



MONTGOMERY COUNTY EXECUTIVE ORDER

Offices of the County Executive • 101 Monroe Street • Rockville, Maryland 20850

Subject CATV Rate Regulation – FCC 1235	Executive Order No. 49-05	Subject Suffix
Originating Department Technology Services Office of Cable and Communication Services	Department Number 346001	Effective Date 3/01/05

**ORDER OF THE COUNTY EXECUTIVE SETTING CABLE
TELEVISION RATES FOR THE ADD-ON RATE TO
THE BASIC SERVICE RATE PURSUANT TO
FCC FORM 1235 FILED APRIL 1, 2004**

March 3, 2005

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ATTACHMENT 1: REPORT OF FRONT RANGE CONSULTING, INC.

ORDER OF THE COUNTY EXECUTIVE
SETTING THE CABLE TELEVISION ADD-ON RATE FOR THE BASIC SERVICE RATE
PURSUANT TO FCC FORM 1235 FILED APRIL 1, 2004

I. COMCAST'S ADD-ON RATE FILING

1. Under Section 623 of the Cable Communications Policy Act of 1984, 47 U.S.C. § 543, as amended ("Cable Act"), and Montgomery County Executive Regulation No. 50-93AM (Oct. 12, 1993) ("Executive Regulation" or "ER"), Montgomery County, Maryland ("County") is permitted to regulate rates for basic cable service and equipment (including installations).

2. The County initiated basic rate regulation on September 1, 1993.

3. On April 1, 2004, Comcast Cable of Potomac, LLC ("Comcast"), filed with the County FCC Form 1235, "Abbreviated Cost of Service Filing for Cable Network Upgrades" ("Add-On Rate Filing"), under a cover letter dated March 31, 2004, seeking the County's approval of an add-on of \$ 2.42 to the maximum permitted rates otherwise established.¹

4. The Office of Cable and Communication Services (the "Office") received and preliminarily reviewed the Add-On Rate Filing and published notice that such filing was available for public review and comment.

5. On April 16, 2004, the County adopted an order extending the County's deadline for acting on Comcast's Form 1235 Filing, and tolling any implementation of rates based on the Form 1235 Filing, for 150 days, in addition to the initial thirty-day review period, pursuant to 47 C.F.R. § 76.933.

¹ On the same date, Comcast also filed for a rate increase on FCC Form 1240 and made a nationally aggregated equipment filing on Form 1205. These forms will be the subject of separate rate orders.

6. The County's financial consultant, Front Range Consulting, Inc. ("FRC"), reviewed Comcast's Add-On Rate Filing. In the course of the FRC review, the County submitted its initial requests for information regarding the Form 1235 to Comcast on April 20, 2004. By letter dated April 26, 2004, Comcast sought an extension from May 11, 2004, to May 18, 2004, of the deadline to respond to the April 20, 2004 request. The County granted Comcast's request and extended the deadline to May 18, 2004.

7. Subsequent requests and responses yielded further information, which is reflected in this Order and in a letter report from FRC dated December 23, 2004, appended as Attachment 1 ("FRC Report"). FRC Report at 5-7.

8. Comcast refused to provide all of the information requested by FRC with regard to Comcast's return on the upgrade costs. FRC Report at 2.

9. FRC's conclusions as to the recalculation of Comcast's add-on rate, arrived at after review of the materials submitted by Comcast and the issues raised, are contained in the FRC Report and in the revised rate calculations attached to the FRC Report ("Revised Rate Calculations").

10. On January 13, 2005, the County sent Comcast a draft of this Rate Order and the FRC Report for review and comment. In response, Comcast submitted a letter from Gary S. Lutzker to Jane E. Lawton dated January 21, 2004 ("Lutzker Letter").

11. The County has reviewed Comcast's comments and taken them into account in the discussions of specific issues below.

12. Federal Communications Commission ("FCC") rules place the burden on the cable operator to prove that its rates for basic service and equipment are reasonable under applicable federal law and regulations. 47 C.F.R. § 76.937(a). The County has provided

Comcast with ample opportunity to provide the necessary support for its rates. Hence, to the extent Comcast has failed to carry its burden of proof, the County may establish Comcast's Form 1235 add-on rate based on the best information available and the conclusions reached thereon by the County as the finder of fact.²

13. The rates set herein will govern Comcast's add-on to its basic service rates for the time period to which that add-on is applicable.

II. THE FCC'S UPGRADE ADD-ON TO BASIC RATES

14. The FCC introduced Form 1235 as an abbreviated cost-of-service showing to ensure that cable operators could recover the costs of cable system upgrades from basic cable rates to the extent the upgrade benefited basic cable services.

15. In its initial rate regulation analysis, the FCC correctly concluded that a special rate increase to cover the cost of a system upgrade should not be necessary.

