COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION

DEPARTMENT OF
TELECOMMUNICATIONS & ENERGY
Cable Television Division

RATE ORDER

CTV 03-7

Review by the Cable Television Division of the Department of Telecommunications and Energy of Federal Communications Commission Form 1205 filed by Adelphia Cable Communications, Inc. proposing a monthly lease rate for high definition television converters.

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FOR: ADELPHIA CABLE COMMUNICATIONS, INC.
Petitioner

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Town Hall
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FOR: TOWN OF DUXBURY
Intervenor

I. INTRODUCTION

On December 15, 2003, Adelphia Cable Communications, Inc.[1] ("Adelphia" or "the Company") filed with the Cable Television Division ("Cable Division") of the Department of Telecommunications and Energy a proposed monthly lease rate for high definition television converters on Federal Communications Commission ("FCC") Form 1205.[2] The Cable Division must review this rate for compliance with federal and state law and regulations. This order addresses the Cable Division's findings with regard to Adelphia's proposed lease rate for this type of customer premises equipment.

II. BACKGROUND

As a result of the significant investments cable operators have made in improving their technology and upgrading their systems, cable operators are able to offer subscribers additional services, including high definition television. High definition television is programming provided in a widescreen format with up to 1080 horizontal lines, compared with an analog television picture with only 480 horizontal lines, providing a substantially more detailed picture. The high definition widescreen format has an aspect ratio of 16 units wide and 9 units high, the

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1 The formal license held by Adelphia Cable Communications, Inc. in each of its Massachusetts communities is under one of the following names: Adelphia Cablevision Corp., Century Berkshire Cable Corp., Chelsea Communications, L.L.C., Frontiervision Cable New England, Inc., Martha's Vineyard Cablevision, L.P., and Mountain Cable Company, L.P.

2 The filing was made for the following regulated communities: Abington, Adams, Amesbury, Aquinnah, Bourne, Cheshire, Clarksburg, Duxbury, Edgartown, Essex, Falmouth, Gloucester, Great Barrington, Halifax, Kingston, Lee, Lenox, Manchester-by-the-Sea, Marshfield, Merrimac, North Adams, Oak Bluffs, Pembroke, Plymouth, Plympton, Rockland, Rockport, Salisbury, Sandwich, Sheffield, and Stockbridge.

same as a movie theater screen, compared with the current analog aspect ratio of 4 units wide and 3 units high. See FCC, Consumer & Governmental Affairs Bureau, Fact Sheet: Digital Television at 1 (2003). High definition television is currently available in all of Adelphia's Massachusetts communities except Adams, Cheshire, Clarksburg, North Adams, and Williamstown (Hearing Audiotape, Side A, at Counter Nos. 100-109). In order to receive a signal in high definition, a specific converter box is required. The high definition television converter allows a cable subscriber to receive not only programming provided in a high definition digital format, but also analog and digital cable programming. For a customer who subscribes to Adelphia's high definition programming, the high definition converter replaces the previously leased converter, whether it were a basic analog or a digital converter. The high definition converters operate with the same remote controls that operate the digital converters.[3]

In this proceeding, Adelphia seeks approval of the lease rate it may charge subscribers for the high definition converter rental. Pursuant to federal rate regulations, cable operators are allowed to adjust basic service tier programming and equipment rates annually.
47 C.F.R. § 76.922(e)(1). Under this annual rate adjustment scheme, equipment and programming rate changes are proposed simultaneously. Adelphia follows the annual method, filing rate forms on December 1 for a rate change date of March 1. However, Adelphia filed this FCC Form 1205 pursuant to 47 C.F.R. § 76.923(o) of the FCC's rate regulations, which

3 The Cable Division established the rate for digital remote controls in Adelphia's last annual FCC Form 1205 rate filing. Adelphia Communications Corporation, CTV 02-3 (2003). The remote control rate will be reviewed later this year in CTV 03-5.

provides for the filing of an FCC Form 1205 to establish the permitted charge for a new type of customer equipment at a time other than the cable operator's annual filing date.

