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

In the Matter of

Media General Cable of Fairfax County, VA

CUID Nos.
VA0301 (Fairfax County, Inc.)
VA0318 (Vienna, VA)
VA0326 (City of Fairfax, VA)
VA0327 (Falls Church. VA)
VA0346 (Herndon, VA)

Cost of Service Filing To Support Cable Programming Service Rate

MEMORANDUM OPINION AND ORDER

Adopted: January 19, 1996; Released: January 26, 1996

By the Commission:

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I. INTRODUCTION

1. Media General of Fairfax County, Inc. ("Media General"; "Company"), which is 100% owned by Media General, Inc., was incorporated in 1982. The Company subsequently sought and was granted separate fifteen-year cable television franchises from Fairfax County and municipalities within the County.[1] Media General's system provides 49 channels on its cable programming services ("CPS") tier to approximately 185,800 CPS subscribers.

2. On November 12, 1993, Media General filed a cost of service submission with the Commission in response to complaints[2] alleging that Media General's CPS rate in its Fairfax County, Vienna, City of Fairfax, Falls Church, and Herndon, Virginia franchises is unreasonable. Media General supplemented its filing on January 11, 1994 and August 15, 1994.[3]

3. Citing the significant number of CPS subscribers in its five Fairfax County communities who have filed complaints, Media General filed a request for waiver of Section 76.956(a) of the Commission's rules, which requires that a cable operator "serve its response on the complainant (and, if the complainant is a subscriber, the relevant franchise authority) via first class mail." Media General filed a response, accompanied by its cost of service submission, to the complaint filed by Fairfax County. However, the Company requests permission to serve the other complainants with only the pleading and not the cost of service filing. Media General also asks to be relieved of the obligation to make copies of its cost of service filing available to complainants free of charge upon request.

4. The Cable Television Administrator for Fairfax County has filed an opposition to Media General's requests. Fairfax County asserts that granting the waiver requested by

[1] Media General provides cable service in the County of Fairfax, the City of Fairfax, Falls Church, Vienna, and Herndon, Virginia.

[2] The Commission has accepted for filing over 80 complaints by subscribers in the five areas in which Media General provides service. The earliest complaint filed and accepted by the Commission for each franchise area served by Media General is: City of Fairfax (CUID No. VA0326) - complaint received by the Commission on September 30, 1993; Fairfax County (CUID No. VA0301) - complaint received by the Commission on September 30, 1993; Vienna (CUID No. VA0318) - complaint received by the Commission on October 21, 1993; Falls Church (CUID No. VA0327) - complaint received by the Commission on December 3, 1993; and Herndon (CUID No. VA0346) - complaint received by the Commission on February 18, 1994.

[3] Media General submitted a supplement to its showing on August 15, 1994. Commission staff had contacted Media General for further information, to be filed no later than July 14, 1994 (as established in Cable Operators' Rate Justification Filings, Sections 76.945, 76.956 of the Commission's Rules, Order, DA 94-526 (released May 23, 1994) ("*May 23 Order*"); *see also*, Cable Operators' Rate Justification Filing, Order, DA 94-619 (released June 14,1994)). Further filings in this proceeding continue to be made that have not been specifically requested by the Commission nor authorized by the Commission. On October 11, 1994, Fairfax County Government filed a supplement to its complaint of October 1, 1993. Media General filed a supplement to its answer to its cable programming service complaint on October 28, 1994 and Fairfax County Government submitted a reply to Media General's supplemental answer on November 2, 1994. We do not condone the practice of late filings of additional pleadings. Such filings, particularly as they have occurred in this case, impede our ability to review and to rely on the information provided to us in the first instance, and further delay resolution of matters before us. We underscore that it is incumbent upon parties to ensure that their filings are accurate and final when submitted to the Commission for filing. While a party is responsible for continuing accuracy and completeness of information which it submits to the Commission, the additional filings have not been of this nature. Nonetheless, since Media General and its local franchising authorities have not had prior experience with these cost of service rules filings, for purposes of this review, we have considered the additional information in our analysis. Consistent with our rules, in the future, we may not consider such additional, unauthorized filings.

