



COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION

**DEPARTMENT OF
TELECOMMUNICATIONS & ENERGY
Cable Television Division**

RATE ORDER

CTV 03-8

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 digital video recorders.

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Adelphia Cable Communications, Inc.
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FOR: ADELPHIA CABLE COMMUNICATIONS, INC.
Petitioner

William J. Kearney
Cable Advisory Committee
Town Hall
878 Tremont Street
Duxbury, MA 02332
FOR: TOWN OF DUXBURY
Intervenor

I. INTRODUCTION

On December 24, 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 a new type of converter on Federal Communications Commission (“FCC”) Form 1205. The converter has the additional capacity to store programming for later viewing. The proposed rate would apply in all of Adelphia’s Massachusetts communities.² The Cable Division must review the proposed rate for compliance with federal and state law and regulations.

As part of our review, the Cable Division held a public and evidentiary hearing in our Boston office on February 5, 2004. The Cable Division granted the petition of the Town of Duxbury to intervene in this proceeding. The evidentiary record consists of Adelphia’s rate form admitted as Exhibit Adelphia-1, Adelphia’s responses to information requests entered as Cable Division Exhibits 1 through 7, and Adelphia’s responses to record requests issued by the Cable Division. References to the transcript are cited as (Tr.). This order addresses the Cable Division’s findings with regard to Adelphia’s proposed lease rate.

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.

II. BACKGROUND

In response to competitive pressure, cable operators are improving their technology, upgrading their systems and, as a result, offering subscribers additional services. One such service enables subscribers to record up to 40 hours of analog and digital programming, and to replay the recorded programming whenever they choose (RR-CTV-1; Tr. at 7-8). In order to use this service, a subscriber requires a converter box with digital video recording capability (“DVR”) (Tr. at 7, 8).³ The Company intends on making these units available to subscribers beginning in March, 2004 (*id.* at 10).

The DVR service is an unregulated service and thus, the Cable Division lacks jurisdiction over the rate charged for the service. However, the FCC permits regulation of rates for subscriber equipment used to receive the basic service tier even if the same equipment also is used to receive unregulated services. 47 C.F.R. § 76.923. In this proceeding, Adelphia seeks approval of the lease rate it may charge subscribers for the DVR equipment rental. The Company proposes a maximum permitted rate of \$13.76, but intends on charging subscribers \$7.95 (Exh. Adelphia-1, at 7).

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

³ For recording high definition television programming, a more advanced unit with greater storage capacity is required. Such a unit is not yet available (Tr. at 8-9).

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 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.

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). 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, at 5716 (1993); see also 47 C.F.R. § 76.937(a).

III. DISCUSSION AND ANALYSIS

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. Indeed, 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). The Company testified that it has not actually deployed any DVR units, and does not intend to do so until sometime after the first quarter 2004 (Exh. CTV-2; Tr. at 10, 13, 14, 17). Consequently, Adelphia cannot base its rate calculation on actual costs. Of particular consequence in this proceeding is Adelphia's use of projected depreciation expense in its calculation. On the pending filing, Adelphia included one full year of depreciation expense on Schedule C, Line J equivalent to a five-year life, based on projected year-end data (Exh. Adelphia-1, at 3).⁴ While projecting this depreciation expense, Adelphia did not project any accumulated depreciation on Schedule C, Line E (id.).

We recently noted that in adopting the Form 1205, the FCC appears to have not addressed the situation in which a cable operator seeks a rate for new, yet un-deployed technology, and for which it cannot produce actual costs. Adelphia Communications, Inc., CTV 03-7, at 7 (February 13, 2004) ("CTV 03-7"). In CTV 03-7, Adelphia sought approval of its lease rate for high definition television converters. Id. at 2. Relying on generally accepted accounting principles, we found that since Adelphia had in fact deployed at least some units, some amount of depreciation expense was appropriate. Id. at 7. Given this, we allowed the Company to elect its depreciation method. Id. at 8.

⁴ The current depreciation reported on Line J was \$98.00, which is one-fifth of the gross book value of \$490.00 reported on Line D.

The matter at hand differs from that in CTV 03-7 in a very significant respect: here, the Company has not deployed any DVR units. As a result it is not entitled to claim any depreciation expense. However, as we discussed in CTV 03-7, eliminating the depreciation expense entirely would not result in a fair and reasonable rate, would likely cause subscriber confusion, and would send improper price signals. See CTV 03-7, at 6-7. Adelphia offered no testimony to support its proposal to claim a full year of depreciation (see RR-CTV-1). Nor did the Company offer any testimony addressing the merit or lack thereof of other accounting methods that are used when introducing new equipment (see id.).

We have stated our preference for some partial year method of determining depreciation expense where there are no actual costs on which to base a calculation. Adelphia CTV 03-7, at 8. A half-year convention allows 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.⁵ 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.⁶ Moreover, since this method accounts for some amount of depreciation expense, the rate produced will be more consistent with the rate produced from a calculation of actual costs. Therefore, even

⁵ These same assets would also be allowed a half year of depreciation during the final year they are on the books.

