

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)
)
Time Warner Cable)
)
Appeal of Local Rate Order of)
the Town of Smithfield, North Carolina)
)

MEMORANDUM OPINION AND ORDER

Adopted: January 17, 2003

Released: January 23, 2003

By the Deputy Chief, Policy Division, Media Bureau:

I. INTRODUCTION

1. Time Warner Cable (“TWC” or the “Company”), has filed an appeal of the local rate order resolution adopted by Smithfield, North Carolina (the “Town” or “Smithfield”) on February 5, 2002. The City filed an opposition to the appeal, and TWC filed a reply. For the reasons set forth herein, we grant the appeal, in part, and remand the rate order for further proceedings.

II. BACKGROUND

2. Rate orders issued by franchising authorities may be appealed to the Commission pursuant to Commission rules.¹ In ruling on appeals of local rate orders, the Commission will not conduct a *de novo* review, but instead will sustain the franchising authority's decision as long as a reasonable basis for that decision exists.² The Commission will reverse a franchising authority's rate decision only if it determines that the franchising authority acted unreasonably in applying the Commission's rules.³ If the Commission reverses a franchising authority's decision, it will not substitute its own decision, but instead will remand the issue to the franchising authority with instructions to resolve the case consistent with the Commission's decision on appeal.⁴

3. In the rate filing at issue in this case, TWC used Form 1205 and 1240. FCC Form 1205 is the form operators use to update and adjust regulated cable equipment and installation rates. Operators

¹ See 47 C.F.R. § 76.944; 47 U.S.C. § 543(b)(5)(B).

² *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, 8 FCC Rcd 5631, 5731-32 (1993) (“Rate Order”); 9 FCC Rcd 4316, 4346 (1994) (“Third Reconsideration Order”).

³ *Id.*

⁴ *Id.*

using the annual rate adjustment method submit their rate justifications on FCC Form 1240. These rate adjustments reflect inflation, changes in the number of regulated channels offered, and changes in certain external costs. External costs include the following categories of costs: state and local taxes specifically applicable to the provision of cable television service; franchise fees; costs of complying with franchise requirements; retransmission consent fees and copyright fees incurred for the carriage of broadcast signals; other programming costs; and Commission regulatory fees.⁵

III. DISCUSSION

A. Summary of Appeal Petition

4. In its appeal petition, TWC states that on October 1, 2001, it submitted to the Town a set of rate forms to justify its BST and basic equipment and installation charges for the year beginning January 1, 2002, and by letter dated November 14, 2001, the Town's consultant responded by requesting additional information regarding TWC's Form 1205 equipment and installation rate justification.⁶ TWC indicates that it was asked to provide a description of the averaging methodology that it used in preparing its Form 1205 and a justification that such averaging methodology produces reasonable rates.⁷ TWC points out that by letter dated December 6, 2001, it told Smithfield that the Form 1205 was completed on a company-wide basis using the sum from all of its divisions and that its national aggregation approach produces reasonable equipment rates because actual divisional data is used.⁸ TWC also told the town that national aggregation tends to mitigate dramatic equipment rate increases associated with new equipment introduction.⁹ TWC explains that after reviewing its letter, the Town's consultant recommended rejecting the HSC calculated on TWC's Form 1205 because TWC failed to establish that the aggregation process produced just and reasonable rates.

5. The consultant's report also recommended that the Town approve TWC's BST rate on condition that TWC submit a refreshed 2002-2003 Form 1240. TWC asserts that in a February 5, 2002 meeting with the Town, it argued that Commission rules provide that absent a finding disputing the accuracy of a cable operator's rate calculations, local franchising authorities are required to approve the rates reflected on the forms.¹⁰ Despite its presentation, TWC states that the Town directed TWC to submit a refund plan to distribute refunds to subscribers.¹¹ The Town also ordered TWC to refresh the inflation rates in the 2002 filing prior to calculating its 2003 FCC 1240.¹² Because the Town ignored the Commission's rules and established precedent, TWC argues that the Commission should impose

⁵ 47 C.F.R. § 76.922(c) and (f).