Media General would allow an inappropriate level of operator responsiveness to subscribers concerned about high cable service

5. The purpose of Section 76.956(a) is to ensure that complainants are fully informed as to the details of the submission which a cable company files in response to their complaints. Without that information, complainants will not have the information necessary to avail themselves of the opportunity to participate in the review of the cable operator's regulated cable rates. However, the Company, which has submitted a voluminous cost of service filing, would have to respond to more than 80 complaints against its CPS rate. Given the high number of complaints, and the voluminous nature of Media General's cost of service filing, requiring service on all parties would be unduly burdensome.[4] Accordingly, we grant Media General's requested waiver of Section 76.956(a). However, making all relevant papers available to all parties is essential to assure fairness in an adversarial proceeding. The Company has offered no evidence that making copies of its filings available to complainants free of charge upon request is unduly burdensome. Therefore, we find that Media General's second waiver request would undermine the underlying interest of the rule and disserve the public interest, and is thus denied. Our grant of a waiver of Section 76.956(a) is predicated on the knowledge that filings and other relevant papers will be freely available to interested parties.

6. Media General's cost of service filing seeks to establish that its CPS rate of $17.77 per month for the period September 1, 1993, through May 14, 1994, is justified based on Media General's cost of providing CPS. Our review of the record indicates that Media General's rate of $17.77 per month in effect for the referenced time period is cost justified under general cost of service principles.[5]

7. Pursuant to our rules, cable operators are required to make showings on a franchise-level basis.[6] The purpose of the rule is to assign costs (both investment and expenses) and revenues accurately to the regulated services offered by the cable operator, so that the rates charged for such services are just and reasonable. Media General has submitted a single cost of service filing for its integrated cable system in Virginia which includes the County of Fairfax (CUID No. VA0301), Town of Vienna (CUID No. VA0318), City of Fairfax (CUID No. VA0326), City of Falls Church (CUID No. VA0327), and City of Herndon (CUID No. VA0346). The record indicates that these franchises are served through the same cable system, the same rates are charged for cable services and associated equipment in all five areas, and the same channel line-ups are offered. Therefore, we will, on our own motion, waive the applicability of Section 76.924(e)(1) and permit the single filing. The characteristics peculiar to Media General's filing distinguish it from filings where the applicability of Section 76.924(e)(1) would be more appropriate and will not compromise our determination of cost-based rates in this proceeding.[7]

8. We emphasize that in this review process, pursuant to the Cable Television Consumer Protection and Competition Act of 1992 (the "1992 Cable Act"), we are analyzing rates for a limited past period to ensure that rates charged were not unreasonable, and if so, to determine the associated refund liability.[8] In reviewing and evaluating this filing, we are applying general cost of service principles with Commission rules and guidance that were available at the time these filings were made.

II. BACKGROUND

9. On May 3, 1993, the Commission released its *Rate Order* 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.[9] 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.[10]

10. 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.[11] 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 oper-

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[4] *See WAIT Radio v. FCC*, 418 F.2d 1153,1157 (D.C. Cir. 1969)

[5] This Order does not make any findings or rulings regarding Media General'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. *See* 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, 8 FCC Rcd 5631, 5637 (1993) ("*Rate Order*"). 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).

[6] 47 C.F.R. Section 76.924(e)(1).

[7] *See WAIT Radio v. FCC*, 418 F.2d 1153,1157 (D.C. Cir. 1969).

[8] *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).

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

[10] 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 Notice* at 40765, n.18.

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

ators seeking to justify rates higher than those determined under the benchmark approach.[12] 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.[13] Media General's cost of service filing under review in this proceeding was submitted during that pre-adoption time period and covers only the period prior to May 15, 1994. We are analyzing the rates in effect for the period prior to May 15, 1994 under general cost of service principles, not under the rules we adopted in February 1994.[14]

III. DISCUSSION

11. We have analyzed Media General's cost of service submission consistent with our cost of service approach discussed above. 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 have disallowed that cost in whole or in part.[15] We have evaluated rate base and expense items to determine whether Media General should be permitted to recover those items in its rates. In some cases, we have found coststhat are not allowable, and we have made appropriate adjustments. We have also adjusted the rate of return to be authorized during this period, as discussed below. Even with our adjustments and disallowances, however, we find that Media General's rate of $17.77 per month for its CPS tier for the period under review has been justified.

