its rate base. InterMedia used an estimated original cost valuation to establish the value of the assets in its rate base. InterMedia also provided a rate base valuation using its

[16] The Commission made clear that the fact that an operator has incurred costs does not necessarily establish its right to recover those costs from subscribers. *See Rate Order*, 8 FCC Rcd at 5794 n.619.

[17] Rate base traditionally consists of plant in service, non-current assets, materials and supplies, and cash working capital considered to be used and useful in the efficient provision of regulated services.

[18] *Final Cost Order* at ¶36.

[19] *Id.*

[20] *Id.*

book cost based on the acquisition price it paid for the above referenced franchise.[21] InterMedia asserts that the intangible assets that it includes in its rate base play an important role in the operation of its cable system.[22] InterMedia further states that a policy of excluding intangibles from rate base fails to recognize the substantial investment cable system operators must make in developing and/or acquiring the many intangible assets that are prerequisites either to operating a cable system or to its efficient operation.[23] According to InterMedia, by excluding intangibles the Commission is unfairly penalizing those operators who have acquired an existing cable system.[24]

11. As the Commission reiterated in the *Final Cost Order*, original cost is a reliable and fair measure of the value of tangible assets. However, as discussed in the *Final Cost Order* it is often difficult, if not impossible, for cable operators to determine the original cost of a tangible asset.[25] Thus, to accommodate this reality for cable systems constructed before May 15, 1994, the *Final Cost Order* allows operators to use the book value that was recorded as of May 15, 1994, regardless of whether the system was built or acquired by the current operator.[26] Therefore, we will allow InterMedia to use the book value of its tangible assets to determine the reasonableness of its rates in this proceeding.

12. In the *Final Cost Order*, the Commission adopted a methodology to exclude that portion of the acquisition price of cable system assets that represents amounts paid for the system in expectation of monopoly profits. Under the methodology, a 34% adjustment would be made to the purchase price a cable operator paid for cable assets (including both tangible and intangible assets) with the result that some portion of the assets would be excluded from rate base.[27] Applying the methodology approved in the *Final Cost Order* to InterMedia's cost of service filing in this proceeding results in a rate base disallowance of $6,977,962.

[21] InterMedia acquired this franchise in June/July 1990.

[22] InterMedia's Aug. 15, 1994 filing at p. 1.

[23] *Id.* at p. 1.

[24] *Id.* at p. 1.

[25] *Final Cost Order* at ¶75.

[26] *Id.*

[27] *Final Cost Order* at ¶58.

B. Equivalent Billing Units

13. In a Public Notice,[28] the Commission announced that a cable operator who does not have an actual subscriber count for purposes of the Commission's benchmark and quarterly increase forms (FCC Forms 1200 and 1210, respectively) may use a subscriber count based on equivalent billing units ("EBUs") in lieu of actual subscriber numbers.[29] The Public Notice on the use of EBUs in these forms, however, was silent regarding the propriety of using EBU counts on FCC Form 1220, the cost of service form.

14. When calculating its maximum permitted rate InterMedia reported subscriber counts based upon EBUs. InterMedia has persuaded us that EBU counts are appropriate to use on Form 1220. EBU counts more accurately account for the unique revenue and cost characteristics of special customer classes. EBU counts correctly recognize the reduced costs of providing services on a per subscriber basis to special customer classes and ensure that related revenues are properly assigned. Therefore, we conclude that InterMedia has used acceptable allocation methodologies, both in allocating costs from higher organizational levels to lower organizational levels and for inter-tier allocations. Therefore, we did not revise its cost allocations.

IV. CONCLUSION

15. Based on our review of InterMedia's cost of service filing and supplemental information, applying the Commission's most current rules and applicable cost allocation rules, we find that, as discussed above, InterMedia has justified the monthly CPS rate of $12.90 (plus franchise fee).

16. Accordingly, IT IS ORDERED, pursuant to Section 0.321 of the Commission's rules, 47 C.F.R. Section 0.321, that the monthly CPS rate charged by InterMedia Partners with respect to the above-referenced community IS JUSTIFIED. [30]

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[28] *See* Questions and Answers on Cable Television Rate Regulation, *Public Notice* dated July 27, 1994.

[29] Under this methodology, as specified in the Commission's "Annual Report of Cable Television Systems (Form 325) instructions, subscribers to bulk-rate service are calculated by dividing "the annual bulk-rate charge" by "the basic annual subscription rate for individual households."

[30] Our findings are based solely on the representations of InterMedia in its rate filings. Should information come to our attention that these representations were materially inaccurate, we reserve the right to take appropriate action. This Order is not to be construed as a finding that we have accepted as correct any specific entry, explanation or argument made by any party to this proceeding not specifically addressed herein.

17. IT IS FURTHER ORDERED that, pursuant to Section 0.321 of the Commission's rules, 47 C.F.R. Section 0.321, that the complaint against the monthly CPS rate charged by InterMedia Partners with respect to the above-referenced CUID number IS DENIED.

FEDERAL COMMUNICATIONS COMMISSION

Meredith J. Jones
Chief, Cable Services Bureau