⁶ *Id.* at 2.

⁷ *Id.*

⁸ *Id.* See Exhibit C, December 6, 2001 Letter from TWC to the Town of Smithfield.

⁹ *Id.*

¹⁰ *Id.* at 3.

¹¹ *Id.*

¹² *Id.*

sanctions on the Town, including the payment of TWC's attorney's fees.¹³

B. TWC's Company-wide Form 1205 Rate Calculations.

6. TWC argues that Sections 76.923(c)(1) and (3) state that when a cable operator submits installation and equipment costs based on average charges, the operator must provide a general description of the averaging methodology employed and a justification that the averaging methodology produces reasonable rates.¹⁴ TWC indicates that its December 6, 2001 letter to the Town clearly indicated that the individual data from all of the company's divisions had been added together in preparing a single, aggregate Form 1205 and that this statement satisfied TWC's obligation under Sections 76.923(c)(1) and (3) to describe and justify the averaging methodology underlying the aggregate Form 1205.¹⁵ Moreover, TWC asserts that Commission decisions establish that cable operators are permitted to aggregate costs at the level of their choosing.¹⁶ Given the fact that the Town does not dispute either TWC's assertion that it used actual cost data from all of its divisions in completing Form 1205 or the mathematical calculations reflected on the form, TWC argues that the Town's rejection of TWC's HSC was arbitrary and must be reversed.¹⁷ TWC cites two cases supporting its argument, *Cabarrus* and *Bainbridge*, which conclude that one of the fundamental guidelines governing the local rate review process is that if a local franchising authority does not dispute the bases for the figures presented in a cable operator's rate forms and has not discovered any mathematical errors in the forms, the LFA should approve the operator's rate as derived from those forms.¹⁸

7. In its opposition, the Town explains that TWC was seeking to increase its hourly service charge from \$28.39 to \$35.83, an increase of 26 percent, and that pursuant to Sections 76.923(c)(1) and (3), TWC was required to provide a general description of the averaging methodology employed and a justification that its averaging methodology produces reasonable equipment rates.¹⁹ The Town asserts that TWC provided a general description of the averaging methodology employed but failed to provide a justification that its averaging methodology produced reasonable rates.²⁰ Moreover, the Town concluded that the proposed HSC rate increase was eight times the rate of inflation and excessive.²¹ The Town

¹³ *Id.* at 7-8.

¹⁴ *Id.* at 4.

¹⁵ *Id.* at 5.

¹⁶ *Id.* at 5, 6. See *TCI of Richardson, Inc.*, 14 FCC Rcd 11700, 11706 (CSB 1999).

¹⁷ *Id.*

¹⁸ *Id.* at 3-4. See *Time Warner Cable (Cabarrus County, NC)*, 16 FCC Rcd 16457 (CSB 2001); *TCI TKR of Georgia, Inc. (Bainbridge, GA)*, 15 FCC Rcd 9123, 9124 (CSB 2000).

¹⁹ Opposition at 2.

²⁰ *Id.* Regarding whether the cable operator's methodology produces reasonable equipment rates, the Town states that because the burden of proof on this issue is on the cable operator one of the factors to be considered in prescribing the rate regulations is the rates for cable systems, if any, subject to effective competition. The Town notes that TWC did not provide evidence of its rates on its cable systems subject to effective competition. Opposition at 5.

