

THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY
CABLE TELEVISION DIVISION

In the Matter of:)	Docket No.: Y-00 INC, Y-00 EQU, Y-00 UPG
)	Date Issued: September 19, 2000
)	
Time Warner Entertainment)	Athol, CUID MA 0013
Advance/Newhouse Partnership)	Dalton, CUID MA 0027
)	Orange, CUID MA 0014
For a Determination of)	Pittsfield, CUID MA 0028
Cable Television Rates)	Richmond, CUID MA 0096

RATE ORDER

APPEARANCES:

Nancy P. Karm
Vice President, Finance
Time Warner Cable – Albany Division
130 Washington Street Extension
Albany, NY 12203-5393
FOR: TIME WARNER CABLE
Petitioner

Michael J. Racicot
Town Administrator
6 Prospect Street
Orange, MA 01364
FOR: THE TOWN OF ORANGE
Intervenor

Jeffrey A. Honig
Assistant City Solicitor
City Hall
70 Allen Street
Pittsfield, MA 01201

FOR: THE CITY OF PITTSFIELD
Intervenor

I. INTRODUCTION

On October 1, 1999, Time Warner Entertainment - Advance/Newhouse Partnership (“Time Warner” or “the Company”) filed with the Cable Television Division (“Cable Division”) of the Department of Telecommunications and Energy proposed basic service tier (“BST”) programming rates on Federal Communications Commission (“FCC”) Form 1240s for all of the above-captioned communities. Two FCC Form 1240s were filed, one for Athol and Orange (the “Athol/Orange system”), and the other for Dalton, Pittsfield and Richmond (the “Pittsfield system”). Pursuant to 47 C.F.R. § 76.933(g), Time Warner put its proposed BST programming rates into effect on January 1, 2000. On October 1, 1999, Time Warner also filed an FCC Form 1235 applicable only to Dalton, Pittsfield and Richmond. This FCC Form 1235 was filed under the FCC’s pre-approval option. FCC Form 1235, Instructions for Completion of Abbreviated Cost of Service Filing for Cable Network Upgrades (February 1996) (“FCC Form 1235 Instructions”) at 2. The Cable Division held a public hearing in Pittsfield on May 11, 2000 on Time Warner’s pending FCC Form 1235 and FCC Form 1240 filings.

On October 1, 1999, Time Warner provided the Cable Division with an FCC Form 1205 covering the 12 months ending June 30, 1999. This FCC Form 1205 was a consolidated filing for Time Warner’s five upstate New York divisions. This filing included the Athol/Orange and Pittsfield systems because they are part of Time Warner’s Albany, New York Division.¹ The Cable Division considered the FCC Form 1205 to be an informational filing only, because we understood that this FCC Form 1205 was included within the Time Warner Social Contract, and hence subject to review by the FCC. See Social Contract for Time Warner, Memorandum Opinion and Order, FCC 95-478 (released November 30, 1995) at Appendix B, Social Contract for Time Warner Cable (“Social Contract”) at 7, Section III.B.

The Social Contract gives Time Warner the option of being relieved from its rate regulation provisions, if there were a material change in the provisions of the Cable Act or the FCC’s rules relating to rates that was favorable to the Company. Social Contract at 20, Section III.I.1.c. On May 25, 2000, Time Warner provided the Cable Division with a letter dated June 28, 1999 from Arthur H. Harding, counsel to Time Warner, to the FCC (the “Harding letter”). In the Harding letter, Time Warner elected to be relieved from the rate-related provisions of the Social Contract (Harding Letter at 1; see Telecommunications Act of 1996, § 301(b)(4); 47 U.S.C. § 543(c)(4)). Pursuant to the Social

¹ Previously, Time Warner had included the Athol/Orange and Pittsfield systems within its Massachusetts FCC Form 1205, which also included Time Warner’s Eastern Massachusetts communities (July 6, 2000 Audiotape, Side 1, at counter nos. 109-123). After these Eastern Massachusetts communities were transferred to MediaOne, Time Warner included the Athol/Orange and Pittsfield systems within the upstate New York FCC Form 1205 currently under review (id.)

Contract, Time Warner's election was self-executing, making relief from the Social Contract immediately effective (Harding Letter at 2, Social Contract at 21, Section III.I.1.c). Time Warner's FCC Form 1205 thus is subject to review by the Cable Division. Accordingly, the Cable Division held a second public hearing in Boston on July 6, 2000, which concentrated on Time Warner's FCC Form 1205 filing. In addition, the Cable Division directed Time Warner to conduct a public meeting in Pittsfield to address public comment on the proposed FCC Form 1205. The public meeting was held on August 10, 2000.

