

THE COMMONWEALTH OF MASSACHUSETTS

**DEPARTMENT OF  
TELECOMMUNICATIONS & ENERGY  
CABLE TELEVISION DIVISION**

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In the Matter of:	)	Docket No. CTV 00-6
	)	Date Issued: August 1, 2001
	)	
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
	)	

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**RATE ORDER**

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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

I. INTRODUCTION

On September 29, 2000, 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, 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, 2001. On September 29, 2000, Time Warner also filed a final FCC Form 1235 applicable only to the Pittsfield system, in response to our Rate Order in Time Warner Entertainment-Advance/Newhouse Partnership, Y-00 INC, Y-00 EQU, Y-00 UPG (2000) (the “2000 Rate Order”). Time Warner also filed, on September 29, 2000, its preliminary FCC 2001 Consolidated Upstate New York and Massachusetts FCC Form 1205, based on data for the actual 12 months ending June 30, 2000. On November 24, 2000, Time Warner filed its final 2001 Consolidated Upstate New York and Massachusetts FCC Form 1205, based on data for the actual 12 months ending September 30, 2000.

The Cable Division held a public hearing in Boston on March 22, 2001 on Time Warner’s pending filings. No communities intervened in the proceeding. The evidentiary record includes five Time Warner exhibits, seven 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.

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

A. The FCC Form 1205 and FCC Form 1240 Approval Process and 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 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 and Findings, FCC Form 1205

Upon review and consideration, the Cable Division determines that Time Warner's final 2001 Consolidated Upstate New York and Massachusetts FCC Form 1205, as filed on November 24, 2000, complies with applicable law, and that the rates proposed therein are reasonable.

C. Analysis and Findings, FCC Form 1240: Interest on True-Up

As stated above, the FCC Form 1240 allows a cable operator to annually update its BST rates to account for inflation, changes in external costs, and changes in the number of regulated channels. A portion of the FCC Form 1240 computation is based upon projected costs. If a cable operator has underestimated its projected costs, it may "true-up" its projection to correct for the difference between its actual and projected costs. The issue is whether Time Warner calculated and reported the true-up amount in compliance with applicable law.

The FCC Form 1240, at Module H, computes true-up and the interest on true-up. FCC Form 1240 Instructions at 19-21. The cable operator begins by computing two versions of its true-up period revenue. First, it computes this revenue using the BST rates it actually charged, reported on Line H1, "Revenue From Period 1."<sup>1</sup> Id. at 19. The operator then computes what its revenue would have been if it had charged its BST MPR, reported on Line H2, "Revenue From Maximum Permitted Rate for Period 1." Id. at 20. Line H1 is then subtracted from Line H2 to derive Line H3, "True-Up Period 1 Adjustment," which is the amount the operator's actual revenue either exceeded or fell short of its maximum possible revenue. Id. The FCC allows interest to be accrued on the Line H3 true-up at 11.25 percent, for the period between the beginning of True-Up Period 1 and the end of the most recent Projected Period shown on the previous FCC Form 1240, reported on Line H4, "Interest on Period 1 Adjustment." Id. Lines H3 and H4 are added together on Line H13, "Total True-Up Adjustment." Id. at 21. Line H13 is then divided into Line H14, the "Amount of True-Up Being Claimed This Projected Rate Period," and Line H15, "Remaining True-Up Adjustment." Id.

On Time Warner's two FCC Form 1240s, the Company claimed Line H13's entire true-up on Line H14, and included it within the BST MPR on Line I9 (Exhs. Time Warner-1 and -2, at 4). However, Time Warner's actual operator selected BST rates on Line I10 were less than the Line I9 BST (id.). Consequently, on the next annual FCC Form 1240s that Time Warner files, the true-up computation would incorporate the true-up included in this year's MPR into Line H2,<sup>2</sup> whereas Line H1 would incorporate this year's lower actual BST rate, excluding much of this true-up.<sup>3</sup> Some or all of this year's excess true-up would appear on the next annual Line H3 and accrue interest for a second time on Line H4. Indeed, the next annual Line H4 would accrue interest on this year's interest.

