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**ATTACHMENT 2**

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November 22, 2005

**VIA U. S. MAIL**

Catherine Lazorko  
Town Information Officer  
Town of Chapel Hill  
306 North Columbia Street  
Chapel Hill, NC 27516

**Re: Report Regarding Review of Time Warner Cable Rates - 2005**

Dear Catherine:

We are including with this letter and in our Report the Report of Charles Gramlich regarding his review of two FCC Form 1240, dated October 13, 2005 and FCC Form 1205, dated September 30, 2005. One of the FCC 1240 forms is for the headend that is located in the Town of Chapel Hill and the other is for the headend that is located in the City of Durham. Both headends provide cable television service to the Town of Chapel Hill.

The FCC Forms are uniform forms prepared by the FCC to be used by cable operators in reporting rates to municipalities. The forms include information regarding basic cable service rates and in addition, cable installation and other charges of the cable company. The forms were prepared by the Time Warner Cable Company and filed with the Town. We in turn then reviewed the Reports for comparison and compliance with the rules of the Federal Communications Commission. These rules include complicated formulas that permit local governments to evaluate compliance by a cable operator with certain permissible rate adjustments.

The Rate Review requirements and rules are more fully explained in the Report of Charles Gramlich. Basically, his report states that the information contained in the forms and the rates as computed by Time Warner Cable are in compliance with the FCC rules. As a result, the Town of Chapel Hill does not need to take any further action.

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However, we recommend that a copy of this Report be made available to the governing body of the Town and that the governing body officially accept and file this Report as part of its record of compliance with the Time Warner Cable Franchise.

You will note that the Report of Charles Gramlich includes certain findings in Section IV of his Report. The rates for Basic Cable Service for both the Chapel Hill and Durham headends are not proposed to be changed from the current basic rate, however, the rates for the total monthly rate are proposed to increase due to changes in the Tier 2 and Digital Tier, both of which are unregulated.

The proposed rate changes will be implemented, according to Time Warner, on February 1, 2006. This date is consistent with the requirements of the FCC.

Should you have any questions concerning this Report, please do not hesitate to call Charles Gramlich or me.

Very truly yours,

Adrian E. Herbst

AEH/cwo  
Enclosure

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**REPORT REGARDING REVIEW OF  
TWO FCC FORMS 1240, WHICH ARE DATED OCTOBER 13 2005,  
AND ONE FCC FORM 1205,  
WHICH IS DATED SEPTEMBER 30, 2005,  
AND RELATED FORMS AND WORKSHEETS  
SUBMITTED BY TIME WARNER CABLE  
TO THE TOWN OF CHAPEL HILL, NORTH CAROLINA**