The Town of Orange and the City of Pittsfield intervened in this proceeding. The evidentiary record includes five Time Warner exhibits, six Cable Division exhibits consisting of Time Warner's responses to our information requests, and responses to record requests posed by the Cable Division. No briefs were filed by any party.

II. THE ANNUAL RATE FILINGS: FCC FORMS 1240 AND 1205

A. Standard of Review

The standard under which the Cable Division must review rate adjustments on FCC rate forms 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 47 U.S.C. § 543 of the Cable Television Consumer and Competition Act of 1992 as amended (the "Cable Act"). 47 C.F.R. § 76.922(a). The Cable Division may accept as in compliance with the statute basic service tier rates that do not exceed the "Subsequent Permitted Per Channel Charge" as determined by 47 C.F.R. § 76.922(c), and may also accept equipment and installation charges that are calculated in accordance with 47 C.F.R. § 76.923. In addition, the Cable Division shall only approve rates it deems reasonable under federal law. 47 C.F.R. § 76.937(d) and (e); 47 C.F.R. § 76.942.

In establishing whether the proposed rates are reasonable and comply with federal regulations, the burden of proof is on the cable operator to demonstrate that its proposed rates for the basic service tier and accompanying equipment comply with 47 U.S.C. § 543 and implementing regulations. 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 (released May 3, 1993) at 5716, ¶ 128; see also 47 C.F.R. § 76.937(a).

The FCC has created specific forms incorporating the provisions of its rate regulations, upon which cable operators must calculate their rates. Local rate regulators, such as the Cable Division, are required to review the Company's FCC rate form filings to determine whether the rates are reasonable and in compliance with the Cable Act. 47 C.F.R. §§ 76.922, 76.923, 76.930.

The FCC Form 1205 establishes rates for installations and equipment, such as converters and remote controls, based upon actual capital costs and expenses. FCC Form 1205 Instructions (June 1996) at 7, 12-13. FCC Form 1205 is prepared on an annual basis using information from the cable operator's previous fiscal year. *Id.* at 2. Subscriber charges for equipment shall not exceed charges based on actual costs as calculated in accordance with the FCC's regulatory requirements. 47 C.F.R. § 76.923(a)(2).

The FCC Form 1240 allows a cable operator to annually update its basic service tier programming rates to account for inflation, changes in external costs, and changes in the number of regulated channels. In order that rates be adjusted on FCC Form 1240 for projections in external costs, or for projected changes to the number of regulated channels, the operator must demonstrate that such projections are reasonably certain and reasonably quantifiable. 47 C.F.R. § 76.922(e)(ii)(A); 47 C.F.R. § 76.922(e)(iii)(A). Although cable operators may project for increases in franchise-related costs to the extent they are reasonably certain and reasonably quantifiable, such projections are not presumed to be reasonably certain and reasonably quantifiable. 47 C.F.R. § 76.922(e)(ii)(A).

B. Analysis of Findings

The Cable Division finds that Time Warner's FCC Form 1240s as filed on October 1, 1999, and its FCC Form 1205 as filed on July 6, 2000, comply with applicable law. However, we note that the Time Warner FCC Form 1240 filed for the Pittsfield system listed no franchise obligations (Exh. Time Warner-2, FCC Form 1240, Worksheet 7). In response to a Cable Division record request, Time Warner described its franchise obligations in each of the three communities included in the Pittsfield system: Dalton, Pittsfield and Richmond (RR-CATV-2). In future filings, Time Warner should include each community's franchise obligations as an element on the Worksheet 7 of the FCC Form 1240. 47 C.F.R. § 76.922(f)(1)(iii); FCC Form 1240 Instructions (July 1996) at 38-40. These filings should be prepared in a way to assure the Cable Division that each community's rates include only those costs provided for in its franchise agreement.