The FCC addressed interest on true-up in its rate regulations at 47 C.F.R. § 76.922(e)(3)(iii):

If an operator has underestimated its cost changes and elects not to recover these accrued costs with interest on the date the operator is entitled to make its annual rate adjustment, the interest will cease to accrue as of the date the operator is entitled to make

<sup>1</sup> FCC Form 1240 requires a cable operator to have more than one true-up period if the true-up will be performed over more than 12 months, hence the reference to "Period 1." FCC Form 1240 Instructions at 5. The Company's FCC Form 1240s' true-up covers only 12 months, between October 1, 1999 and September 30, 2000, so it completed only the True-Up Period 1 portion of Module H, Lines H1 through H4 (Exhs. Time Warner-1 and -2, Worksheet 8).

<sup>2</sup> Line H2 is computed by multiplying together three numbers, including Line F9, "Maximum Permitted Rate for True-Up Period 1." FCC Form 1240 Instructions at 20. Line F9 in turn is derived by adding together five numbers, including Line F8, "True-Up Segment for True-Up Period 1." Id. at 18. Line F8 is computed by dividing Line H14 from the previous FCC Form 1240 by the estimated number of subscribers during the true-up period and by the number of months in the true-up period. Id. at 18.

<sup>3</sup> The Instructions direct cable operators to report the "average rate you elected to charge." FCC Form 1240 Instructions at I9.

the annual rate adjustment, but the operator will not lose its ability to recover such costs and interest.

The FCC explained the rationale for this rule in its Thirteenth Order on Reconsideration, MM Docket No. 92-266, FCC 95-397, 11 FCC Rcd. 388 (released September 22, 1995) ("Thirteenth Order"). The FCC stated that operators would be able to recover excess accrued costs with interest to the extent that the projected costs did not cover the increases that actually took place. Id. at 422, ¶ 80. On the operator's next filing, the operator would be entitled to recover the excess costs plus interest between the date the costs are incurred and the date the operator is entitled to make its next annual rate adjustment. Id. The FCC reasoned that this rule gives operators the flexibility to delay rate increases without losing the opportunity to recover interest on costs that accrued due to circumstances beyond their control, while ensuring that where an operator makes a business decision to delay a rate increase, subscribers are not required to pay for the cost of the delay. Id.

The FCC Form 1240 ensures an operator's compliance with this rule. First, the FCC Form 1240 Instructions state that "the accrual of interest is cut off at the end of the most recent Projected Period (except for first time filers of Form 1240.) For example, if, on your most recent Form 1240, you defined the Projected Period as running from January 1 to December 31, your next true-up has the accrual of interest stopping at the end of December 31." FCC Form 1240 Instructions at 5.<sup>4</sup>

Second, the FCC designed Module H of the FCC Form 1240 to prevent operators from accruing interest on the same true-up on two successive FCC Form 1240s. Line H13 computes the "Total True-Up Adjustment." Id. at 21. However, not all of this true-up adjustment is required to be reported on Line H14, "Amount of True-Up Being Claimed This Projected Rate Period," in all instances. The Instructions to Line H14 begin: "[e]nter the amount of the True-Up Adjustment being passed through to your subscribers during the Projected Period." (Emphasis added.) Id. Therefore, only true-up amounts that will be included in subscribers' rates at the outset of the Projected Period may be properly carried over to Line H14. The FCC provided Line H15, "Remaining True-Up Adjustment," so the cable operator could report the excess true-up it would not pass through during the Projected Period, but could elect to recover in future years. Id. The FCC Form 1240 Instructions direct that on the next annual FCC Form 1240, Line H15 shall be reported as Line H12, "Previous Remaining True-Up Adjustment." Id. The form indicates that Line H12 be added directly into the total true-up adjustment on Line H13, without any interest being accrued upon it. Id. In addition, on the next annual form, the BST rates used to compute true-up on Lines H1 and H2 shall contain the same amount of previous true-up.<sup>5</sup> Id. at 19-20. Thus, none of this true-up is to be included on Line H3 and none of it is

<sup>4</sup> See also the FCC's Cable Letter, Richard D. Treich, 12 FCC Rcd 10340, DA 97-1518, CSB-ILR 97-6 (released July 18, 1997).

