

Action Audits, LLC

Town of Chapel Hill Review of Time Warner Cable's 2008 FCC Forms 1240 and 1205

December 14, 2007

REPORT

TO: Roger Stancil, Town Manager

FROM: Robert Sepe, President

RE: Review of Time Warner Cable's FCC1240 and 1205 rate filings

I have reviewed Time Warner Cable's FCC1240 and FCC1205 filings, documents gathered by the Town and consulted related FCC rules, regulations and publications. The values stated in the Company's FCC rate requests is the responsibility of the cable operator.

Supplied data were reviewed to determine whether the cable operator calculated "updated" rates consistent with the procedures prescribed by the FCC in accordance with the FCC's 13th Report and Order, and the FCC's Cable Rate Regulation rules §76.900 - §76.990 and the Telecommunications Act of 1996.

Original computations were performed and compared with data provided by Time Warner Cable. The accompanying report provides a reasonable basis for the opinions expressed herein.

Time Warner Cable - R/D Division Cable Television Rate Report

**A Review of Time Warner Cable's 2008
FCC Forms 1240 & 1205
Rate Filing Seeking Approval to Set New Rates
for Regulated Cable Services
in the Town of Chapel Hill**

**Federal Community Unit
Identification Number:
NC0234**

December 14, 2007

FINDINGS

Time Warner Cable's FCC Cable Rate Filing: On October 17, 2007, Time Warner Cable (Time Warner) submitted a Form FCC1240-Basic Cable Service Tier to set a new regulated rate for basic cable service. Time Warner did submit a Form 1205-Equipment and Installation Charges to set new regulated rates for equipment rental and installation services. These documents were submitted to the Town for approval.

Time Warner's *proposed* Maximum Permitted Regulated¹ Rate for the Basic Service Tier (BST) in 2008 is \$10.46 for the Chapel Hill system and \$14.12 for the Durham system.

The proposed monthly **selected**² rate is \$9.33 for the Chapel Hill system and \$13.95 for the Durham system.

The next table tracks changes in the **selected** Rate for the Basic Service Tier (BST).

Table 1
Chapel Hill System

Year	BST Rate	+/-	Delta
2001	\$9.50		
2002	\$10.10	\$0.60	6.32%
2003	\$11.00	\$0.90	8.91%
2004	\$11.25	\$0.25	2.27%
2005	\$10.60	(\$0.65)	-5.78%
2006	\$10.60	\$0.00	0.00%
2007	\$9.35	(\$1.25)	-11.79%
2008	\$9.33	(\$0.02)	-0.21%

¹Unregulated cable services include: Standard or expanded basic, digital cable services, video on demand and premium movie networks, such as HBO.

²Maximum Permitted Rate is the rate an operator could charge verses the **selected** rate which is the rate the operator has chosen to charge.

The next table tracks changes in the **selected** Maximum Permitted Rate for the Basic Service Tier (BST).

Table 2
Durham System

Year	BST Rate	+/-	Delta
2001	\$13.70		
2002	\$13.40	(\$0.30)	-2.19%
2003	\$14.25	\$0.85	6.34%
2004	\$14.30	\$0.05	0.35%
2005	\$14.50	\$0.20	1.40%
2006	\$14.50	\$0.00	0.00%
2007	\$13.91	(\$0.59)	-4.07%
2008	\$14.12	\$0.21	1.51%

Within the Town limits, Time Warner reported 13,150 current customers and expects an increase in its customer base by year end to 13,357 households³.

Rationale: The guiding principle of the Cable Act of 1992,⁴ is to protect subscribers from unreasonable rates by ensuring that cable rate levels are equivalent to rates that would be charged in the presence of effective competition.⁵ Anecdotal evidence of rates examined in six matched pair markets by the GAO⁶ where Cable Operators face true effective wireline competition reveals that rates in these communities are between 15% and 41% lower⁷ than in communities served by a single wireline cable provider. The GAO reported that cable operators tend to lower their rates

³Form 1240, Module B.