III. THE NETWORK UPGRADE SURCHARGE: FCC FORM 1235

A. The FCC Form 1235 Approval Process and Standard of Review

The FCC developed FCC Form 1235 as an abbreviated cost-of-service filing that enables cable operators to justify rate increases based upon significant capital expenditures used to improve regulated cable services. FCC Form 1235, Instructions for Completion of Abbreviated Cost of Service Filing for Cable Network Upgrades (February 1996) ("FCC Form 1235 Instructions") at 1. The FCC determined that cable operators who make significant upgrades to their systems should be allowed to recover the costs of the upgrade by adding a network upgrade surcharge to their rates otherwise

determined pursuant to FCC Form 1240 methodologies. Id. The network upgrade surcharge is not adjusted for inflation but remains unchanged over the useful life of the improvement, which is determined in accordance with the FCC's cost-of-service requirements. Id., See Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of Uniform Accounting System for Provision of Regulated Cable Service: Report and Order and Further Notice of Proposed Rulemaking, MM Docket No. 93-215, CS Docket No. 94-28, FCC 94-39, 9 FCC Rcd 4527 ("Cost Order") (released March 30, 1994) at 4676.

An operator, therefore, is permitted to set a BST rate based on two components. The first component is the benchmark rate, i.e., the rate established by FCC Form 1240. The second component is the network upgrade surcharge. The sum of these two components will yield the maximum allowable rate that may be charged to subscribers. Id. Thus, the network upgrade surcharge is a separate calculation on FCC Form 1235 which, if approved, may be added to the overall BST maximum permitted rate ("MPR"). See FCC Form 1235, page 3, Part III, Line 4, and FCC Form 1240 Instructions at 9.

An operator who seeks to establish a network upgrade surcharge must file FCC Form 1235 following the end of the month in which the upgraded cable services become available and are providing benefits to customers of regulated services. FCC Form 1235 Instructions at 2. Alternatively, an operator may elect to file for pre-approval at any time prior to the upgraded services becoming available using projected upgrade costs. Id. If a cable operator chooses the pre-approval option, it must refile FCC Form 1235 following the end of the month in which the upgrade is providing benefits to all customers of regulated services in the filing entity. Id. In this filing, the cable operator must substitute actual costs for projected costs. Id.

The FCC established five criteria that a cable operator must satisfy in order to be eligible for an FCC Form 1235 rate increase. See Cost Order at 4675-4676; See also Public Notice, Cable Services Bureau Develops System Upgrade Form, DA 95-1893, 11 FCC Rcd 5554 (released September 19, 1995); Marcus Cable Partners, L.L.C., DA 00-1071 (released May 15, 2000) ("Marcus Partners") at ¶ 8. First, the upgrade must be significant and require added capital investment, such as for the expansion of bandwidth capacity and conversion to fiber optics, and for system rebuilds. Cost Order at 4675. Second, the upgrade must actually benefit subscribers of regulated services, through improvements in those services. Id. Third, the operator may not assess the network upgrade surcharge until the upgrade is both complete and is providing benefits to subscribers of regulated services. Id. Fourth, the operator must demonstrate that the amount of the net increase in costs is justified, taking into account current depreciation expense, likely changes in maintenance and other costs, changes in revenues, and expected economies of scale. Id. at 4675-4676. Fifth, the operator must allocate the net increase in costs in conformance with the FCC's cost allocation rules for cost-of-service showings, to assure that only costs allocable to regulated services are imposed on subscribers

to those services. Id. at 4676.

B. Analysis and Findings

Time Warner certified on its FCC Form 1235 that it satisfied the FCC's minimum technical specifications for an upgrade (Exh. Time Warner-2, FCC Form 1235, at 2). The Company also reported that its system has been upgraded from 450 MHz to 750 MHz, using fiber to node architecture (Exh. CATV-5; Exh. Time Warner-2, FCC Form 1235, at 2). The upgraded network has 500 homes per fiber node (May 11, 2000 Audiotape, Side 1, at counter nos. 279-282). We find that the Time Warner upgrade is significant, and satisfies the FCC's minimum technical specifications.² Given this, we also conclude that the upgrade benefits Time Warner's subscribers through improvements in services. Our conclusion is based on the presumption set forth by the FCC. The FCC has held that "[s]ubscribers are presumed to benefit from improved service quality and reliability when an operator meets the minimum technical specifications, and no showing of additional channels of service is required." Cox Communications San Diego, Inc., Chula Vista, DA 98-1536 (released August 4, 1998) at ¶ 9.