<sup>5</sup> Line H1 and H2 contain the same amount of true-up for two reasons. First, on this year's FCC Form 1240, the Line H14 true-up would have been carried over to Line I8 and been incorporated into both the

to accrue interest on Line H4.

We find that Time Warner's proposal to claim its entire true-up on Line H14 without passing it completely through in subscribers' rates does not comply with the Instructions to FCC Form 1240, and will result in the Company's improper accrual of interest on this true-up over a second Projected Period. The "discretion" in the Instructions to Line H14 merely gives cable operators the discretion of not passing on to subscribers the entire true-up during the Projected Period; it does not permit true-up to be claimed and included in the MPR but not passed through to subscribers. Moreover, we determine that Time Warner's calculation of true-up is not in the subscribers' interest, because the subscribers would be required to pay two years' interest on the same true-up, as well as interest on interest.

Accordingly, Time Warner should remove the excessive true-up from Line H14, and record it on Line H15, "Remaining True-Up Adjustment." This adjustment will reduce its BST MPR, but will have no effect on the Company's revenues during the Projected Period. We note that under the FCC's regulations, the Company is generally prohibited from raising its rates later in the Projected Period. 47 C.F.R. § 76.922(e)(1). Nevertheless, the Company is not prejudiced by this adjustment, because the unused true-up, now on Line H15, will be available on its next filing, and could be passed on to subscribers during the next Projected Period. This process "ensures that where an operator makes a business decision to delay a rate increase, subscribers are not required to pay for the cost of the delay." Thirteenth Order at 422, ¶ 80.

The Cable Division concludes that Time Warner's FCC Form 1240s are not in compliance with the applicable statutes and regulations and are therefore unreasonable as filed. The Company is therefore directed to file amended FCC Form 1240 filings. On the Athol and Orange FCC Form 1240, Time Warner should remove from Line H14 the true-up that is claimed but not passed through to subscribers in their BST rate effective on January 1, 2001, and report this true-up on Line H15. For the Pittsfield system, Time Warner should determine how much of the network upgrade surcharge is being passed through to subscribers in their total BST rate. Following this determination, the Company should subtract this surcharge pass through amount from the total BST rate that was effective on January 1, 2001, to determine the amount of the BST operator selected rate on Line I10. As in the Athol and Orange system, Time Warner should remove from Line H14 the true-up that is claimed but not passed through to subscribers in their BST rate effective January 1, 2001, and report this true-up on Line H15. On both forms, Line I8 must also be changed to conform with Line H14, as amended.

### III. THE NETWORK UPGRADE SURCHARGE: FCC FORM 1235

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MPR on Line I9, and the operator selected rate on Line I10. Because only true-up actually charged to subscribers on Line I10 appears on Line I9, the true-up on both lines is identical. Second, Lines H1 and H2 are both calculated by multiplying together three numbers. Two of them – the number of subscribers and the number of months in the true-up period – are the same for both lines; only the third number is different; the rates charged during the true-up period.

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

1. Allocation of Upgrade Costs

In the 2000 Rate Order, the Cable Division concluded that Time Warner's FCC Form 1235, filed for pre-approval, did not satisfy the fourth and fifth criteria. 2000 Rate Order at 6. On the pre-approval FCC Form 1240, Time Warner had reported that its rebuilt Pittsfield system would have 750 megahertz ("MHz") of bandwidth, with a capacity of 125 analog channels. Id. at 5. However, the Company allocated the costs of the upgrade among only 80 channels. Id. at 6. Time Warner did not describe the services it was planning to provide over the remaining 45 channels, other than to report that it was offering Internet service, whose costs were not included in the upgrade costs. Id. The Cable Division concluded that the record did not explain how many of the 45 non-allocated channels were dedicated to Internet service or other non-cable services, and did not confirm that no costs related to these 45 channels had been included in the allocation. Id. Therefore, the Cable Division was unable to confirm the accuracy of the allocation of upgrade costs between cable and non-cable services, nor was it able to determine that the upgrade costs were justified by the record. Id. We directed Time Warner to file its final FCC Form 1235 so that its upgrade costs, including those for non-cable services, would be allocated among the equivalent of 125 channels. Id.