**PREPARED FOR:  
THE TOWN OF CHAPEL HILL, NORTH CAROLINA**

November 9, 2005

**PREPARED BY:**

Charles Gramlich  
of  
**CHARLES GRAMLICH & ASSOCIATES**  
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Austin, Texas 78750  
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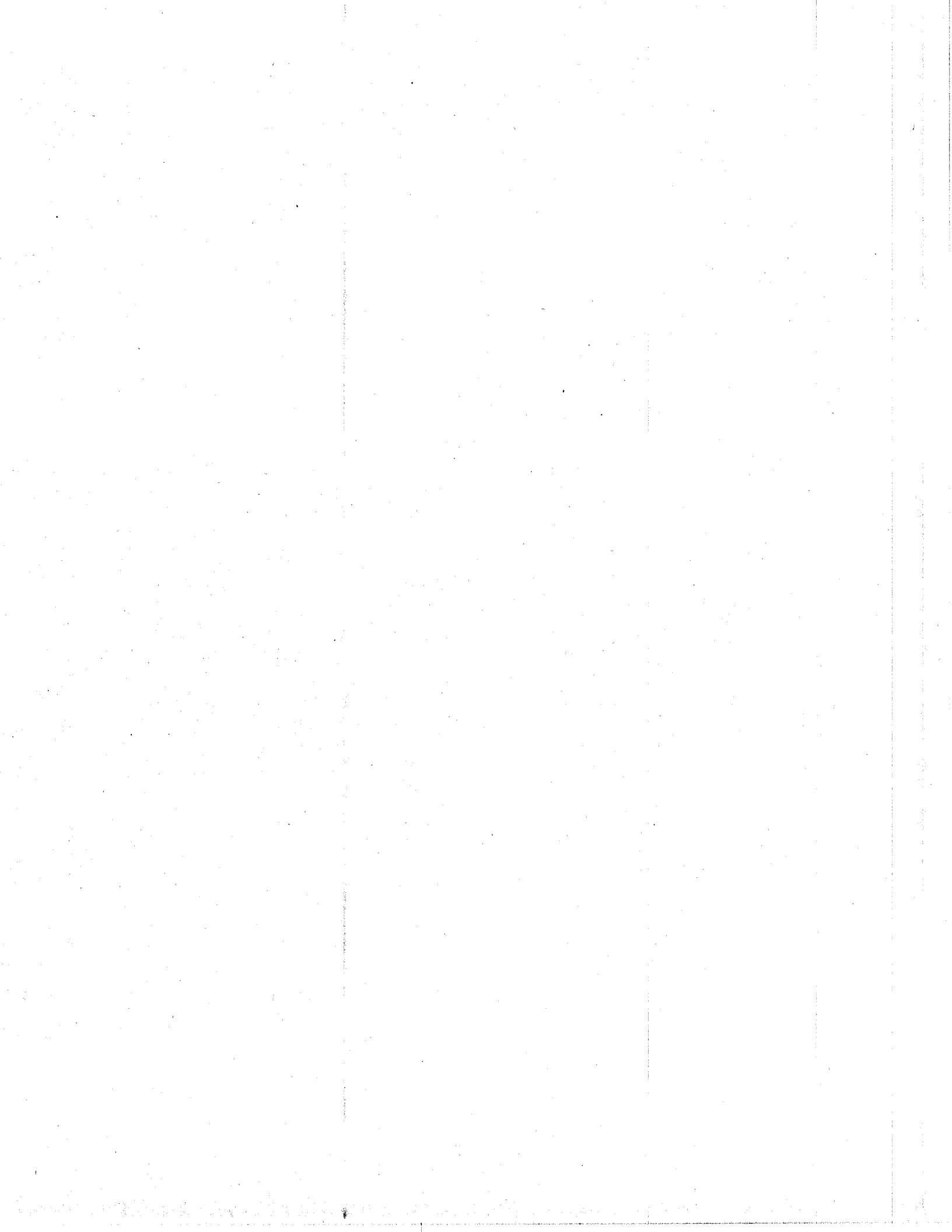
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## I. FINDINGS

1. Based upon my review of the information supplied by Time Warner Cable, ("TWC"), it is my opinion that the rates for Basic Cable Service as computed by TWC on the two Federal Communications Commission ("FCC") Form 1240s (dated October 13, 2005), and for certain regulated equipment and installation cost as computed by TWC on FCC Form 1205 (dated September 30, 2005) are accurately calculated according to FCC rules and regulations.



## II. OVERVIEW OF FCC RATE REGULATIONS

In 1992, Congress passed the Cable Television Consumer Protection and Competition Act. The 1992 Cable Act included significant provisions regarding the regulation of cable rates, and directed the FCC to adopt rules prescribing rate regulation. Local franchising authorities that desire to regulate rates are permitted to do so by (1) filing FCC Form 328, (2) adopting the FCC's rate rules and (3) notifying the cable operator of its intent to regulate rates. The FCC has retained the obligation to oversee the regulatory process. A cable operator's basic service tier, certain in-home equipment charges, and certain installation charges are subject to rate regulation by local franchising authorities. Other cable television services and other services, which are provided by cable television operators, are not currently subject to regulation by either local franchising authorities or the FCC.

In implementing its rate regulations, the FCC adopted a uniform rate scheme that is applicable to both the rates for basic cable service and cable programming service tiers in areas where there is no effective competition. The 1992 Cable Act permits local franchising authorities to regulate the rates charged for basic cable service and certain installation and certain in-home equipment rates. The FCC had the sole authority to regulate the rates for cable programming service tiers. Over the last few years the FCC has adopted several modifications to the rules and regulations regarding cable television rates. On September 15, 1995, the FCC adopted rules giving regulated cable operators the option of filing for rate adjustments on an annual basis instead of the then existing quarterly system.