With respect to the third criterion, that the surcharge not be assessed until the upgrade is both complete and providing benefits, the Company has not yet charged an upgrade surcharge to subscribers (Exh. Time Warner-2, at FCC Form 1235 & 1240, Projected Period 2000 Rates). In fact, the Company did not implement a surcharge even though it has completed its upgrade of the Pittsfield system (July 6, 2000 Audiotape, Side 1, at counter nos. 109-123). Thus, the third criterion is satisfied.³

As stated above, the operator must demonstrate that the amount of the net increase in costs is justified. Cost Order at 4675-4676. Also, the operator must allocate the net increase in costs in conformance with the FCC's cost allocation rules for cost-of-service showings, to assure that only costs allocable to regulated services are imposed on subscribers to those services. Id. at 4676. Time Warner has reported that since each analog channel consumes 6 MHz of bandwidth, the analog channel capacity of its rebuilt 750 MHz plant would be 125 channels. Nevertheless, Time Warner also

² The FCC's minimum technical specifications for a system other than a small system are an increase in usable bandwidth to at least 550 MHz with an upgrade capability to 750 MHz, fiber to the node or beyond, and no more than 1,500 homes per node. FCC Form 1235 Instructions at 5.

³ We note that while the FCC regulations require Time Warner to file a final FCC Form 1235 following the end of the month in which upgraded cable services are available, using actual costs where applicable, it was inefficient to do so while the pre-approval process was pending. FCC Form 1235 Instructions at 2. Accordingly, Time Warner must refile the FCC Form 1235 in its final form immediately following the issuance of this Rate Order.

reported that its rebuilt system would carry a total of 80 channels, consisting of 18 BST channels,⁴ 48 CPST channels, and 14 channels either designated to other categories of service or unused (Exh. Time Warner-2, Form 1235 at 7). The Company's FCC Form 1235 allocates the expenses of the upgrade using only 80 analog channels (Exh. Time Warner-2, FCC Form 1235 at 7). Thus, Time Warner allocated the costs of the upgrade to the three service categories, based on the percentage of the 80 channels that are included in each category (*id.* at 4, 6). Time Warner did not describe the services it would provide over the upgraded system's remaining 45 channels or 270 MHz of bandwidth, other than to report that the Company is offering Internet service, but does not plan to offer either telephone or other high speed data services at this time (Exh. CATV-5). Nor did Time Warner provide the Cable Division with a calculation of non-cable related costs except to claim that the costs related to the provision of the Internet service were not included in the upgrade costs reported on its FCC Form 1235 Worksheets (*id.*).

Clearly, if the FCC Form 1235 includes upgrade costs that are not related to cable services, then the amount of the upgrade costs allocated to the BST, and thus the monthly upgrade surcharge, would be unreasonable. Although the Company claims that the costs relating to Internet service have been excluded from the FCC Form 1235, the record of this proceeding neither explains how many of the 45 non-allocated channels have been dedicated to Internet service, nor confirms that no costs related to these 45 channels have been included in the allocation. Based on the record before us, the Cable Division is unable to confirm the accuracy of the allocation of upgrade costs between cable and non-cable services. Moreover, we are unable to find that the upgrade costs are justified on the record before us. Accordingly, the Cable Division rejects Time Warner's method of allocation.

Time Warner stated that its final FCC Form 1235 will allocate its upgrade costs based on the total capacity of the system, or 125 channels (July 6, 2000 Audiotape at counter no. 329). The Cable Division directs that Time Warner's final FCC Form 1235 must reflect the accurate number of total analog channels or their equivalent in MHz, that will be included in each service tier of the upgrade, broken down into BST, CPST, and "All Other," which would include other cable services and non-cable services, including Internet services. The Cable Division further directs Time Warner to include, with its final FCC Form 1235 filing, an actual channel lineup that will verify the number of BST channels reported on the final FCC Form 1235.

C. The Impact of the Time Warner Social Contract

⁴ Time Warner reported on its FCC Form 1235 that its BST carried 18 channels (Exh. Time Warner-2; FCC Form 1235 at 7). However, in response to a Cable Division record request, the Company reported that it was currently carrying 20 channels on the BST for the Pittsfield system (RR-CATV-2). To compound the uncertainty, the Comparative Lineup attached to the Pittsfield system's FCC Form 1240 reports that following the upgrade, the BST tier will carry 17 channels (Exh. Time Warner-2, FCC Form 1240).

Also at issue is whether the BST network upgrade surcharge calculated by Time Warner's Pittsfield FCC Form 1235 should be offset by the CPST rate increases that were implemented pursuant to the Social Contract. As part of the Social Contract, Time Warner agreed to make a capital investment of \$4 billion to upgrade its cable systems. Social Contract at 13, Section III.F.1. To recover this investment, the Social Contract permitted Time Warner to increase the monthly rates for the most highly penetrated CPST on each of its systems by \$1.00 during each year of the Social Contract; increases "established at a level designed to recover solely those costs allocable to BST and CPST subscribers." *Id.* at 14, Section III.F.4.a.