Under the FCC's regulations, the proposed rate may become effective 60 days after the date of the filing, unless the Cable Division, upon review and consideration, issues an order rejecting that rate. 47 C.F.R. § 76.923(n)(4). As part of our review, the Cable Division held a public and evidentiary hearing in its Boston offices on January 13, 2004. The Town of Duxbury was admitted as an intervenor in this proceeding. The evidentiary record consists of Adelphia's rate form admitted as Exhibit Adelphia-1, and Adelphia's responses to record requests issued by the Cable Division.

The standard under which the Cable Division must review the proposed rate is found in the FCC's rate regulations. Specifically, the regulations provide that the rate regulator shall assure that the rates comply with the requirements of Section 623 of the Communications Act of 1934, as amended. 47 U.S.C. § 543; 47 C.F.R. §§ 76.922, 76.923, and 76.930. The Cable Division may accept equipment charges that are calculated in accordance with federal regulations. See 47 C.F.R. § 76.923. In addition, the Cable Division shall only approve rates it deems reasonable. G.L. c. 166A, §§ 2, 15; 47 U.S.C. § 543; 47 C.F.R. §§ 76.937(d) and (e), and 76.942.

The burden of proof is on the cable operator to demonstrate that its proposed rates for equipment comply with Section 623 of the Communications Act of 1934, as amended, and implementing regulations. 47 U.S.C. § 543; Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Report and Order and

Further Notice of Proposed Rulemaking, MM Docket No. 92-266, FCC 93-177, 8 FCC Rcd 5631 (May 3, 1993) at 5716, ¶ 128; see also 47 C.F.R. § 76.937(a).

III. DISCUSSION AND ANALYSIS

As permitted by 47 C.F.R. § 76.923(o), on its FCC Form 1205, Adelphia prepared only Schedule C and Step D of the Worksheet for Calculating Permitted Equipment and Installation Charges (Exh. Adelphia-1, at 3, 5). The Company's cost calculation on Schedule C raised three issues: 1) whether the Company appropriately accounted for the different per unit costs associated with a particular manufacturer, 2) whether the Company should have included any depreciation expense in its calculation of annual capital costs, and 3) whether the Company should have included accumulated depreciation in its calculation of net book value. We address these issues in turn.

A. Per Unit Cost

As support for its filing, Adelphia attached sales invoices from the two manufacturers from whom Adelphia purchases its high definition converters: Motorola and Scientific-Atlanta (Exh. Adelphia-1, Attachments; see also Hearing Audiotape, Side A, at Counters No. 287-289). The Motorola invoice reported a unit price per converter of $344.00, while the Scientific-Atlanta invoice reported a unit price per converter of $300.00 (Exh. Adelphia-1, Attachments). Adelphia completed Schedule C of its form by including one unit of each converter at Line C, "Total Number of Units in Service," and at Line D, "Gross Book Value," thereby assuming an equal deployment of both the Motorola and Scientific-Atlanta units.

The Company testified that when it prepared its filing, it had not yet deployed any converters, so that an actual deployment ratio was not available (RR-CTV-7).[4] The Company stated that because additional systems are introducing high definition converters on a weekly basis, it is difficult to ascertain an accurate ratio between the Motorola and Scientific-Atlanta units (id.). The Company could offer only its best guess as to its current deployment, suggesting that across all Adelphia systems, its current deployment possibly consisted of 60 percent Motorola units and 40 percent Scientific-Atlanta units (id.).

Given the disparity in costs for these two manufacturers, the Company's deployment ratio is relevant. Although Adelphia has provided the Cable Division with the actual per-unit costs of its high definition converters, the Company cannot provide us with an accurate total cost amount, because it cannot predict the deployment ratio of Motorola and Scientific-Atlanta units. The Company has stated that the deployment ratio changes weekly (RR-CTV-7). The Company does not have confidence that the cited 60 percent to 40 percent ratio will persist, and neither do we. Therefore, given the particulars of this situation, the most reasonable approach is to accept Adelphia's proposed ratio of 50 percent Motorola converters and 50 percent Scientific-Atlanta converters in calculating the per unit cost for this filing.