On Time Warner's final FCC Form 1235s filed in this proceeding, the Company has allocated its costs associated with its upgraded system over the entire 750 MHz spectrum, or 125 channels (Exh. TimeWarner-3, at 7; RR CTV-1). The BST consists of 19 channels, so 19/125<sup>th</sup> or 15.2 percent of the costs have been allocated to the BST. The Cable Division has reviewed the cost allocations made by Time Warner and finds them to be in compliance with the Cost Order, the FCC Form 1235 Instructions, and the 2000 Rate Order. We therefore find that Time Warner has now satisfied both the fourth and fifth criteria necessary to be eligible for an FCC Form 1235 rate increase.

2. Rate Of Return

The rate of return is an important element used to determine the FCC Form 1235 total upgrade revenue requirement. FCC Form 1235 at 2. The rate of return percentage is multiplied by the net upgrade rate base in order to compute the return on the upgrade rate base. Id. In a separate calculation, any interest expenses or distributions to partners or shareholders are subtracted from the computed upgrade return amount. Id. If a positive sum remains, it is multiplied by a grossed up rate factor, calculated using federal and state income tax rates, to arrive at an income tax allowance. Id., FCC Form 1235 Instructions at 7. The cable operator's total upgrade revenue requirement is calculated by adding together the income tax allowance, the computed return on the upgrade rate base, and operating expenses. FCC Form 1235 at 2. This revenue requirement thus allows the operator both a return on its investment and an allowance to cover its income tax obligations. The upgrade revenue requirement is then divided by the number of subscribers and by 12 to determine the monthly upgrade surcharge charged to subscribers. Id.

The FCC has prescribed a presumptive rate of return of 11.25 percent. Cost Order at 4612. The FCC stated that an operator seeking a higher rate of return "is required to show exceptional facts and circumstances...." Id. at 4616, n.327. On Time Warner's pre-approval FCC Form 1235, the Company used the FCC's prescribed rate of return of 11.25 percent (RR CTV-1). However, on its final FCC Form 1235, first submitted on September 29, 2000, the Company used a rate of return of 13.30 percent (Exh. TimeWarner-3, at 2). This form showed that interest expenses and distributions to partners exceeded the return on the upgraded rate base, and therefore no income tax allowance was included (id.). In response to a Cable Division record request, Time Warner explained that the 13.30 percent, which was an adjusted rate of return taking the income tax effect into account, was calculated using information from the preliminary FCC 2001 Consolidated Upstate New York and Massachusetts FCC Form 1205 filing (RR CTV-1). The Company explained that no additional income allowance was taken because the grossed up rate of return already included the income tax effect (id.).

Time Warner's response also included a revised final FCC Form 1235 that used the unadjusted prescribed rate of return of 11.25 percent (id.). This revised FCC Form 1235 used the same interest expenses and distribution percentages that were reported on the preliminary FCC Form 1205 filing (id.). The revised FCC Form 1235 results in the same monthly upgrade surcharge of \$0.54 that appeared in the original final FCC Form 1235 (id.; Exh. Time-Warner 3). The Cable Division has reviewed all of the information presented and accepts the revised final FCC Form 1235.

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 1205 as filed on November 24, 2000 for Athol, Dalton, Orange, Pittsfield and Richmond.

Further, 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 1235 filed for final approval on April 13, 2001.

Further, the Cable Division hereby rejects Time Warner's FCC Form 1240s as filed on September 29, 2000 for Athol, Dalton, Orange, Pittsfield and Richmond. The Cable Division directs Time Warner to refile its FCC Form 1240s for Athol, Dalton, Orange, Pittsfield and Richmond, in compliance with this Rate Order, on or before August 13, 2001.

The attached schedule provides the current and maximum permitted equipment and network upgrade surcharge rates for each community.

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

/s/ Alicia C. Matthews  
**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.