Such expenditures are likely to be significant and if automatically passed through could lead to substantially increased rates. Additionally, system improvements typically increase channel capacity, which will increase the total revenues per subscriber achievable, even under the benchmark formula, or reduce maintenance or other service expenses.

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket 92-266, *Report and Order and Further Notice of Proposed Rulemaking*, FCC 93-177, 8 FCC Rcd 5631 at ¶ 256 n.608 (1993). The Commission's observation is even more apt today, when system upgrades enhance a cable operator's ability to deliver high-profit advanced services and thus are likely to result in a net gain to the operator rather than a net cost.

² See, e.g., *Comcast Cablevision of Tallahassee, Inc.: Appeal of Local Rate Order of City*

16. In 1994, the FCC nonetheless decided to allow for an abbreviated cost-of-service filing for network upgrades. This filing was intended to be a rare exception:

For many systems, this option will be unnecessary or inapplicable. The benchmark/price cap mechanism is already based on the rates of competitive systems, including those with upgraded networks. The rates charged by those systems presumably recover their capital costs. The benchmark also includes factors reflecting the number of channels a system furnishes to customers. Nevertheless, there may be cases where the benchmark rates do not provide sufficient revenue to attract capital for upgrades because of unusual costs associated with capital improvements. For these cases the abbreviated cost-of-service showing should provide the ability to attract the capital needed for the upgrade.³

17. Form 1235 was initially introduced at a time when both basic service tier (“BST”) and cable programming service tier (“CPST”) rates were subject to regulation. The FCC’s rules recognized that the operator could recover any unusual costs for a system upgrade *either* through BST and CPST rates, *or* through CPST rates only.⁴

18. The sunset of CPST regulation in 1999 thus raised the fundamental question of whether retention of Form 1235 in any form was appropriate. Since CPST rates were now unregulated, a cable operator could always recover any unusual costs in the CPST rates. Any additional recovery through basic rates could reasonably be assumed to be a double recovery.

of Tallahassee, Fla., DA 95-1561, 10 FCC Rcd 7686 at ¶¶ 28-29, 37, 48-49, and 54 (1995).

³ Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket 92-266, *Report and Order and Further Notice of Proposed Rulemaking*, FCC 94-39, MM Docket No. 93-215, CS Docket No. 94-28, 9 FCC Rcd 4527 at ¶ 286 (1994).

⁴ See FCC Form 1235, Part III, question 5. See also, e.g., *Marcus Cable Associates, L.P.: Complaints Regarding Cable Programming Services Tier Rate Increases*, CUID No. CA0180, Order, DA 97-983, 12 FCC Rcd 23216 at ¶ 12 n.30 (Cab. Serv. Bur. 1997); *Charter Communications: Complaint Regarding Cable Programming Services Tier Rates*, CUID No. CA0826 (Altadena), Order, DA 98-2211, 13 FCC Rcd 21860 at ¶ 6 (Cab. Serv. Bur. 1998); *Carriage of Digital Television Broadcast Signals Amendments to Part 76 of Commission's Rules*, CS Dkt No. 98-120, 16 FCC Rcd 2598, FCC 01-22 at ¶ 110 (2001).

19. In light of this and other issues, the FCC asked in its new 2002 rulemaking on rate regulation whether Form 1235 should be retained:

In light of the breadth of unregulated services that can now be delivered over cable systems, including CPST, we seek comment on whether we should continue to allow operators to file abbreviated cost-of-service showings.⁵

20. At the same time, the FCC recognized that there were a number of other problems now involved in the use of Form 1235, which had not been revised or updated to reflect the changes in applicable law since its introduction.⁶

21. The FCC has not yet issued an order addressing the questions raised in the 2002 NPRM&O. Moreover, until recently cable operators have used Form 1235 on relatively rare occasions, consistent with the FCC's original description of this filing as an extraordinary measure inapplicable to most normal systems. Thus, as opposed to the decisions relating to Forms 1240 and 1205, there is relatively little FCC precedent upon which the County may rely in calculating the correct amount of the Form 1235 add-on charge.

22. It is reasonable to question (since the FCC itself has done so) whether a cable operator should ever need to file a Form 1235 under present conditions, especially in light of the fact that BST subscribers derive little, if any, benefit from a cable network upgrade. Nonetheless, the FCC has not yet precluded the use of Form 1235. Thus, the County is required to address Comcast's Add-On Rate Filing under the FCC's current rules, even though it seems likely that any such add-on charge will result in unreasonable rates for basic subscribers. The following analysis, therefore, puts aside the general issues raised in this Section II and seeks to

⁵ Revisions to Cable Television Rate Regulations, MB Docket No. 02-144 *etc.*, *Notice of Proposed Rulemaking and Order*, FCC 02-177, 17 FCC Rcd 11550 at ¶ 36 (2002) ("2002 NPRM&O").