B. Depreciation

The FCC Form 1205, Schedule C, includes a calculation of annual capital costs for the equipment. Instructions to FCC Form 1205, at 12-13. As part of this calculation, the cable

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[4] Adelphia submitted its FCC form 1205 on December 15, 2003. However, the date appearing on the form's certification statement was October 2, 2003 (Exh. Adelphia-1, at 7).

operator must enter, on Line J, the current provision for depreciation, based on the year-end balance for the equipment included on Schedule C. Id. On the pending filing, Adelphia included one full year of depreciation expense on Line J equivalent to a five-year life, based on projected year-end data (Exh. Adelphia-1, at 3).[5]

In developing the regulatory process for determining equipment rates, the FCC based its Form 1205 on traditional cost of service ratemaking principles. In this way, the FCC Form 1205 is a cost-based form requiring an operator to calculate rates based on the operator's own actual costs. Instructions to FCC Form 1205, at 2. In fact, the FCC's regulations specify that subscriber charges for equipment shall not exceed charges based on actual costs. 47 C.F.R. § 76.923(a)(2). Here, however, the Company began deploying high definition units in October 2003 (Hearing Audiotape, Side A at Counter Nos. 79-91). The majority of the deployment will not occur until 2004. As such, the full year of depreciation expense Adelphia has included on the form is more in the nature of a projected expense.

Removing the depreciation expense from Line J would eliminate any projected costs in Adelphia's proposal. While such a course would likely produce a substantially lower rate, since the depreciation expense component figures heavily in the rate calculation, it would also establish a maximum permitted rate that would not permit the Company to recoup its investment during the first year and, thus, establish a rate that would be neither fair nor reasonable. That rate might be attractive to subscribers initially, influencing their decision with respect to the high definition service. However, that rate would bear very little resemblance to the rate

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5 The current depreciation reported on Line J was $129.00, which is one-fifth of the gross book value of $644.00 reported on Line D.

implemented in subsequent years, due to the inclusion of depreciation expense. We seek to send subscribers the proper price signals on which they may base their purchasing decisions. Therefore, for these policy considerations, and given the fact that the Company actually deployed some units by year-end, we find that the Company should claim some depreciation expense.

The question of how much depreciation expense is appropriate in this instance is not easily resolved from our review of the federal rate regulations. In developing the FCC Form 1205 process, the FCC appears not to have addressed the situation where, as here, a cable operator seeks a rate for new, yet un-deployed technology, and for which it cannot produce actual costs. Nevertheless, we are guided by generally accepted accounting principles ("GAAP") to determine a method of calculating depreciation that produces a reasonable rate.

One method commonly used when calculating depreciation for newly deployed capital equipment is the use of a half-year convention, allowing one half year of depreciation on assets in the year they are put into service regardless of at what point during the year they were deployed.[6] This method treats all units as if they were deployed equally throughout the year, allowing an operator to earn a reasonable return during the first year that the asset is deployed while assuring that the operator does not over-recover depreciation expense over the life of the asset.[7]

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6 These same assets would also be allowed a half year of depreciation during the final year they are on the books.

7 With the half-year convention, if Adelphia were to include a full year of depreciation expense on next year's filing, the units would be fully depreciated in the sixth year of