⁴Specifically, the 1992 Cable Act requires the Commission's regulations "shall be designed to achieve the goal of protecting subscribers of any cable system that is not subject to effective competition from rates for the basic service tier that exceed the rates that would be charged for the basic service tier if such cable system were subject to effective competition." Communications Act, § 623(b)(1), 47 U.S.C. § 543(b)(1)

⁵As the FCC stated in its first rate rulemaking order: "The priority established in the Act is clearly to protect the interests of subscribers. An important focus for both basic tier and cable programming service rates, consistent with providing system operators a fair return, is the establishment of rate levels equivalent to rates that would be charged in the presence of effective competition. The criteria to be applied in setting both basic tier and cable programming service rates include a comparison with 'the rates for cable systems, if any, that are subject to effective competition.'" See Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, 8 FCC Rcd 5631 at para 8 and footnote 10 [April 1993 Report and Order].

⁶Wire-Based Competition Benefitted Consumers in Selected Markets, United States General Accounting Office, February 2004.

⁷GAO Report, Highlights, February 2004 at page 1.

when they face competition from another wireline provider.⁸

The FCC's rate-making process (forms 1240 & 1205) is intended to adjust monopoly pricing to produce rates that would be found in competitive wireline markets.

As a local government authority certified to regulate rates, it is the Town's responsibility to enforce the fundamental guiding principles of the Cable Act of 1992 and the FCC's rate regulation rules "to protect the interests of subscribers from unreasonable rates by ensuring that cable rate is equivalent to rates that would be charged in the presence of effective competition." It is the responsibility of the Town to make certain that the rates are set by the cable operator in accordance with the FCC's rate rules.

Analysis of the Proposed Rate Adjustments

Time Warner's Form 1240 rate adjustments reflect changes in the following external cost elements: external costs for true-up and projected periods, inflation from true-up and projected periods; franchise related (PEG) expenses, and any program expense adjustments. Generally FCC regulatory fees, franchise fees and sales taxes are external to the calculation of the subscriber monthly bill.

External Cost: Time Warner's Form 1240 rate adjustments reflect multiple external cost elements. An external cost is an expense a cable operator incurs during the normal course of business and may be included in rate calculations. External cost categories are state and local taxes; franchise fees; costs of complying with franchise requirements, including costs of providing public, educational, and governmental access channels; retransmission consent fees and copyright fees incurred for the carriage of broadcast signals; other programming costs; Commission Regulatory Fees, and costs associated with channel additions.

The Form 1240 must be filed with the local franchise authority ninety (90) days before the rates are scheduled to take effect and may be filed no more frequently than annually. The Form 1240 rate filing method allows cable operators to estimate their future costs for a 12 to 24-month period: this is referred to as the projected period. The form 1240 allows operators to recover prior period expenses, referred to as the true-up period. If a cable operator incorrectly estimates its costs for a projected period, it must correct those estimates by using the true-up process in the next rate filing.

Inflation Adjustment: In its Form 1240 rate filing, Time Warner correctly applied the various FCC reported inflation factors.

Franchise Related Expenses (Public Access or I-Net): Time Warner reported no franchise related expenses for 2006. Franchise related costs incurred by the operator may include such expenses as public, government and education access facilities and equipment, signal transportation, headend accommodations as well as Institutional Network related expenses.

⁸GAO Report, February 2004 at page 30.

Programming Cost Adjustment: Time Warner will collect for the projected period ~ \$1.34(CH) and ~\$1.41 (D) monthly, per subscriber, during 2008 for anticipated BST external costs, most of which are attributable to programming costs. Various cable operators have advised that program service providers customarily increase service fees annually. Time Warner attributes its programming cost changes to what it must pay for each service offered. However, this amount is relatively low compared to upper cable tier service programming costs. Some of the BST program services included in the BST service group offered by Time Warner are obtained at little cost because they are either "must-carry" broadcast television stations, public, government or education access channels or "shop-at-home" services. The exceptions are WGN and News 14 Carolina.

FCC Regulatory Fees: The FCC requires cable operators to pay an annual 75 cent⁹ "Commission Regulatory Fee" to fund the Commission's regulatory oversight of cable television matters. The fee is calculated on the number of customers at the end of the previous calendar year.

The regulatory fee must be treated as an external expense and included in the 1240 BST MPR calculation as a pass through. The cable operator is **only** permitted to show the amount attributed to each customer as an informational item on the customer's monthly invoice; the FCC regulatory fee cannot be treated as a PEG fee or a separate tax.

Related Matters

The following expenses are associated with cable rates, hence, they merit discussion.

North Carolina Sales Tax: Effective January 1, 2008, Time Warner's gross receipts from providing cable service are subject to a new state sales tax at the combined general rate of 7%. Taxable cable services include basic, extended, premium, digital, and pay-per-view movie and special event program service.