²¹ *Id.* at 11.

asserts that although TWC argues that an LFA's authority is limited to checking the math on the cable operator's 1205 rate form, Sections 76.923(c)(1) and (3) require a franchising authority to evaluate whether the operator has justified that its aggregated rate is both accurate and reasonable.²² The Town also argues that the *Cabarrus* and *Bainbridge* decisions, which TWC cites for support, are inapplicable to this case because the facts differ so noticeably.²³ Smithfield points out that in those cases the franchising authority issued brief orders rejecting the operator's rate request based on concerns relating to signal quality issues and customer service performance, which the Town asserts was the reason for the Commission's rejection of the franchising authority's ruling, as such issues should have been addressed using other Commission regulations, not the rate regulation process.²⁴ The Town asserts that such circumstances are in contrast to the present case because the Town of Smithfield issued a "fully documented written order and rejected TWC's 2002 proposed HSC rate based on appropriate rate regulation grounds."²⁵ Moreover, the Town asserts that in *TCI of Richardson, Inc.* the Commission instructed the City of Richardson to focus its rate review on whether the rates at issue were accurately calculated pursuant to the Commission's rules, and also stated that if the City determined that the rates were not reasonable, the City should clearly state its reasons for such conclusion in its written decision.²⁶ Smithfield therefore makes the argument that the accuracy of submitted rate data cannot be the only measurement of reasonableness.²⁷

8. In reply, TWC asserts that the flaw in the Town's argument is that it is based on a misunderstanding of the relevant rules and precedents governing the regulation of basic cable equipment and installation rates.²⁸ It states that in Section 623(b)(3) of the Communications Act, regulated equipment and installation charges are to be based on the operator's actual cost and the rules do not empower LFAs to apply an essentially subjective test in assessing the reasonableness of equipment and installation charges.²⁹ TWC states that the Town's reading of Sections 76.923(c)(1) and (c)(3) is mistaken, in that while the provisions require that a cable operator explain and justify its averaging methodology, they also serve to ensure that a cable operator's aggregated equipment and installation rates reflect actual costs.³⁰ TWC maintains that TWC satisfied its obligations under Sections 76.923(c)(1) and (c)(3) by explaining that the entries in its company-wide Form 1205 simply reflected the sum of actual divisional cost data.³¹ TWC adds that the Town's review of TWC's HSC should have focused on whether the rates at issue are accurately calculated and not on whether the rates were higher than those charged by

²² *Id.* at 6.

²³ *Id.* at 7.

²⁴ *Id.* at 7.

²⁵ *Id.*

²⁶ *Id.* at 9, citing *TCI of Richardson*, 14 FCC Rcd at 11710.

²⁷ *Id.* at 9.

²⁸ Reply at 3.

²⁹ *Id.* at 3, 4.

³⁰ *Id.*

³¹ *Id.*

systems subject to effective competition.³² In addition, TWC indicates that the Commission has concluded that the magnitude of a rate increase alone is not determinative of reasonableness.³³ Because there is no dispute that TWC's HSC was accurately calculated on the bases of actual costs, TWC argues that the Town's decision to reject the HSC as unreasonable was arbitrary and must be reversed.³⁴

9. The Town must follow the Commission's rate regulations when reviewing an operator's rate filing.³⁵ As the Cable Services Bureau stated in *Falcon Cable Media*, if a local franchising authority does not dispute the bases for the figures presented in a cable operator's rate forms and has not discovered any mathematical errors in the forms, the LFA should approve the operator's rates as derived from those forms.³⁶ If an LFA rejects an operator's proposed rates, it must issue a written decision affirmatively demonstrating why the rates are unreasonable.³⁷ The LFA may address other, non-rate concerns through our rules on technical standards,³⁸ our rules on customer service obligations,³⁹ the LFA's own cable regulations, and the franchise agreement.

10. Sections 76.923(c)(1) and (3) provide that a cable operator may aggregate equipment and installation costs on a franchise, system, regional, or company level. In addition, when submitting its equipment and 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 rates.⁴⁰ Smithfield asserts that TWC did not satisfactorily justify that its averaging methodology produced a reasonable rate. The information before us indicates otherwise. There is no dispute that TWC accurately calculated its HSC on the basis of actual costs.⁴¹ Based upon the December 6, 2001 letter from TWC to the Town it appears that TWC provided a detailed description of its averaging methodology, adequate justification of the considerations and variables used in calculating a reasonable rate, and a reasonable justification for the arrived-at rate. The information TWC supplied appears to have been sufficiently informative as a basis for identifying the costs claimed on its aggregated Form 1205.