On February 8, 1996 President Clinton signed the Telecommunications Act of 1996 into law. The new law made sweeping changes to federal telecommunications law and policy. Under the new law, regulation of cable programming and some basic service tier rates will be lifted or gradually phased out, depending on the size of the cable system and presence of effective competition. In addition, the new law allows telephone and cable companies to compete in each other's business, and creates a new statutory entity known as an "open video system" to govern certain video programming. Many areas of cable regulation are not affected by the 1996 act. For example, local franchising authorities can continue to regulate rates charged for basic cable service and certain installation and certain in-home equipment rates, unless effective competition exists.

### **FCC Form 1240**

Pursuant to the FCC rules FCC Form 1240 may be used to adjust the maximum permitted rate for the Basic Cable Service (which was determined either by Form 1200, a previously filed Form 1210 or Form 1240, a cost-of-service showing, or election of a streamlined rate reduction for qualified systems) for the following reasons: increases or decreases in external costs; the addition and deletion of channels from regulated tiers; and inflation. The FCC Order establishing the annual system calls for a series of calculations, involving both the projection of future events and an accounting of events that are known to have happened.

FCC Form 1240 is used to adjust rates annually, instead of quarterly, to reflect changes in external costs, inflation, and the number of regulated channels that are projected for the 12 months following the rate change. A cable operator has the burden of proving that projected changes in external costs, inflation or the number of channels are reasonably certain and quantifiable. (The FCC rules recognize seven categories of external costs: retransmission consent fees, copyright fees, programming costs, certain cable specific taxes, franchise-related costs, franchise fees and FCC regulatory fees.) FCC Form 1240 is not used to compute franchise fees or FCC regulatory fees. An operator whose actual cost exceed its projections during a rate year may at the time of its next annual rate filing adjust or "true up" its rates. Generally, the FCC rules require a cable operator opting for annual adjustments to file a basic rate adjustment request with its local franchising authority 90 days prior to the effective date of the proposed change. After the 90 days, the operator may change the rate, unless the local franchising authority has rejected the change as unreasonable. A cable operator may ask whether the local franchising authority intends to issue a rate order after the 90-day review period, and if it does not respond within 15 days, the local franchising authority will lose its ability to order a refund or a prospective rate reduction.

### **FCC Form 1205**

For cable operators using the annual rate method, changes to equipment and installation rates must be filed on FCC Form 1205 concurrently with FCC Form 1240. An operator must base proposed annual adjustments to certain in-home equipment and certain installation rates on past costs. The Hourly Service Charge is used to set all regulated installation rates.

### **FCC Form 1235**

The Form 1235 provides for the recovery of system upgrade costs when the upgrade meets certain minimum technical specifications. The Form 1235 is filed in conjunction with Form 1240 and is an "add-on" to the Form 1240 maximum permitted rate. The Form 1235 "add-on" portion should only be charged to subscribers receiving benefits of the system upgrade.



### III. OVERVIEW OF REPORT PREPARATION

With a letter dated October 13, 2005, TWC filed two FCC Form 1240s, Updating Maximum Permitted Rates For Regulated Cable Services (dated October 13, 2005), and one FCC Form 1205, Determining Regulated Equipment and Installation Costs (dated September 30, 2005), with the Town of Chapel Hill, North Carolina (the "Town"). Apparently, the Town received the letter on or before October 17, 2005. In the letter of October 13, 2005, TWC indicated its intention to implement the new rates on February 1, 2006.

One of the FCC Form 1240s is for the headend that is located in the vicinity of the Town of Chapel Hill and provides cable television service in the Town of Chapel Hill. The other FCC Form 1240 is for the headend that is located in the vicinity of the City of Durham and provides cable television service in the Town of Chapel Hill.

Pursuant to a request from Adrian E. Herbst, representing the Town, Charles Gramlich of Charles Gramlich & Associates reviewed the information provided by the Town and TWC concerning the above mentioned FCC Forms 1240 and 1205 and related forms and worksheets.

Provided below are some of the questions that CGA asked representatives of TWC and the responses.

1. Has TWC for any reason changed or amended any of the information contained in the FCC Forms and worksheets that have been submitted to the City that would cause or that have caused rates charged by TWC to be reduced?

*No.*

If yes, please provide specific information regarding each situation. If no, please affirm that TWC will reduce the rates in the City and make any necessary refunds, if and when, for any reason, the information contained in the FCC Forms that have been submitted to the City would cause or have caused the rates charged by TWC to be reduced?