Franchise Fees: The new North Carolina Video Service Competition Act (S.L. 206-151) suspends franchise fee payments to Town, except for a levy on equipment rental, installation and advertising revenues for those communities where cable operators remain subject to a local franchise. Time Warner Cable is subject to Wilson's local franchise and so must continue to remit the Town remnant franchise fees on equipment rental, installation and advertising revenues.

Sales tax and remnant franchise fees are not embedded in the BST, but typically appear as a separate line item on each customer invoice as a single aggregated amount.

Upper Tier Regulation: A sunset provision within the Telecommunications Act of 1996 terminated upper cable service tier regulation on March 31, 1999. The cable operator is allowed to change upper service tier rates at will upon thirty (30) days notice to the franchise authority and subscribers. Residents can expect Time Warner to raise rates for the most viewed cable

⁹FCC Regulatory Fact Sheet, August 2007, page 2.

services, the unregulated analog and digital service plans, about 5% beginning January 1, 2008.

*FCC Report:*¹⁰ Nationally, rate hikes across most viewed cable tiers averaged 6.6%.

FCC1205 Equipment & Installation Rates

A Local Franchising Authority (LFA) is authorized to review the operator's rate forms to determine whether the operator's proposed rate increase for installation and lease of equipment comports with FCC rules. If the proposed rate is accurately calculated pursuant to the Commission's regulations, using accurate information, the rate is deemed reasonable and lawful under the 1992 Cable Act.¹¹

Time Warner calculated the form1205 maximum permitted equipment¹² and installation¹³ rates by aggregating its costs across all Time Warner systems in the USA; this type national filing is permitted by the FCC. Time Warner Cable has not aggregated on a regional basis since 2001.

Table 3

Year	HSC	+/-	%
2001	\$28.39		
2002	\$35.83 ¹⁴	\$7.44	26.21%
2003	\$37.62	\$1.79	5.00%
2004	\$37.50	\$-0.12	-0.32%
2005	\$37.81	\$0.31	0.83%
2006	\$36.55	\$-1.26	-3.33%
2007	\$42.96	\$6.41	17.54%
2008	\$48.56	\$5.60	13.04%

¹⁰ FCC: Twelfth Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, February 2006, #42.

¹¹ 47 U.S.C. § 543(b).

¹² §76.923 (c)(1) Costs of customer equipment may be aggregated, on a franchise, system, regional, or company level. When submitting its equipment costs based on average charges, the cable operator must provide a general description of the averaging methodology employed and a justification that its averaging methodology produces reasonable equipment rates.

¹³ §76.923 (c)(3) Installation costs may be aggregated, on a franchise, system, regional, or company level. When submitting its installation costs based on average charges, the cable operator must provide a general description of the averaging methodology employed and a justification that its averaging methodology produces reasonable equipment rates.

¹⁴ Company-wide national USA aggregation ~ 3000 franchises

Time Warner proposes a 13.04% increase in the Hourly Service Charge; it is related to equipment, personnel and operating costs.

The following table discloses changes in Form1205 equipment and installation rates since 2001.

Table 4

FCC1205	2001 NC	2002 USA	2003 USA	2004 USA	2005 USA	2006 USA	2007 USA	2008 USA	Delta
Remote Control	\$0.28	\$0.35	\$0.35	\$0.34	\$0.33	\$0.31	\$0.32	\$0.30	(\$0.02)
Addressable	\$4.26	\$8.49	\$7.34	\$7.99	\$8.82	\$8.25	\$7.66	\$7.21	(\$0.45)

Time Warner aggregated its equipment and installation expenses on a national basis to establish a uniform rate structure in its ~3000 franchises. In addition to equipment rentals, a variety of installation services are tied to the HSC rate. The next table lists the differences in the amount of time required to install cable service since 2001. The 2001 installation average installation times represent North Carolina “regional” values where as the later years reflect consolidated balance sheets for all its USA cable properties.