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While we regard some partial year method of calculating depreciation preferable, we recognize that the Company seeks to establish a fair cost-based rate for this equipment that is in line with the annual rate the operator will charge once a significant number of units are placed into service and actual costs are considered. As stated above, we further recognize that since Adelphia has actually deployed units, it is entitled to some depreciation expense. Thus, we find that the Company may elect to claim a full year's depreciation expense on this form. However, if Adelphia elects to retain its current method of taking a full year's depreciation expense prior to the converters being fully deployed, Adelphia must ensure that no over-recovery of depreciation occurs. We note that the Company's next annual FCC Form 1205 will be based on data for the year ending December 31, 2003, i.e., the same data as this filing. As a result, the information for the second year of use will again be based on projected expenses. As a practical matter, the rate established on this filing applies to all units deployed not only in 2003 but also during the 2004 calendar year. Hence, Adelphia could depreciate the units over six years, instead of the five-year life selected. In order to ensure that the units are depreciated on a schedule consistent with the depreciable life selected by Adelphia, during the next annual rate proceeding, the Cable Division directs Adelphia to file an amended FCC Form 1205 as soon as fiscal year 2004 data becomes available.

C. Accumulated Depreciation

The FCC Form 1205, Schedule C also includes a calculation of the net book value. Instructions to FCC Form 1205, at 12-13. To arrive at the net book value, the Instructions to

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deployment, a reasonable result.

FCC Form 1205 direct the cable operator to provide, at Line C, the total number of units in service on the last day of the fiscal year. Id. The instructions further provide that the cable operator must include, at Line D, the gross book value of the listed equipment on the date the books were closed for the time period covered by the form. Id. at 13. At Line E, the cable operator enters the accumulated depreciation for the equipment listed on the schedule. At Line F, the cable operator enters any deferred taxes that are calculated as of the date books are closed for the time period covered by the form. Id. Finally, at Line G, the cable operator computes the net book value for its equipment by adding the accumulated depreciation (Line E) to deferred taxes (Line F), and then subtracting the result from the gross book value (Line D). Id.

In the pending filing, when Adelphia calculated its net book value, it did not reduce the gross book converter value reported on Line D by reporting accumulated depreciation on Line E (Exh. Adelphia-1, at 3). As discussed above, the Company did, nonetheless, include one year of depreciation expense on Line J, when calculating its annual capital costs (id.). Adelphia explained that it included no accumulated depreciation on Line E because its high definition converters had not been deployed at the time the filing was prepared (RR-CTV-6). The Company also explained that it included a current provision for depreciation on Line J, based upon the projected year-end balance for the equipment (id.). Thus, Adelphia provided information on Schedule C as of two different dates.

The Instructions to FCC Form 1205 state that the form should be completed using financial data from a company's general ledger and subsidiary records maintained in accordance with GAAP. Instructions to FCC Form 1205, at 3. The FCC's cost accounting rules also require a cable operator to maintain its account in accordance with GAAP. Id.; 47 C.F.R. § 76.924. One fundamental concept of GAAP is that a balance sheet is prepared "at a point in time." Patrick J. Delaney, et al., Wiley GAAP 2003, at 35 (2003) ("Wiley"). "[T]he date assigned to the balance sheet does not cover a period of time, but rather represents a moment in time." Peter J. Eisen, Accounting The Easy Way at 17 (2003) ("Eisen"). See also Charles T. Horngren, et al., Introduction to Financial Accounting at 8 (1999) ("Horngren").

In filing an FCC Form 1205 at a time other than its annual filing date pursuant to 47 C.F.R. § 76.923(o), Adelphia is establishing a permitted rate for new equipment that is being introduced between its annual filings. That Adelphia is not filing this FCC Form 1205 as its annual filing after the end of a fiscal year, does not entitle it to disregard the standard rules applicable to financial reporting, which are incorporated in the rate setting methodology established by the FCC. There is absolutely nothing in the FCC Form 1205 Instructions or the provisions of GAAP accounting suggesting that the accumulated depreciation reported on Line E may be determined as of a date different from the date applicable to the other entries on the schedule. Both the current provision for depreciation and the accumulated depreciation must be determined as of the same date. It follows that during the first year the equipment is placed in service, the current provision for depreciation and the accumulated depreciation will be equal.[8]

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[8] On future FCC Form 1205 filings, the accumulated depreciation amount on Line E