⁶ *Id.* at ¶ 37.

apply the FCC's current rules and instructions in a reasonable way to reach results consistent with the FCC's rate methodology and regulations.

III. FINDINGS AND CONCLUSIONS

23. With respect to Comcast's Add-On Rate Filing, the FRC Report concludes that certain adjustments are necessary in Comcast's Form 1235 pursuant to FCC regulations. The following rate adjustments are necessary to reach an appropriate add-on rate.

A. Comcast Did Not Eliminate Embedded Investment in Cable System Plant Being Recovered in the Existing Form 1240 Rate.

24. The Form 1240 rate allows a cable operator to recover the costs of its existing cable system plant, to the extent those costs are attributable to the basic service tier.⁷

25. The Form 1235 add-on represents a surcharge, over and above the Form 1240 rate, to allow a cable operator to recover the additional costs of a system upgrade, over and above those of the pre-upgrade plant. See Section II above.

⁷ See, e.g., *In re Falcon Cable Systems Company, Appeal from a Local Rate Order of the County of San Luis Obispo, California*, Memorandum Opinion and Order, 14 FCC Rcd. 2105 at ¶ 7 (1999) ("*Falcon*") ("[T]he benchmark system presumes that the rate charged allows recovery of capital costs"; *Suburban Cable TV, Inc.: Complaint Regarding Cable Programming Services Tier Rates and Petitions for Reconsideration*, CUID No. PA1686 (Northampton), Order on Reconsideration and Rate Order, DA 97-1987, 12 FCC Rcd 23862 at ¶¶ 9-10 ("*Suburban*") ("the benchmark rates . . . are expected to provide adequate recovery of an operator's total revenue requirement needed to cover all capital and operating costs"); *In re TCI of Southeast Mississippi, Appeal of Local Rate Order of the City of Ocean Springs, Mississippi*, Memorandum Opinion and Order, 10 FCC Rcd. 8728, n.30 (1995) ("The benchmark rates . . . internalize any other system variances that existed at the time of the survey, such as the carriage of revenue-producing channels").

As the FRC Report notes, Comcast recovers a *return on* its costs, as well as recovering the costs themselves. See, e.g., FRC Report at 9, 10. For simplicity's sake, this recovery is referred to here simply as a recovery of costs. The Revised Rate Calculations take into account the return on Comcast's investment as well as the return of the investment itself.

26. Thus, the Form 1235 add-on charge cannot be used to recover again the costs already being recovered for the existing system plant – the “embedded investment.” Otherwise, Comcast would achieve a double recovery in the combined Form 1240 and Form 1235 basic tier rate. FRC Report at 8-9, § III.D.1.

27. Hence, to the extent Comcast’s investment in the upgraded plant overlaps the original investment in the pre-upgrade plant, the cost of the pre-existing plant must be subtracted from the total upgrade cost before the Form 1235 add-on is determined. This overlap is represented by the plant Comcast used before the upgrade which is no longer being used after the upgrade. In effect, Comcast is already recovering the cost of that portion of the upgrade – the portion that replaces existing plant – in its Form 1240 rates. *See* FRC Report at 9.

28. The Form 1235 instructions do not specifically state that embedded investment must be removed from the base on which the Form 1235 add-on is calculated. However, any other approach would be inconsistent with the general principle of the FCC’s rules that costs embedded in an existing rate must be subtracted from the total costs submitted to justify a rate increase, to avoid a double recovery. *See, e.g., Suburban* at ¶¶ 9-10; *Mountain Cable Company d.b.a. Adelpia Cable Communications et al.: Appeal of Local Rate Order of the Public Service Board, State of Vermont*, DA 99-1434, Memorandum Opinion and Order, FCC 03-211, 18 FCC Rcd 18436 (2003) (“*Mountain Cable*”).

29. The FCC has stated that “[t]he benchmark system presumes that the rate charged allows recovery of capital costs. Therefore, the subtraction of retired assets on an actual costs basis is appropriate.” *Falcon* at ¶ 7 (footnote omitted). *See* FRC Report at 9.

30. Comcast argues that the removal of these embedded costs is “foreclosed” by the FCC’s instructions for Form 1235. Lutzker Letter at 2. Those instructions state that Comcast

must offset against its upgrade costs any gains realized from disposition of property used prior to the upgrade. However, this requirement to offset actual gains from disposition of property is not inconsistent with removing embedded costs. Merely offsetting the gains from sale of unused property would not by itself prevent Comcast from recovering the embedded costs twice. Those gains do need to be offset, but once that is done, Comcast will still be recovering in its 1240 rates the cost of plant no longer in use. Thus, removing the embedded costs is necessary to prevent double recovery.