The Social Contract provides that "[i]n the event any such system elects to be relieved from such [rate] contract provisions ... such system will only be allowed to recover any incremental amount that results under such favorable regulatory provisions in excess of any amount already recovered pursuant of Section III.F.4.a of this Contract." Social Contract at 20-21, Section III.I.1.c. This provision suggests that the Pittsfield system's BST network upgrade surcharge should be reduced by that portion of the annual CPST increases charged in the Pittsfield system that are allocable to BST subscribers. This provision of the Social Contract was not affected by the Harding letter, and Time Warner remains bound by it (Harding Letter at 1, 2). The requirement of an offset arises because the upgrade for which Time Warner has filed its Pittsfield FCC Form 1235 also is authorized by the Social Contract, *see* Social Contract at 12, Section III.F.1, thus preventing double recovery.

The Cable Division asked Time Warner either to provide evidence that it had offset the cost of the proposed upgrade on its FCC Form 1235 by the BST-allocated percentage of the \$1.00 increase, or to explain why the offset provision does not apply (RR-CATV-6). Time Warner responded that the language of the Social Contract referring to costs allocable to BST and CPST subscribers only intended to define which upgrade costs were includable for recovery (*id.*). The Company argued the language does not mean that the \$1.00 charged to CPST subscribers intended to recover both the BST and CPST portions of the upgrade, but only the CPST portion (*id.*).

The difficulty with Time Warner's argument is that the Social Contract specifically states that the increases are designed to recover "costs allocable to BST and CPST subscribers." (Emphasis added.) Social Contract at 14, Section III.F.4.a. It may seem illogical that the BST portion of the Pittsfield network upgrade surcharge should be adjusted downward because of CPST rate increases. However, this result can be explained both by the FCC's requirement that all CPST subscribers also receive the BST, 47 C.F.R. § 76.920, and by the Social Contract's requirement that Time Warner create a low-cost, lifeline, BST, which indicates a special concern for BST-only subscribers. Social Contract at 4, Section III.A.1. In addition, the Social Contract contains other references to BST subscribers receiving benefits from the upgrades. It specifies that at least 60 percent of all capital expended for the upgrades "shall be applied for the benefit of BST and CPST subscribers." *Id.* at 13, Section III.F.1. The Social Contract also requires Time Warner to make regular progress reports to

the FCC, including “the number of BST and CPST subscribers benefitting from such upgrade.” *Id.* at 13, Section III.F.3. It thus is reasonable that if a portion of the annual increases in the monthly CPST rates financed the upgrade of the BST, that an appropriate adjustment should be made to prevent a double recovery for the upgrade through an FCC Form 1235 filing.

Accordingly, the Cable Division directs Time Warner to calculate the amount of the annual increases to be allocated to the BST. First, the Company should calculate the channel allocation percentage, dividing the number of BST channels by the total number of BST and CPST channels. The resulting figure should then be multiplied by the total amount recovered from the \$1.00 annual increases in CPST rates permitted by the Social Contract, to arrive at the amount applicable to the BST. This amount should then be used to offset the basic tier revenue requirement reported at FCC Form 1235, Part II, Line 6.

D. Conclusion

For the reasons described above, the Cable Division concludes that Time Warner’s FCC Form 1235, as initially filed, does not satisfy the fourth and fifth criteria established by the FCC. The Cable Division will apply these criteria to the final FCC Form 1235 to be filed by Time Warner in accordance with this Rate Order.

IV. CONCLUSION AND ORDER

Upon due notice, hearing and consideration, the Cable Division hereby accepts as reasonable and in compliance with applicable statutes and regulations, Time Warner’s FCC Form 1240s as filed on October 1, 1999 for Athol, Dalton, Orange, Pittsfield and Richmond.

Upon due notice, hearing and consideration, the Cable Division hereby accepts as reasonable and in compliance with applicable statutes and regulations, Time Warner’s FCC Form 1205s as filed on July 6, 2000 for Athol, Dalton, Orange, Pittsfield and Richmond.

The Cable Division denies the FCC Form 1235 filed by Time Warner for pre-approval on October 1, 1999, and directs Time Warner to file its final FCC Form 1235 for Dalton, Pittsfield and Richmond, on or before September 29, 2000, in accordance with this Rate Order.

The attached schedule provides the current and maximum permitted basic service tier programming rates for each community.

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

**Alicia C. Matthews
Director**

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. 1997, c. 164, § 273. 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 7 days of the filing of the initial petition for appeal.