A. Test Year

12. Determining a regulated company's cost of service involves the selection of an appropriate test year. The test year measures a company's operating experience during a twelve-month period and is the basis for determining representative levels of revenues, expenses, and rate base and capital structure.[16] The test year is one of the fundamental concepts upon which a determination as to a company's revenue requirement and the reasonableness of its rates is based. In its cost of service submission Media General selected a test year that consisted of actual data for the twelve months of calendar year 1992. We conclude that the test year selected by Media General is appropriate for determining the reasonableness of the CPS rates which the Company charged during the period under consideration. The test year is a recent time period for which actual data is available and reasonably represents Media General's cost of providing cable service.

B. Rate Base

13. 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] Under traditional cost of service principles, 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 Media General's filing, we have reviewed the components of the Company's rate base to determine the investment upon which Media General is entitled to earn a return. For purposes of this review, we have made adjustments to the rate base as discussed below.

14. *Operating Losses:* Media General has included accumulated start-up losses in the amount of $61,123,293 for the years 1984 through and including 1991.[18] The Company proposes to amortize the accumulated operating losses over four years which represents the remaining life of the franchise in the five franchise areas.[19] Of the total amount of accumulated losses, $15,280,823 has been included as amortization expense for 1992, the first year of its proposed four-year amortization period. The remaining $45,842,470 represents the portion for which Media General seeks rate base treatment until that amount is fully recovered during its proposed amortization period (the amount in rate base would be reduced by 1/3 for each of the remaining three years of amortization, with a corresponding amount for amortization expense included in operating expenses for each of those year).

15. Media General asserts that it incurred these substantial start-up losses because an immediate return on its investment in the cable system was deferred to allow the Company to price its service at a level which promoted the growth of the system, as well as permit reinvestment in the system.[20] Media General states that when cable services were first introduced in Fairfax County, it was a new service to potential subscribers, requiring considerable promotion and aggressive pricing, as well as system construction. The Company also maintains that competition from over-the-air broadcast stations and the nonessential nature of the service created market price elasticities higher than those for traditional utility services.[21] Media General asserts that these differences in the market environment confronting cable required the Company to operate at a loss for several years in order to ensure its long-term viability.[22] Therefore, it is Media General's position that it is entitled to recover all accumulated start-up losses incurred in the construction and operation of its cable system.[23]

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[12] 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 30, 1993) (*"Notice"*).

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

[14] In February 1994, the Commission adopted an order setting forth specific regulatory requirements to govern cost of service filings to justify rates above levels determined under its benchmark requirements. The new rules apply to rates charged or to be charged after May 14, 1994. *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) (*"Cost Order"*).

[15] 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. "When electing [to make] a cost of service showing, the cable operator assumes the risk that its rate could be lowered if such action is justified by the cost showing." *Id.* at 5800.

[16] *Notice* at 40771.

[17] Rate base traditionally consists of plant in service, noncurrent assets, materials and supplies, and cash working capital.

[18] The accumulated losses include operating losses, interest expenses, and depreciation and amortization expenses.

[19] Amortization means the systematic recovery, through ratable charges to expenses, of the cost of assets.

[20] November 11, 1993 Initial Submission at Section 13.

[21] *Id.*

[22] *Id.*

[23] *Id.;* October 28, 1994, Supplemental to Media General's Answer to Cable Services Complaint at 2-5.