31. To support Comcast's position, the Lutzker Letter refers to *Mountain Cable Company d/b/a Adelpia Cable Communications et al.: Appeal of Local Rate Order of the Public Service Board, State of Vermont*, CSB-A-0628, Memorandum Opinion and Order, DA 99-1434, __ FCC Rcd ____ at ¶ 1 (Cable Services Bureau 1999) ("*Mountain Cable*"). In that decision the FCC in fact endorsed the general principle on which the County's analysis relies: "subscribers paying for the cost of the upgrade through an upgrade add-on to their rates should not also be expected to continue paying for what is no longer used and useful." *Id.* at ¶ 19. Contrary to Comcast's statement, however, the FCC did not say that "the *only* 'embedded' investment to be offset against capital costs . . . are gains realized from the disposition of property."⁸ Thus, *Mountain Cable* supports, rather than undermining, the conclusion of the FRC Report.

⁸ Lutzker Letter at 2 (emphasis added).

32. Moreover, Comcast's comments fail to make any reference to the *Falcon* order cited above, which is more precisely on point. See ¶ 29 above. Nor does Comcast deny that its methodology here would lead to over-recovery.

33. It is telling – both with respect to this issue, and with respect to many other arguments in the Lutzker Letter – that Comcast does not deny that its preferred interpretation of the FCC's rules would result in over-recovery. Rather, Comcast is basically claiming that it is entitled to manipulate the rules so that it is allowed to over-recover in its basic tier rates. To interpret the FCC's rules in such a way as to allow Comcast to over-recover, however, would be to defeat the purpose of the statute and the rules. See 47 U.S.C. §§ 543(b)(1) (FCC's rules are to ensure that basic rates are reasonable), 543(h) (FCC rules must prevent evasions of the requirements of this section). Unless the FCC were to direct specifically that its rules must be applied in such a way as to allow such overcharges, it would be inappropriate for the County to approve a rate that demonstrably over-recovers Comcast's costs.

34. Comcast stated that it removed about \$31.3 million in assets from its general ledger accounts for pre-existing cable system plant that was removed during the upgrade. FRC Report at 9. This amount, then, derived from Comcast's own data, represents plant whose costs were already being recovered in the Form 1240 rate.

35. The FRC Report corrects this double recovery in Comcast's Form 1235 by reducing Comcast's claimed \$84 million investment by Comcast's \$31.3 million retirement of pre-upgrade system assets. FRC Report at 9.

B. Comcast Did Not Include the Offset in its Rate Base for Accumulated Deferred Income Taxes and Accumulated Depreciation.

36. The FRC Report corrects two problems related to depreciation of the upgraded plant.

37. The first issue has to do with accumulated deferred income taxes. Federal tax regulations allow Comcast to deduct accelerated depreciation on its plant investments. The income tax benefits of this deduction reduce the net cost of the upgrade to Comcast in the early years of the useful life, based on the amount of accumulated deferred income taxes for each year. FRC Report at 9, § III.D.2.

38. In a cost-of-service filing such as a Form 1235 filing, or in a Form 1205 equipment filing, accumulated deferred income taxes must be taken into account. 47 C.F.R. § 76.922(i)(7).

39. Comcast's Add-On Rate Filing did not take into account the accumulated deferred income taxes. The FRC Report corrects this problem, using the accelerated tax rates provided by Comcast in response to an information request. FRC Report at 10.

40. Comcast objects that the FCC's rule relating specifically to Form 1235 does not specifically refer to accumulated deferred income taxes. Lutzker Letter at 3. However, the rule cited by Comcast, 47 C.F.R. § 76.922(j)(3), does not purport to contain an exclusive list of the factors that must be taken into account in a Form 1235 analysis to reach a reasonable rate. The rule does, however, emphasize that it is the cable operator's burden to demonstrate the amount of the *net* increase in costs. Thus, the regulatory authority must consider Comcast's entire cost picture, including the tax savings the company gains through accelerated depreciation. (Again, Comcast does not deny that its preferred interpretation would lead to over-recovery.)

41. The second issue relates to accumulated depreciation. Comcast's predecessor in interest began the upgrade in 1998; it was completed by Comcast in 2002. Thus, the cable operator should have been depreciating the investment since 1998. However, Comcast's Add-On Rate Filing treats the entire investment as if it were made at the time of the rate filing, using the gross investment of \$84.4 million rather than the net investment taking into account depreciation since 1998. FRC Report at 10.

42. The FRC Report corrects this problem by calculating the net investment as of December 2003 for determining the Form 1235 add-on rate.