*Time Warner Cable will refund and/or adjust BST rates if in this event.*

2. Has TWC filed a "Petition for Special Relief" with the FCC requesting that the Commission find that TWC faces "effective competition" in the franchise area, including the City? If yes, please provide specific information including date of filing and status of the petition? If no, please indicate if TWC has plans to file a petition, which would affect the City.

*Time Warner filed a "Petition for Special Relief" which was subsequently withdrawn (FCC ordered Motion to Withdraw the Petition for Special Relief without Prejudice on March 11, 2005 - DA 05-646). No other petition has been filed.*

The review included:

1. Communications with representatives of TWC, including Paul Baccellieri, Vice President Finance, Raleigh Division of TWC and Claudia T. Pileggi, Financial Manager, Raleigh Division of TWC, regarding the rate filings for the Town and related exchanges of information.
2. Mathematical verification of all steps and assumptions necessary to complete the forms, worksheets and accompanying schedules.

Please note, however, that Charles Gramlich & Associates has not undertaken an "on-site audit" of TWC's books and records to determine whether the information included in the Forms and worksheets or the accompanying schedules has been accurately identified. Such an on-site audit would require physical presence by employees of Charles Gramlich & Associates, or a qualified accounting subcontractor, at the premises of TWC to review the books and records and verify that entries have been accurately recorded and assumptions properly calculated. In completing the worksheets and schedules of the FCC Forms and related worksheets, cable operators are required to make certain assumptions and report information to the best of their ability. In some cases, it may be appropriate for local franchising authorities to verify the accuracy of the information reported by a cable operator by conducting an on-site audit of the operator's books and records. Currently, I do not believe that such an on-site audit is necessary, based on the information I have reviewed in TWC's FCC Forms and related worksheets and the other relevant information I have reviewed. However, I make no representation with respect to the accuracy of the information reported by TWC on its FCC Forms and related worksheets but simply base my conclusions and analysis on the information TWC has provided.

The Basic Cable Service is regulated by the Town. The Basic Cable Service includes the lowest level of cable television service offered by TWC in the Town. Other cable television services and other services, which are provided by cable television operators, are not currently subject to regulation by either local franchising authorities or the FCC.

According to TWC:

1. The Basic Cable Service, currently, consists of approximately 22 channels of mainly broadcast stations that are received off the air and public, educational & governmental access channels.
2. Tier 2, currently, consists of approximately 52 channels for both the Durham headend and the Chapel Hill headend.
3. The Digital Tier, currently, consists of an additional approximately 85 video channels.
4. TWC last increased the monthly rate for Basic Cable Service on January 1, 2005 (Chapel Hill headend only).

Outlined on the following Rate Change Checklist are the current and the proposed Maximum Permitted Rates ("MPR") and the current and proposed Operator Selected Rates ("OSR"). The MPR is the maximum rate that TWC can charge as calculated by TWC using the

FCC's rules and regulations. The OSR is the rate that TWC has indicated that it will charge subscribers. The OSR cannot exceed the MPR.

CGA asked specific questions of TWC regarding the inflation segment of the computations. In response, TWC stated: "Our practice is to use the most currently published FCC inflation factors at the time of the filing. At the time of our filing at about, the last published FCC inflation factor was for the second quarter of 2005. Hence, we assumed that factor for the rest of this year, as well as 2005. We will always make the appropriate adjustment to the inflation factors within the true up mechanisms allowed in the subsequent year's filing."

Since TWC has selected monthly rates for Basic Service, which are less than the MPRs, the use of a later inflation factor would not lower the rates paid by subscribers during the next year. In any case, the appropriate adjustment is made during the subsequent year's true up segment.

Based upon my review of the information supplied by TWC, it is my opinion that the rates for Basic Cable Service as computed by TWC on the two FCC Form 1240s (dated October 13, 2005) and for certain regulated equipment and installation cost as computed by TWC on the FCC Form 1205 (dated September 30, 2005) are accurately calculated according to FCC rules and regulations.

The new proposed rates for Basic Cable Service, certain regulated in-home equipment and installation can become effective 90 days after the Town actually received the completed FCC Forms 1240 and 1205.