16. In response, Fairfax County objects to the inclusion of start-up losses. Fairfax County asserts that Media General has not met any of the conditions imposed by the *Cost Order* for the inclusion of start-up losses in the rate base.[24]

17. We continue to consider the issue of the inclusion of accumulated start-up losses in rate base for ratemaking purposes.[25] We recognize that a prudent investor will commit to build a cable system with a level of investment that makes economic sense, i.e., the return reasonably expected on the investment justifies the capital expenditures. As part of that decision cable operators realize that, since they will incur significant capital and operating expenses building the physical plant and implementing marketing and development plans to expand their customer base, they will experience substantial losses during the early years of operation. As part of that effort, in most if not all instances, cable rates were set at levels that were more concerned with attracting potential customers than recouping costs. We also recognize that the range of prematurity periods and the associated accumulated start-up losses will vary widely depending upon the particular circumstances in each cable system. We conclude that Media General has presented sufficient probative evidence to demonstrate that these are the same circumstances under which it began to build and operate its cable system in Fairfax County.[26]

18. Therefore, we will allow Media General to recover its accumulated start-up losses. The period of losses which we will consider for rate recognition will be those years from the period when the first subscriber's revenue was earned (1984) until Media General no longer had negative net operating income (1991).[27] As previously discussed, Media General proposes to amortize the accumulated operating losses over four years. We have determined that this time period is too short and results in an unusually high expense in the test year. We have determined that a reasonable time period for amortization is the service life of Media General's longest depreciable asset. Because this time period will not vary significantly among cable companies, it provides a reasonable time period within which companies may recover operating expenses in those instances where a much shorter period would, as in this case, result in an unusually high expense in the test year. The burden shall be on the Company to support a shorter amortization period. The unamortized balance will be included in Media General's rate base and the Company may earn a return on the rate base portion consistent with the rate of return adopted in our discussion below.

19. Accordingly, Media General's amortization expense for 1992, the first year of the amortization period, and each subsequent year until the accumulated start-up losses are fully amortized is $4,074,886 ($61,123,293 x 1/15).[28] The total remaining unrecovered balance to be included in rate base in 1992 is $57,048,407 ($61,123,293 - $4,074,886).[29]

20. *Construction Work In Progress:* Media General includes an amount for Construction Work In Progress ("CWIP") of $452,079 which was not used and useful at the time of its filing. Under general cost of service principles, allowable costs in rate base are associated with plant that is used and useful. Review of Media General's submission shows that this plant was not used and useful at the time of filing and, thus, was not providing cable service to current subscribers. Therefore, we removed the amount reported as CWIP from the rate base and made appropriate adjustments to the CPS revenue requirement.

C. Operating Expenses

21. Cable operators may recover in rates their reasonable operating expenses normally associated with providing rate regulated cable services. Operating expenses incurred by the cable operator could be expected to include plant specific costs (e.g., maintenance), plant non-specific costs (e.g., programming expense, engineering and testing), customer operations (e.g., marketing, billing and collection), and corporate operations (e.g., legal, planning, accounting and finance). Our review of Media General's expenses under general cost of service principles results in the adjustments discussed below.

22. *Allocations:* Our rules in effect at the time of the Company's filing required that cable operators generally aggregate expenses and revenues at either the franchise, system, regional, or company level in a manner consistent

[24] November 2, 1994, Reply of Fairfax County to Media General's Supplemental Answer at 2-4. The County states that Media General has not met the following conditions in the *Cost Order:* (1) the Company has never recorded start-up or past losses on the audited balance sheets of either Media General or its parent corporation; (2) Media General did not begin amortization of start-up losses at the end of the second year of operation, and has never engaged in any such amortization on its own or its parent's audited income statements; and (3) the Company has included no detailed evidence of the effect of inclusion of start-up losses on its rates in comparison to the competitive rates of similar systems.

[25] In the *Notice* we did not reach any tentative conclusions as to the appropriate treatment of accumulated losses but, instead, we sought comment on the issue, noting that it might be reasonable to view such losses as capital invested with the expectation of recovery in future periods as the industry reaches maturity. We also asked whether these losses should be amortized over some future period, and whether a return should be allowed on such unrecovered amounts until they are fully recovered. *See Notice* at 40767, n.44. The interim rules adopted in the *Cost Order* allow recovery in the rate base of accumulated start-up losses that are equal to the lesser of the first two years of operating costs or accumulated losses incurred until the system reaches the end of its prematurity stage as defined by the Statement of Financial Accounting Standards No. 51, Financial Reporting by Cable Television Companies. *See Cost Order,* 9 FCC Rcd at 45.