43. Comcast objects that the language of § 76.922(j)(3) refers only to "*current* depreciation expense." Lutzker Letter at 3. Here, again, the FCC's mention of one expense does not automatically exclude proper accounting treatment of another, if such treatment is necessary to avoid allowing Comcast to over-recover its costs.

44. Comcast has in effect waited six years to begin recovering the upgrade costs it claims to have incurred, and now wishes to *extend* the useful life of its plant six years beyond its end, so as to recover from later subscribers, after the plant involved has been fully depreciated, the claimed costs it declined to recover at the proper time. Nothing in the FCC's rules entitles Comcast to "bank" upgrade costs in this way, or to recover them after the end of an asset's useful life. Indeed, if Comcast had really needed a basic tier rate increase to recover those costs, the company would certainly have put in for it when the costs were incurred, not six years later. Thus, Comcast's own approach to the upgrade costs demonstrates that the company does *not* need the claimed increase to recover its costs in full.¹⁰

¹⁰ The County notes that Comcast claims never to have incorporated any upgrade costs "in its regulated rates," Lutzker Letter at 3. However, Comcast does not show that it has not

C. Comcast Did Not Consider the Reduction in the Rate Base Over the Useful Life of the Facilities.

45. Over the useful life of an asset, the revenue requirements necessary to recover its cost decline each year, as a result of the accumulation of depreciation expense on the asset. FRC Report at 10-11, § III.D.3.

46. Comcast's Add-On Rate Filing, however, assumes that the amount recovered in the first year of the useful life should also be recovered in every successive year thereafter. FRC Report at 11.

47. Using Comcast's approach would result in an over-recovery of approximately \$7.2 million over the life of the add-on charge – a total recovery of almost twice the approximately \$8.4 million recovery needed. As the FRC Report notes, the FCC has recognized this problem in its most recent rate regulation NPRM.¹¹ FRC Report at 10 n.1.

48. In order to arrive at an add-on rate that can be applied uniformly over the useful life, as the FCC's Form 1235 assumes, the calculation must also take into account the net present value of the future revenue requirements. FRC Report at 11.

49. The FRC Report corrects the problem of Comcast's over-recovery in this respect by modifying the calculation to take into account the useful life of the investment. The calculation methodology is shown in the Revised Rate Calculations.

50. Comcast's comments, again, do not deny that its methodology would over-recover. Instead, Comcast claims that its method complies with the FCC's rules, and argues that

fully recovered any of its upgrade costs through its unregulated rate increases on *other* services. See ¶ 18 above. The County's analysis, however, does not depend upon this observation.

¹¹ 2002 NPRM&O at ¶ 37.

the County must allow the company to recover almost twice its actual costs because the FCC has not yet changed its rules to close this alleged loophole. Lutzker Letter at 3-4.

51. It would be unreasonable to interpret the FCC's rules to allow recovery of the same total upgrade cost over again in each of successive years – once by depreciation and then again by continuing to charge for the depreciated costs – in the absence of a clear affirmative statement from the FCC making clear that the Commission intended such an illogical result. No such statement appears to exist. The passage quoted by Comcast indicates that cable operators can “earn a rate of return on their total upgrade investment throughout the life of the upgrade.” Lutzker Letter at 4. But this is more sensibly interpreted to mean that the company earns a return of and on its investment *once* over the life of the upgrade, rather than to suppose with Comcast that it means the company can earn that same return over and over again. The County assumes that the FCC intended its forms to be applied in such a way as to produce reasonable results, and not in such a way as to allow acknowledged over-recoveries, as Comcast argues.

D. Comcast Failed to Include Interest Expense in Determining its Income Tax Gross-Up.

52. A calculation of revenue requirements in a cost-of-service analysis such as that of Form 1235 typically allows the regulated entity to consider income taxes on the return element. The income tax, however, varies depending on how much of the investment is debt and how much is equity. Thus, it is necessary to determine the debt and equity components of the investment in order to calculate the correct rate. FRC Report at 11, § III.D.4.

53. Form 1235 addresses this issue by asking the cable operator to identify the interest expense associated with the upgrade. In its Add-On Rate Filing, Comcast took the position that the investment had *no* interest component, claiming that it had not incurred any *new*

debt *specifically associated* with the upgrade, since Comcast borrows money in the aggregate at the corporate level and not by individual systems. Comcast stated:

Comcast did not specifically incur any bank debt or use other means of financing, to fund the Montgomery County upgrade project. The funds used for this project were provided by Comcast as part of the annual capital budget for the Montgomery County system. Therefore, we did not include any interest expense in the Form 1235 rate-base calculation.¹²

Thus, in effect, Comcast sought to gain a return based on 100% equity, even though Comcast's actual debt-equity ratio is far different. FRC Report at 12.