Table 5

Average Hours* per Installation	2001 NC	2002 USA	2003 USA	2004 USA	2005 USA	2006 USA	2007 USA	2008 USA	Delta	
Un-wired Home Installation	0.96	1.20	1.22	1.26	1.16	1.23	1.18	1.19	0.01	0.86%
Pre-wired Home Installation	0.84	0.85	0.85	0.88	0.77	0.83	0.79	0.82	0.03	3.90%
Additional Connection at Time of Installation	0.55	0.54	0.53	0.50	0.50	0.55	0.51	0.55	0.04	8.00%
Additional Connection Requiring Separate Installation	0.73	0.85	0.84	0.88	0.80	0.87	0.79	0.85	0.06	7.50%

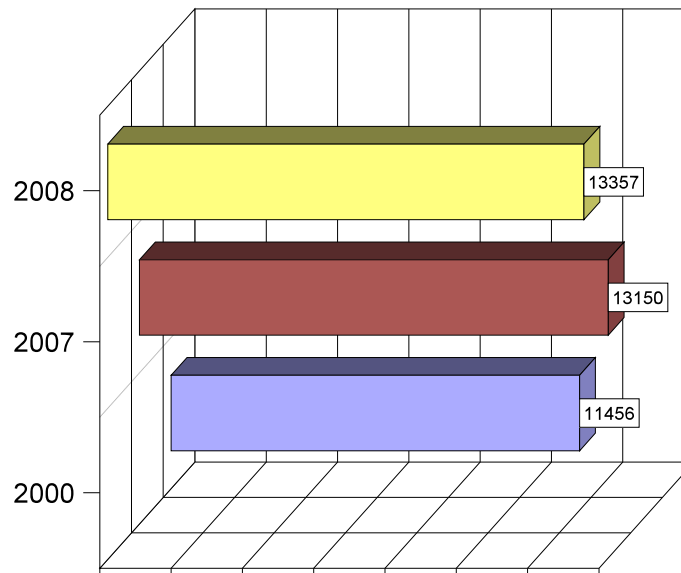
*time in hours is expressed as decimal equivalents

The most significant increases are related to the installation of additional outlets, either at the time of installation or subsequent to the completion of an initial installation. Time Warner aggregates the time during the previous year to perform these tasks to compute the average installation time.

Time Warner did not provide documentation to support the basis for Total Maintenance Hours for (Schedule C(B)), the average time required to wire a home (Schedule D(A)), time required to complete a “pre-wire” (Schedule D(B), extra average time required to install an additional outlet simultaneously with a primary installation (Schedule D(C), average time required to install an additional outlet subsequent to the primary installation (Schedule D(D)), average time to perform a hard disconnection (Schedule D(E), average time to perform a tier change, and the average time to perform an “apartment” installation (Schedule D(F)), although required to do so under FCC rate rules. Time Warner should provide this information with its FCC Form 1205 filing to be compliant with the FCC’s Form 1205 rules.

Subscriber History

Time Warner projects that its customer base will reach 13,357 homes next year. The following chart shows the growth of Time Warner’s customer base since 2000, a 15% increase since 2000.



Recommendation

The Consultant recommends the Town:

1. Find that Time Warner's proposed Form 1240 maximum permitted Basic Service Tier rate compliant because it was calculated in accordance with the FCC’s Form 1240 instructions.
2. Find that Time Warner's proposed Form 1205 maximum permitted Equipment and Installation charges compliant because they were calculated in accordance with the FCC’s rules.

Proceeding

The franchise authority must either approve or deny the operator's FCC Forms 1240 and 1205 on the basis of whether the requested rates are reasonable. This determination must be based upon a finding of fact.

The franchise authority should adopt the Consultant's report as its own, and the public must be granted an opportunity to offer comment on the matter. It is suggested that a public comment period on the matter coincide with a regular public meeting.

To be valid, the Rate Order must be:

1. Executed following the conclusion of a public meeting where the Town Council grants interested parties an opportunity to comment;
2. Adopt the Consultant's Report as its own - required by FCC rules (this requires a motion to adopt, a second, and a vote);
3. Approve and execute the Rate Order;
4. Serve the Rate Order and a copy of the Report upon Time Warner Cable via certified mail.

It is appropriate for public comment to be heard, as related to the various rate issues, when this matter is scheduled before the Town Council for consideration. Although a statutory public hearing is not required, it is customary and good public policy to call for public comment in these matters. The comment period may be publicized by issuing a press release to the print and electronic media or announced in other appropriate ways. A courtesy notice should be provided to Time Warner Cable about the public meeting with a request that the Company representative be present to respond to the findings contained in this Report and other questions elected and appointed Town officials and the public may ask.