[26] We reject Fairfax County's assertion that Media General has not met any of the conditions imposed by the *Cost Order* for the inclusion of start-up losses in the rate base. The purpose of this proceeding is to determine the reasonableness of the CPS rate charged by the Company during the period from September 1, 1993 through May 14,1994. In the *Notice* we stated that general cost of service principles would apply to cost of service filings submitted for rates in effect during this period. The interim rules adopted in the *Cost Order* apply to the review of rates charged or to be charged *after* May 14, 1994.

[27] November 11, 1993 Initial Submission at Section 13.I

[28] The Commission's rules in effect at the time of Media General's filing specify that inter-tier allocations of all categories of costs are to be made based on the ratio of channels on each tier to the total number of channels offered. *See* 47 C.F.R. Section 76.924(e)(2). The calculation for Media General results in an allocation factor of 42.32% for the CPS tier. Therefore, the amortization expense allocated to the CPS tier equals $1,724,491 ($4,074 x 42.32%).

[29] Consistent with the allocation factor used for amortization expenses, the capitalized start-up losses allocated to the CPS tier is 42.32% of that amount: $24,142,885 ($57,048,407 x 42.32%).

with the practices of the operator as of April 3, 1993.[30] We also established cost allocation requirements. Costs aggregated at a higher level are to be allocated to the franchise level proportional to the number of subscribers in the franchise area, and the costs are to be allocated between tiers proportional to the number of channels on the tiers.[31] For the most part, Media General's allocation methodology conforms to our rules. However, the Company employed an indirect assignment analysis (based on the allocated costs of the distribution system and cable network fixed costs) in allocating certain operating expenses (commercial sales and easements; project administration, engineering design, restoration, and safety; construction and maintenance; and engineering management). Therefore, in our review and analysis of Media General's rates in effect for the period under review we have reallocated these operating expenses on the basis of the channel factor allocator.[32]

23. *Amortization Expenses:* As discussed above, the Company's amortization expense associated with its accumulated operating losses is $4,074,886.

24. *Corporate Expenses:* As previously stated, Media General Cable of Fairfax is a wholly owned subsidiary of Media General, Inc. The parent company provides a variety of services (e.g., research, internal auditing, budgeting and planning, data processing and risk management) to its subsidiaries including Media General. Media General of Fairfax's filing includes a "management fee" in the amount of $857,024, which was adjusted by an additional $3,408,047 of allocated corporate expenses for a total of $4,265,071,of which $3,329,741 is proposed for recovery in regulated rates. We requested, and obtained, from Media General its detailed study of corporate expenses. A review of the study reveals that costs incurred by some corporate cost centers are allocated to subsidiaries and the parent company on the basis of direct assignment or are directly attributable. We take no exception to the costs allocated to Media General using this methodology. Those costs incurred by Media General, Inc.'s corporate cost centers which were not directly allocated were allocated to the parent company and its subsidiaries, including Media General of Fairfax using a general allocator. Media General, Inc. developed its allocator by taking an average of each subsidiary's proportion of operating expenses, operating revenues and assets. Thus, Media General Inc.'s general allocation factor is calculated as follows:

% of Assets Directly Assigned/Attributed to Media General	33.93%
% of Operating Revenues Directly Assigned/Attributed to Media General	18.70%
% of Operating Expenses Directly Assigned/Attributed to Media General	17.39%
Average	23.34%

On the basis of this allocation method, an additional $1,466,566 of costs was assigned to Media General of Fairfax.

25. Generally, we take no exception to developing a general allocator for the allocation of corporate expenses. However, the general allocator should be based on the expenses directly assigned or attributed to regulated and nonregulated activities as opposed to an average of each subsidiary's assets, revenues and expenses. Under our rules which were in effect at the time of Media General's filing, common costs "shall be allocated to each service cost category based on the ratio of all costs directly assigned and attributed to a service category over total costs directly assignable and attributable."[33] Under this rule, the allocator, which is to be "based on the ratio of all costs," would more accurately use expenses as the basis for determining the proper allocator.