54. The FRC Report corrects this problem by including interest expense consistent with the income tax gross-up used in Comcast's Form 1205: 1.944% of net assets. In this way, Comcast is prevented from over-recovering by limiting its income tax gross-up to the non-debt portion of its capital structure. FRC Report at 11-12.

55. Comcast claims that the Form 1235 instructions limit includable interest expense to "debt acquired for the completion of the upgrade" from a worksheet "completed for the filing level." Lutzker Letter at 4. Presumably Comcast takes the position that this language justifies ignoring the parent company's debt structure when filing on behalf of a subsidiary. The FCC's instruction does not, however, indicate that parent company debt should not be allocated to the subsidiary ("the filing level") when such debt is routinely incurred for the benefit of all subsidiaries and for all purposes by the parent company. As noted in the FRC Report at 12, Comcast conceded in its Form 1205 filing that its debt-equity structure included debt. Once again, Comcast's comments do not dispute the basic accuracy of the analysis; they merely seek

¹² See FRC Report at 12.

to find a pretext in the FCC’s language for inaccurate or unreasonable use of the forms. Thus, Comcast’s arguments do not show that the FCC’s rules require the County to pretend that the upgrade was funded solely by equity.

E. Comcast Included Upgrade Investment Not Attributable to the Basic Service Tier.

56. In assigning costs to categories, the FCC prefers direct assignment rather than indirect allocation in a cost-of-service calculation such as that of Form 1235. *See, e.g.,* 47 C.F.R. § 76.924(f)(6)-(7).

57. With the assistance of the County’s engineering consultants, Columbia Telecommunications Corporation (“CTC”), FRC reviewed the data provided by Comcast to determine whether the company had improperly allocated any plant costs to the basic tier. FRC determined that Comcast had allocated to the basic tier a number of items that should have been directly assigned to other purposes. FRC Report at 12, § III.D.5. The items so identified were:

<i>Item</i>	<i>Amount</i>
I-Net Construction (Labor)	\$779,214
Tap Audit (Labor)	\$2,277,246
Materials – I-Net	\$118,864
Materials – Reverse Equalizers	\$105,954
Total	\$3,281,278

58. As these items are not used and useful in providing basic service, the FRC Report corrects the problem by directly assigning their costs to the “all other” category. FRC Report at 13.

59. Comcast did not provide complete information on these costs to FRC and CTC; the company claimed to have no records for the costs incurred by the previous owner. Thus,

CTC's analysis could not include all the accounting entries comprising Comcast's claimed \$84.4 million investment. For this reason, the reduction made by FRC here is extremely conservative. It is most likely that the amount directly assigned to categories other than basic would have been much greater had Comcast provided all the relevant information. FRC Report at 13.

60. Comcast's comments agree that I-Net labor and materials costs should not have been included in Form 1235. Lutzker Letter at 4-5. The company argues, however, that the cost of tap audits and reverse equalizer equipment "benefit the entire cable system equally." *Id.* at 5. This position appears to be groundless. The purpose of tap audits is to improve Comcast's profit margin by detecting theft of service; they do not enhance the quality of basic service to subscribers. The purpose of reverse equalizer equipment is to improve upstream transmission for purposes such as cable modem service; again, such equipment provides no benefit to the basic service tier. Thus, no part of these costs should be allocated to the basic rate. The FRC Report instead assigns them directly to the "all other" cost category, to be recovered through rates other than the basic rate.

F. Comcast Did Not Take Into Account Subscriber Growth Over The Life Of The Upgraded Facilities.

61. In deriving a fixed add-on charge for a twelve-year period based on the current number of subscribers, Comcast implicitly assumed that its subscriber base would remain constant. Comcast's add-on charge was designed to ensure full recovery from the existing number of subscribers. If Comcast's subscriber base increased over the twelve-year time period, payment of the add-on charge by each new subscriber would constitute an over-recovery by Comcast.

62. Comcast did not provide a projection of customer growth over the useful life of the upgrade. To prevent over-recovery, it is necessary for the County to make a reasonable projection using the best available information. FRC Report at 13, § III.D.6.

63. After refusing to provide its own subscriber projections, Comcast argues that the FRC Report's projections are "unsupported." Lutzker Letter at 5. This is incorrect. As noted below and in the FRC Report, these projections are based on historical data.

64. Since 2001, the County has experienced population growth at about 1.5% per year. Comcast has increased its homes passed by a similar amount over the same period. FRC Report at 13.

65. The FRC Report conservatively assumes that subscriber growth may be less than the growth of the County's population as a whole. It is quite possible that the reverse will occur: as Comcast improves its market position and offers new advanced services, its penetration may increase. Nonetheless, FRC's Revised Rate Calculations assume a growth rate of only 0.5% per year over this 12 year period, one-third of the historic population growth rate. FRC Report at 13.