**IV – CHAPEL HILL - RATE CHANGE CHECKLIST - 2005**

<u><b>TYPE OF SERVICE</b></u>	<u><b>Current</b></u>	<u><b>Proposed</b></u>	
<b>Basic Cable Service (Durham headend):</b>			
Maximum Permitted Rate	\$14.91	\$15.44	Note 1
Operator Selected Rate	\$14.50	\$14.50	

The following table summarizes the changes to the maximum permitted rate for the Basic Cable Service (Durham headend) as per the different elements in the FCC Form 1240:

Prior maximum permitted Basic Cable Service Rate	\$14.91	
Remove Prior Period		
External Cost	\$1.21	
Markup Method	\$0.00	
True-up Segment	\$0.53	
Inflation Segment	<u>\$0.30</u>	
Portion Subject to Inflation		
Inflation True Up Periods	\$0.28	
Projected Periods-		
External Cost	\$1.39	
Markup Method	\$0.00	
True-up Segment	\$0.62	
Inflation Segment	<u>\$0.28</u>	
Proposed Maximum Permitted Rate	\$15.44	Note 1

<b>Basic Cable Service (Chapel Hill headend):</b>	<u><b>Current</b></u>	<u><b>Proposed</b></u>	
Maximum Permitted Rate	\$10.61	\$10.89	Note 2
Operator Selected Rate	\$10.60	\$10.60	

The following table summarizes the changes to the maximum permitted rate for the Basic Cable Service (Chapel Hill headend) as per the different elements in the FCC Form 1240:

Prior maximum permitted Basic Cable Service Rate	\$10.61
Remove Prior Period	
External Cost	\$1.18
Markup Method	\$0.00
True-up Segment	\$0.04
Inflation Segment	<u>\$0.21</u>
Portion Subject to Inflation	
Inflation True Up Periods	\$0.19
Projected Periods-	
External Cost	\$1.35

Markup Method	\$0.00
True-up Segment	(\$0.02)
Inflation Segment	<u>\$0.19</u>

Proposed Maximum Permitted Rate \$10.89 Note 2

<b>Hourly Service Charge:</b>	<b>Current</b>	<b>Proposed</b>	
Maximum Permitted Rate	\$37.81	\$36.55	Note 3
Operator Selected Rate	\$37.50	\$36.55	

<b>Remote Control (All Types):</b>		
Maximum Permitted Rate	\$0.33	\$0.31
Operator Selected Rate	\$0.33	\$0.31

<b>Converter Box (Addressable):</b>		
Maximum Permitted Rate	\$8.82	\$8.25
Operator Selected Rate	\$7.62	\$7.64

<b>Converter Box (Non-Addressable):</b>		
Maximum Permitted Rate	\$0.76	\$0.55
Operator Selected Rate	\$0.68	\$0.55

<b>CableCARD</b>		
Maximum Permitted Rate	\$2.02	\$3.14
Operator Selected Rate	\$1.75	\$1.75

According to TWC, all rates exclude FCC fee, sales tax, if any, and franchise fee. All rates are monthly, except for the Hourly Service Charge.

Note 1 – Includes \$2.11 from an FCC Form 1235 that was filed approximately six years ago upon the completion of the cable system upgrade. CGA has not reviewed the FCC Form 1235.

Note 2 – Includes \$1.81 from an FCC Form 1235 that was filed approximately six years ago upon the completion of the cable system upgrade. CGA has not reviewed the FCC Form 1235.

Note 3 - Hourly Service Charge is used to calculate certain installation fees, for unwired & prewired homes, additional outlets and other regulated installations.

The following charts outline the current monthly rates for the Basic Cable Service, Tier 2 and the Digital Tier, and the operator selected monthly rates for each.

	<u>Current (Durham headend)</u>	<u>Proposed</u>
Basic Cable Service	\$14.50	\$14.50
Tier 2	\$31.75	\$34.00 – not regulated
Digital Tier	<u>\$14.80</u>	<u>\$15.50</u> – not regulated
Total	\$61.05	\$64.00

	<u>Current (Chapel Hill headend)</u>	<u>Proposed</u>
Basic Cable Service	\$10.60	\$10.60
Tier 2	\$32.90	\$35.20 – not regulated
Digital Tier	<u>\$14.80</u>	<u>\$15.50</u> – not regulated
Total	\$58.30	\$61.30

According to representatives of TWC, the monthly rates for additional outlets will not change from the current rates of \$1.00 for the Digital Tier and \$0 for the Premium Service additional outlets. Rates for additional outlets are not regulated.