³² *Id.* at 4.

³³ *Id.* at 5. See *TCI of Pennsylvania, Inc. (Shaler Twp.)*, 13 FCC Rcd 5119, 5120-21 (CSB 1998).

³⁴ *Id.* at 5.

³⁵ See *TCI of Southeast Mississippi*, 10 FCC Rcd 8728 (CSB 1995) (The Bureau concluded that neither signal quality issues nor concerns about equipment compatibility may be remedied through application of the Commission's rate regulations. Rather, signal quality is subject to the Commission's rules of technical standards (47 C.F.R. §§ 76.601-630) and equipment-related problems are addressed by the Commission's equipment compatibility rules (47 C.F.R. § 76.630). The Order noted that a franchising authority may not arbitrarily reduce prices for programming and equipment below maximum permitted rate levels in an effort to address signal quality or equipment compatibility issues).

³⁶ 13 FCC Rcd 11996, 11998 (CSB 1998).

³⁷ 47 C.F.R. § 76.936; *Rate Order*, 8 FCC Rcd at 5715-16.

³⁸ See 47 C.F.R. §§ 76.601-630.

³⁹ See 47 C.F.R. § 76.309.

⁴⁰ See 47 C.F.R. § 76.923(c)(1) and (3).

⁴¹ See Opposition at 10.

The local franchising authority's concern about the rate level does not provide a legitimate basis for rejecting TWC's Form 1205 calculations. As we have stated, although the magnitude of a rate increase may be reason closely to examine supporting information, the magnitude of a rate increase alone is not determinative of its reasonableness.⁴²

C. Refreshing Trued-up Inflation Calculation.

11. TWC indicates that the "true-up"⁴³ period on its 2002-2003 Form 1240 ran from October 2000 through September 30, 2001, but because by October 1, 2001, the Commission had only released quarterly inflation data through the first quarter of 2001, TWC used the first quarter 2001 inflation update as the true-up inflation rate for the second and third quarters of 2001.⁴⁴ TWC argues that this approach is supported by Commission precedent, citing *TCI Cablevision of Ohio, Inc.*, in which the Cable Services Bureau rejected a local franchising authority's contention that it may require a cable operator to update the estimated inflation figure used in a true-up calculation.⁴⁵ TWC points out that the Town's consultant acknowledged that TWC's inflation true-up calculations were consistent with the Commission's rules. Moreover the consultant pointed out that TWC could not be compelled to update its Form 1240 to reflect inflation updates released subsequent to October 1, 2001. Notwithstanding these circumstances, the Town directed TWC to refresh its inflation true-up calculation prior to calculating its 2003-2004 Form 1240.⁴⁶

12. The Town states that its decision requiring TWC to refresh the inflation rates by incorporating more accurate, updated inflation figures, was reasonable and in the public interest.⁴⁷ It maintains that by refreshing the 2002 rates and replacing the inflation figures of 3.23% for the last two quarters with the FCC's more accurate figures of 2.08% and 2.25%, the maximum permitted basic service tier rate for 2003 would be lowered for consumers.⁴⁸

13. In reply, TWC asserts that the Commission has held that LFAs may not require a cable operator to update estimated inflation figures used in the true-up calculation where there are no other

⁴² See *TCI of Richardson, Inc.*, 14 FCC Rcd at 11710.

⁴³ As part of the annual rate change, the Commission's rules include a "true-up" mechanism which permits an operator to correct projected cost changes with actual cost changes associated with external costs, inflation, and the number of regulated channels. The true-up requires operators to decrease their rates or permits them to increase their rates to adjust for over-or-under estimations of these cost changes. See *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Thirteenth Order on Reconsideration*, 11 FCC Rcd 388, 420-21 (1995).