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Moreover, in any GAAP accounting system, each entry must appear on both sides of the balance sheet, in order for the balance sheet to stay in balance. See Eisen at 29; Horngren at 8-9; Wiley at 40. Current depreciation is an expense, representing the loss in value of the asset. Eisen at 50. To keep the balance sheet balanced, the value of the asset must be reduced by the amount of the current depreciation. Id, at 50-51. This is done, not by reducing the value of the asset itself, but by adding the current depreciation to a "contra-asset" account, accumulated depreciation, which appears on the asset side of the balance sheet and offsets the gross book value of the asset. Id. at 51; Jan R. Williams, 1998 Miller GAAP Guide at 11.10 (1998); Arlene K. Mose, et al., Day-to-Day Business Accounting, at 66-67 (1997). This principle is incorporated in FCC Form 1205, Schedule C. The first part of Schedule C computes an asset amount, the equipment's net book value, on Line G. It then proceeds to compute an expense amount, the annual capital cost of the equipment, on Line K. If Adelphia includes current depreciation in its annual capital cost computation on Line G, it must also include the same amount in the accumulated depreciation entry used to compute the net asset value of the equipment. To do otherwise would create an incorrect annual capital cost on Line K, because the computation of one of its components, Line I, includes Line G.

We therefore find that since Adelphia did not reduce the high definition converter gross book value by an accumulated depreciation increment equal to the depreciation expense it took during the first year, it overstates the net book value for converters. As a result, Adelphia's

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would be greater than Line J, because it would include depreciation amounts from previous filing periods.

calculation produces a higher return on capital, and consequently, a higher maximum permitted equipment rate than that to which the Company is entitled.

IV. CONCLUSION

Based on these findings, we conclude that Adelphia must adjust its entries related to depreciation on the Schedule C under review by including the depreciation expense from Line J as the current accumulated depreciation on Line E. The Cable Division, therefore, rejects Adelphia's proposed high definition converter rate and orders Adelphia to resubmit its FCC Form 1205, reporting the same amount of depreciation on both Schedule C, Line E and Schedule C, Line J, and recalculating its proposed maximum permitted rate for its high definition converters accordingly. We further direct Adelphia to identify the depreciation method that the Company has adopted for its resubmitted form.

V. ORDER

Upon due notice, hearing and consideration, the Cable Division hereby rejects Adelphia's FCC Form 1205 as filed on December 15, 2003 for Abington, Adams, Amesbury, Aquinnah, Bourne, Cheshire, Clarksburg, Duxbury, Edgartown, Essex, Falmouth, Gloucester, Great Barrington, Halifax, Kingston, Lee, Lenox, Manchester-by-the-Sea, Marshfield, Merrimac, North Adams, Oak Bluffs, Pembroke, Plymouth, Plympton, Rockland, Rockport, Salisbury, Sandwich, Sheffield, and Stockbridge.

Further, upon due notice, hearing and consideration, the Cable Division hereby orders Adelphia to refile its FCC Form 1205, in accordance with this Rate Order, on or before February 19, 2004.

Further, upon due notice, hearing and consideration, the Cable Division orders Adelphia to comply with all other directives in this Rate Order.

By Order of the
Department of Telecommunications and Energy
Cable Television Division

/s/ Alicia C. Matthews
Alicia C. Matthews
Director

Issued: February 13, 2004

APPEALS

Appeals of any final decision, order or ruling of the Cable Division may be brought within 14 days of the issuance of said decision to the full body of the Commissioners of the Department of Telecommunications and Energy by the filing of a written petition with the Secretary of the Department praying that the Order of the Cable Division be modified or set aside in whole or in part. G.L. c. 166A, § 2, as most recently amended by St. 2002, c. 45, § 4. Such petition for appeal shall be supported by a brief that contains the argument and areas of fact and law relied upon to support the Petitioner's position. Notice of such appeal shall be filed concurrently with the Clerk of the Cable Division. Briefs opposing the Petitioner's position shall be filed with the Secretary of the Department within seven days of the filing of the initial petition for appeal.