66. Comcast's suggestion that it faces "ever-increasing competition" in the County, Lutzker Letter at 5, is unsupported. Moreover, even if Comcast made good its claim, this would not show that Comcast's subscribership would not continue to grow.

67. Comcast suggests that the FCC's form instructions require the number of subscribers to be treated as constant over the life of the recovery. Lutzker Letter at 5. Again, Comcast does not deny that failing to take subscriber growth into account would skew the results

of the calculation. Rather, Comcast apparently seeks to trade upon an incompleteness in the FCC's instructions. The instructions (p. 8) do not explicitly deal with the division of upgrade cost recovery into annual amounts. For this reason, they also do not explicitly address the adjustment of subscriber counts over the course of the projected recovery. The FCC's rules do not, however, appear to preclude the County from making the necessary adjustment to ensure that Comcast does not over-recover its actual upgrade costs.

G. Comcast's Allocation of Revenue Requirements to the Basic Service Tier Reflects an Overstatement of the Benefits Received by Basic Subscribers.

68. As noted above, direct assignment is preferable to allocation in a Form 1235 calculation. However, Comcast did not directly assign any costs. Comcast chose to allocate a portion of its upgrade costs to the basic service tier based on a ratio of the number of 6 MHz channels on the basic tier to the total number of 6 MHz channels available on the upgraded system. FRC Report at 13, § III.D.7.

69. The FCC approved channel-based allocations in some early Form 1235 decisions. *See, e.g., Falcon* at ¶ 8; *Mountain Cable* at n.36. However, the FCC does not appear to have ruled that channel-based allocations are appropriate in all possible cases – especially after the sunset of CPST regulation – or that this is the only appropriate method that may be used. Rather, the FCC has merely indicated that a channel-based allocation method may be “reasonable.” FRC Report at 14.

70. In the current environment, a pure channel-based allocation method appears to overstate the degree to which the upgrade benefits basic cable subscribers. A modern cable system upgrade is primarily intended to allow a cable operator to expand its digital offerings and to sell new services such as high-speed Internet access and telephony. By contrast, the only

apparent benefits to basic subscribers are a certain degree of hypothetical improvement in reliability and picture quality; that is, the cable operator becomes better able to provide the subscriber consistently with the same basic service the subscriber was paying for in the first place, without suffering outages and signal degradation. FRC Report at 14.

71. Comcast's Add-On Rate Filing assigned to the basic service tier approximately 28 percent of the overall revenue requirements from its upgrade. It is implausible, however, that the possible marginal improvements in basic service clarity and reliability actually constitute 28 percent of the benefits achieved for Comcast or its subscribers through the upgrade. FRC Report at 14.

72. The FRC Report seeks to achieve a more accurate estimate of the upgrade benefits by using a hybrid allocation formula based 50 percent on the number of 6 MHz channels available on the system, and 50 percent on the number of incremental 6 MHz channels added to the system as a result of the upgrade. This weighted allocation ensures that basic service subscribers bear only a reasonable proportion of the cost of the upgrade in recognition of the presumed reliability and quality benefits, and also for any increase in the number of channels carried on the basic tier. FRC Report at 14.

73. Further, FRC notes that the use of Comcast's add-on charge over a twelve-year recovery period assumes that the allocation to the BST will remain static over the life of the upgrade. Comcast, however, has discretion to increase or decrease the size of the basic tier. Thus, if the channel count for basic service were reduced beginning (for example) in 2006, this could result in a significant over-recovery. FRC recommends that the County reserve its rights to revisit this allocation if Comcast reduces the number of basic service channels. FRC Report at 14.

74. Comcast's comments on this issue admit that cost assignment should be cost-causative. Lutzker Letter at 6. Comcast also argues that its network upgrade costs "benefit all the services provided on Comcast's cable system equally." Lutzker Letter at 5. As noted above, that is obviously false. Comcast's comments do not provide any basis for concluding that under today's conditions a straight channel ratio must be used to allocate upgrade costs. The hybrid method proposed in the FRC Report appears to provide a more accurate way of gauging the degree of benefit, and hence of cost, properly allocable to the basic tier, insofar as it recognizes that by far the greater part of the benefits of the upgrade accrue not to the basic subscriber, but to the other services on which Comcast can expect to earn the bulk of its return on the investment.