26. Therefore, we reject Media General's allocation factor of 23.34% and, instead, we will use 17.39%, which is based upon expenses, as the general allocator. Consequently, we disallow $373,868 of the $1,466,565 in corporate expenses allocated to Media General under this method, of which $140,873 is deducted from the CPS tier. The disallowance is computed based upon the difference between the 23.34% allocator used by Media General and our recommended allocator of 17.39% based upon expenses.

27. Corporate expenses allocated under the direct assignment and general allocator methodologies discussed above result in the allocation of $4,943,153 of corporate expenses to the parent company itself. These costs are then reallocated to the subsidiaries based on various percentages ("load" factor). On the basis of this load factor, $950,088 of the parent company's expenses were allocated to Media General.

28. The allocation of the parent company's expenses necessitates the need for a general, or common, allocator since these costs, by their very nature, could not directly or indirectly assigned. Employing the previously discussed corporate general allocator of 17.39%, which is based on expenses, versus a load factor, results in a disallowance of $90,473 of corporate expenses allocated to Media General, of which $34,090 is deducted from the CPS tier.

29. *Revenue and Income Adjustments:* Note 5 to Media General's audited financial statements for the years ending December 27, 1992, and December 29, 1991, and included as Appendix A with Media General's cost of service filing, discusses other related party transactions. The Note, in part, states:

> The Company has an agreement with a wholly-owned subsidiary of Media General whereby the subsidiary acts as the Company's exclusive advertising sales representative. The Company receives revenues (1992: $1,177,000; 1991: $973,000) from the subsidiary, based on advertising placed on the cable system.

[30] *See Rate Order,* 8 FCC Rcd at 5976. *See also* 47 C.F.R. Section 76.924(d).

[31] *See Rate Order,* 8 FCC Rcd at 5976. *See also* 47 C.F.R. Section 76.924(e)(1) and (2). This requirement does not apply to programming costs, franchise fees, or public, education and government access costs, which are allocated entirely to the basic service tier or directly assigned as appropriate.

[32] The only deviations from this method were direct assignments of those operating expenses that could be specifically identified with either the equipment basket or one of the tiers.

[33] 47 C.F.R. Section 76.924(f)(3).

30. Under general cost of service principles, the expenses incurred by a company are offset against the revenues it receives. Therefore, advertising revenues received by Media General from the use of its cable plant and resources should be offset against its operating expenses. As noted above, $1,777,000 in advertising revenues were received in 1992. Allocating these revenues based on the ratio of channels on each tier to the total number of channels offered[34] results in a reduction to the revenue requirement on the CPS tier of $510,465.

D. Rate of Return

31. A regulated entity is entitled to the opportunity to earn a fair return on investment.[35] That return should be sufficient to ensure confidence in the financial integrity of the enterprise,[36] but should be balanced against our interest in protecting a company's subscribers from paying excessive rates. In the *Rate Order,* we stated that we would make a case-by-case determination of reasonableness for submissions made before specific cost rules were adopted.[37] In order to make a determination of a reasonable rate of return for an operator, we stated that we would evaluate the operator's capital structure, cost of debt, and cost of equity, among other factors.

32. In the *Notice,* released several weeks before the submission date of Media General's cost of service filing, the Commission discussed its analysis of rate of return generally, and tentatively concluded that an after tax, overall rate of return in the range of 10% to 14% would reflect a reasonable balancing of subscriber and cable interests.[38] The Commission reached its conclusion based on a summary analysis of the cost of equity and the capital structure of regulated cable services.[39] The Commission examined the risk premium between the yield on public "Aa" rated bonds and the estimated cost of equity for the Standard & Poor's 400 companies (S&P 400). The Commission specifically found that

> [i]f we use the S&P 400, or a subgroup of S&P 400 companies, as the primary surrogate for determining an appropriate cost of equity of regulated cable service, we tentatively conclude that the cost of equity will be in the range of 12-17%. This, in turn, assuming a debt/equity ratio of 50%, would lead to a rate of return for regulated cable service of between approximately 10 to 12.4%. Given market changes in the cost of debt and equity, we tentatively conclude that a rate of return somewhere in the range of 10% to 14%, after taxes, would reflect a reasonable balancing of subscriber and cable operator interests and that we would select a final rate of return within this range to achieve our balancing of goals for cost-based rates for cable services.[40]

Thus, as a general approach for the evaluation of refund liability from cost of service submissions filed before the effective date of the interim cost of service rules, we find it appropriate and reasonable to use the range established in the *Notice* for our analysis.