⁴⁴ Appeal Petition at 6. The Smithfield Rate Order indicates that the Commission published inflation figures of 2.8% and 2.25% in October 2001, subsequent to TWC's FCC 1240 rate filing. The Town ordered TWC to refresh the inflation rates in TWC's 2002 FCC 1240 filing prior to calculating a 2003 FCC 1240 filing by incorporating updated inflation figures for 2001 and 2002. See Exhibit A, February 5, 2002 Rate Order.

⁴⁵ *Id.* See *TCI Cablevision of Ohio, Inc., (Warren, OH)*, 13 FCC Rcd 11954, 11958 (CSB 1998).

⁴⁶ *Id.*

⁴⁷ Opposition at 12.

⁴⁸ *Id.*

changes being made to the Form 1240.⁴⁹ TWC also points out that the Commission has recognized that the public interest is also served by providing cable operators with a measure of finality and by reducing the administrative expenses associated with the rate regulation process.⁵⁰ Moreover, TWC makes the argument that if LFAs are allowed to require a new true-up calculation when the inflation rate is declining, cable operators would have to be allowed to perform a similar update when inflation rates are on the rise.⁵¹

14. Operators using Form 1240 may adjust rates once per year to reflect reasonable certain and quantifiable changes in external costs, inflation, and the number of regulated channels that are projected for the 12 months following the rate change.⁵² An operator using Form 1240 true-ups the inflation information on the rate form by using the quarterly inflation figures published by the Commission.⁵³ If the true-up on the worksheet includes months for which the Commission has not released an inflation figure, the operator must use the figure for the most recent quarter for which a figure is available.⁵⁴ The operator then computes an average inflation factor for the true-up period, which is used in calculating the maximum permitted rate for the true-up period.⁵⁵ The inflation factor most recently released by the Commission is also used to compute the current inflation factor for the projected period.⁵⁶ A franchising authority should not find a rate unreasonable solely because more current inflation data has become available by the time the franchising authority reviews a cable operator's submission.⁵⁷ However, if a rate is unreasonable on its face or has to be adjusted for reasons other than the availability of a more current inflation figure, the franchising authority may recalculate the maximum permitted basic service tier rate using the most accurate inflation information for the period at issue that is available at the time of its review.⁵⁸ The Town has not shown that TWC's rate is unreasonable on its face or that the rate has to be adjusted for any other reason. Thus, the Town should accept the Form 1240 and the data TWC submitted and TWC should not be required to refresh its inflation true-up calculation.

⁴⁹ Reply at 6. See *TCI Cablevision of Ohio, Inc. (Warren, OH)*, 13 FCC Rcd at 11958.

⁵⁰ *Id.* at 6.

⁵¹ *Id.* at 6.

⁵² 47 C.F.R. § 76.922(e)(3).

⁵³ See *Comcast Cablevision of Detroit, Inc.*, 15 FCC Rcd 24022, 24027 (CSB 2000) citing Form 1240 Instruction at 13, 24-25.

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

15. We decline to assess sanctions on the Town as TWC requested. Although we have previously addressed the issues raised in this appeal, that fact alone is not an adequate basis to justify our assessing sanctions.

IV. ORDERING CLAUSES

16. Accordingly, **IT IS ORDERED** that the Appeal of Time Warner Cable from a Rate Order of the Town of Smithfield, North Carolina **IS GRANTED IN PART** and **DENIED IN PART** as provided above and the Rate Order of the Town of Smithfield **IS REMANDED** for further consideration consistent with this Memorandum Opinion and Order.

17. This action is taken pursuant to authority delegated by § 0.283 of the Commission's rules. 47 C.F.R. § 0.283.

FEDERAL COMMUNICATIONS COMMISSION

John B. Norton
Deputy Chief, Policy Division
Media Bureau