⁶ 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 deployment, a reasonable result.

though the Company has not yet deployed any units in Massachusetts, the use of a half-year convention ensures that the Company implement a reasonable rate. Accordingly, since Adelphia failed to meet its burden of proving the reasonableness of claiming a full year of depreciation, we find that it is appropriate for Adelphia to adopt a half-year convention for its DVRs in this case.

Having determined that the Company may claim depreciation expense based on the half-year convention, we turn to the issue of accumulated depreciation. The current provision for depreciation and the accumulated depreciation should be equal in the first year the equipment is booked. See CTV 03-7, at 10-11. This is because both the current provision for depreciation and the accumulated depreciation must be determined on the same date. Id. In its testimony, the Company appears to have conceded this point by submitting a revised FCC Form 1205, reporting the same amount of accumulated depreciation as current depreciation (RR-CTV-1). Given our findings above, the Cable Division finds that Adelphia must adjust the accumulated depreciation amount to reflect use of the half-year convention.

We note that on the Company's originally filed FCC Form 1205, Adelphia reported a grossed-up rate of return of 0.1370 at Schedule C, Line H, and used this rate of return to compute the return on investment grossed-up for taxes reported at Schedule C, Line I (Exh. Adelphia-1, at 3). The Company explained that this was its specific grossed-up rate for the regional form (Tr. at 12). The Company also explained that its national grossed-up rate is higher (id.). On Adelphia's revised FCC Form 1205, the Company included accumulated depreciation with a grossed-up rate of return of 0.1592 (RR-CTV-1). The Company explained

that it had used the same grossed-up rate of return “from the last filing on record” with the Cable Division (id.). This appears to be a reference to another of Adelphia’s pending filings, docketed as CTV 03-5, which the Company filed with the Cable Division on November 26, 2003. The Cable Division has made no findings concerning the reasonableness of the revised grossed-up rate of return proposed in docket CTV 03-5. Further, the Company presented no testimony concerning the reasonableness of any grossed-up rate of return different from that proposed on its initial filing. Unlike projected inflation numbers used in preparing the FCC Form 1240, the information presented on this rate form is historical in nature. When an operator is asked to update certain information on its FCC Form 1240, it also can update inflation using more accurate numbers than what was available when its form was originally filed. Time Warner Cable, Chatham County et al., DA 98-967, at ¶¶ 6-7 (1998). In this case, however, Adelphia has provided no new information to justify changing the rate of return used in preparing its original filing. The Cable Division finds no basis for accepting a different rate of return at this point, particularly since the interim FCC Form 1205 filings before us were prepared prior to the national form submitted with the annual FCC Form 1240 filing pending before us. In fact, had Adelphia decided to include the high definition and DVR units on its annual filing, we would not be conducting this proceeding. Adelphia, however, has elected to seek the flexibility to put both its high definition and DVR units into service prior to its proposed March 1 rate change date. The trade off for this flexibility is that Adelphia must use the most recently approved FCC Form 1205 rate of return. We find that, in this proceeding, a grossed-up rate of return of 0.1370 is appropriate.

Finally, as noted above, the DVR unit for which a rate is being established in this proceeding lacks the required capacity to store high definition programming (Tr. at 8). The Company expects that it will soon be able to purchase a hybrid high definition/DVR converter (id. at 9). The Company stated that it did not plan to file a separate FCC Form 1205 to justify the rate for the hybrid unit, as the functionality is equivalent to the units it has in place and it expects to charge the same rate (\$7.95).

As is evidenced by the recent filings for new types of equipment, the changes in technology both in terms of price and function are rapid. The cost of the hybrid unit might be equal to or greater than the combined costs of the high definition television converter and the DVR unit, thus resulting in a similar price to subscribers. However, the possibility exists that as technological advances are made and production costs decline, the cost of the hybrid unit will be less than the combined costs of its component units. To the extent that Adelphia elects to introduce this equipment prior to its next FCC Form 1205 filing and charge a rate higher than the currently proposed \$7.95 for high definition and DVR units, the Company must file a FCC Form 1205 pursuant to 47 C.F.R. § 76.923(o).

IV. CONCLUSION

Based on our review, we find that the use of the half-year convention to determine depreciation expense is reasonable in this case. We further find that the amount of accumulated depreciation in the first year the equipment is booked must equal the current provision of depreciation expense. Finally, we find that a grossed-up rate of return of 0.1370 is reasonable in this case.

Accordingly, we direct Adelphia to submit a revised FCC Form 1205, adjusting its entries related to depreciation on the Schedule C consistent with the use of a half-year convention. In addition, on this revised FCC Form 1205, we direct Adelphia to employ, at Schedule C, Line H, the same grossed-up rate of return of 0.1370 that it employed in its initial filing. The Cable Division directs the Company to recalculate its maximum permitted rate accordingly.

V. ORDER

Upon due notice, hearing and consideration, the Cable Division hereby rejects Adelphia's FCC Form 1205 as filed on December 24, 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 27, 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 20, 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.