33. The *Rate Order* postulated a case by case determination of reasonableness regarding the rate of return. Media General's cost of service submission claims an allowable after-tax rate of return of 16%. While Media General does discuss its "higher cost situation," it does not assert any particulars of capital structure, cost of equity, or cost of debt that would justify an after-tax rate of return of 16% in this proceeding. Therefore, Media General has not sustained its burden of proving that a 16% rate of return is reasonable. In the *Cost Order,* which was issued shortly after Media General had filed its cost of service showing, we adopted a presumptive unitary rate of return of 11.25% for regulated cable operations.[41] Under the circumstances, we have no reason to believe that an 11.25% rate of return would be unreasonable in this context. The period of time for which the 11.25% rate of return was calculated is sufficiently close to the period of time at issue in Media General's cost of service showing and we believe that the methodology used in arriving at a presumptive rate of return of 11.25% is reasonable, and would be reasonable in this context as well. Moreover, no commenters have suggested that the appropriate rate of return should be any lower than 11.25%. Even if we found that Media General was only allowed to earn a rate of return of 11.25% during the test year rather than the 16% claimed by Media General, we would find that its CPS rates are reasonable, and no refund is due.

IV. CONCLUSION

34. Based on our review of Media General's cost of service filing and supplemental information, applying general cost of service principles and applicable cost allocation rules, we find that, even with the adjustments discussed above, Media General's costs still justify a higher rate than the CPS rate of $17.77 per month which Media General is seeking to justify for the period September 1, 1993, through May 14, 1994.[42]

35. Accordingly, IT IS ORDERED, pursuant to Section 0.321 of the Commission's rules, 47 C.F.R. Section 0.321, that the CPS rate charged by Media General Cable of

[34] *See* 47 C.F.R. Section 76.924(e)(2).
[35] *Notice* at 40769.
[36] *Id.; see also,* Federal Power Commission v. Hope Natural Gas Company, 320 U.S . 591, 603 (1944).
[37] *Rate Order,* 8 FCC Rcd at 5795.
[38] *See Notice* at 40765. Since the release of the *Notice,* the Commission has adopted a unitary rate of return for cable of 11.25%. *Cost Order,* 9 FCC Rcd at 4634-35. The Commission adopted the 11.25% rate of return on an interim basis, based on evidence in the record. However, the *Cost Order* applies to rate justification filings submitted after the effective date of the rules, and not to filings already pending. *Id.* at 45277; *see also, Rate Order,* 8 FCC Rcd at 5854, n.859.
[39] *See Notice* at 40765.
[40] *Id.*
[41] *Cost Order,* 9 FCC Rcd at 4635.
[42] This finding is based solely on the representations of Media General in its cost of service filing. Should information come to our attention that these representations were material 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 (including the operator's Form 393). The findings in this Order do not in any way prejudge the reasonableness of prices for CPS service after May 15, 1994.

Fairfax County, Inc. with respect to the above-referenced CUID numbers, for the period September 1, 1993, through May 14, 1994, of $17.77 per month, ARE JUSTIFIED, and no refund liability for the CPS rate during that period will be imposed.

36. IT IS FURTHER ORDERED that, pursuant to Section 0.321 of the Commission's rules, 47 C.F.R. Section 0.321, the complaints against the CPS rate of $17.77 per month, charged by Media General of Fairfax County, Inc. with respect to the above-referenced CUID numbers, for the period September 1, 1993, through May 14, 1994, ARE DENIED.

37. IT IS FURTHER ORDERED that the request of Media General Cable of Fairfax County, Inc. for waiver of Section 76.956 of the Commission's rules, 47 C.F.R. Section 76.956(a), IS GRANTED TO THE EXTENT INDICATED HEREIN.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton
Acting Secretary