H. Comcast Did Not Include The Required Plant Maintenance, Support And Other Revenue Offsets In Its Add-On Rate Filing.

75. FCC regulations require Comcast to take into account not only the capital costs of the upgrade, but also the increases and/or decreases in operating costs that will result from system improvements. 47 C.F.R. § 76.922(j)(3). For example, the installation of more fiber-optic cable in the distribution system and the concomitant reduction in amplifiers should normally result in less maintenance and fewer repair calls, and thus reduce the company's operating costs.¹⁶

76. The Form 1235 instructions require Comcast to project its incremental and decremental expenses for operation and support. Comcast did not include the required projections in its Add-On Rate Filing, nor in response to the County's requests for information.¹⁷

¹⁶ This is the basis of the increased reliability that is supposed to result from such an upgrade, as discussed in Section III.G above.

¹⁷ See, e.g., RFI #2, questions 10, 14, 15.

FRC thus estimated these cost savings using the best available information.¹⁸ Based on the general CPI increases reported by the Bureau of Labor Statistics, FRC estimated that Comcast has saved approximately \$940,000 from 2000 through 2004.¹⁹ FRC Report at 14.

77. Comcast objects to the FRC Report's determination of reduced expenses as "arbitrary and capricious." Lutzker Letter at 7. Having refused to provide the information on this subject required by the FCC's forms, and having refused to conduct any study to produce such information, Comcast is precluded from making any such claim. As noted above, when Comcast refuses to provide the necessary data, the County is entitled under FCC rules to act on the best available information.²⁰

78. Comcast's sole justification for assuming no savings on operating costs is the suggestion that "the new, more advance [*sic*] equipment installed in the network upgrade is 'more sensitive to minor disruptions in signal strength, increasing the need for more rigorous maintenance schedules.'" Lutzker Letter at 7. If this greater sensitivity exists, however, it would seem to apply to digital and cable modem service, particularly on the upstream path—not to basic service. Indeed, Comcast's statement here, if taken as correct, would undermine the company's entire rationale for allocating *any* of the upgrade costs to basic subscribers. One of the principal reasons for assuming that an upgrade benefits basic subscribers is the increased reliability that results from using a largely fiber-based system. If Comcast's "improvements" have actually

¹⁸ See e.g., 47 C.F.R. § 76.937(d); *Comcast Cablevision of Dallas, Inc.: Order Setting Basic Equipment and Installation Rates, Farmers Branch TX (TX0624)*, CSB-A-0698, Order, DA 04-1703, 19 FCC Rcd 10628 at ¶ 8 (Media Bur. June 14, 2004) (best available information).

¹⁹ FRC suggests that Comcast has probably achieved even greater cost savings for the basic service tier, since the company has admitted that it is redirecting its efforts to advanced services and away from the basic service tier. However, FRC included only the conservative estimate of \$940,000 in its Revised Rate Calculations.

rendered the system *more* unreliable and unstable for basic subscribers – in the interest of offering other, more advanced services – then basic subscribers could hardly be required to pay extra for the privilege of *less* effective service.

79. It is, however, inherently implausible, given recent advances in technology, for Comcast to claim that more up-to-date equipment is less reliable and requires more maintenance than older, more primitive equipment. Having admittedly failed to conduct any study on its actual costs, Comcast has failed to carry its burden of proof to show that no gains in reliability were achieved. Accordingly, the FRC Report appears to have used the best available information to determine the savings Comcast refused to investigate.

80. In addition, the Form instructions require Comcast to offset against its revenue requirements any additional revenues it will receive from the upgrade. 47 C.F.R. § 76.922(j)(3). The primary source of such revenues is advertising. FRC Report at 15.

81. Comcast suggests that it will gain no advertising sales from the upgrade because no new channels were added to basic service. However, the allegedly improved quality of Comcast's basic service product,²¹ together with improved technology for ad insertion, will probably result in increased advertising sales for Comcast even from the existing basic tier lineup. FRC Report at 14-15.

82. Comcast has provided the County with no information, historical or otherwise, to support Comcast's zero entry on the Form 1235 for increased revenues. Therefore, FRC used the best available information to estimate the increased revenues over the life of the upgrade. FRC reviewed Comcast's total "other cable revenues" from January, 2000 through June, 2002, and

²⁰ See n.2 above and accompanying text.

²¹ See Section III.G above.

determined that Comcast has experienced an annual growth rate of 7.72% per year in such revenues.²² FRC has thus projected that “other cable revenues” will grow at this 7.72% over the life of the upgrade. FRC Report at 15.²³

83. The FCC decisions cited in Comcast’s comments on this subject distinguish revenue received for advertising on the BST from revenue from advertising *on other tiers*. Lutzker Letter at 7-8. This is irrelevant to the analysis of the FRC Report, which does not address Comcast’s gains in advertising revenues on non-basic services due to the upgrade. Rather, as noted above, the FRC Report seeks to project only the additional advertising revenues that will result from advertising *on existing basic tier channels*.²⁴ Thus, Comcast has presented no reason to alter the conclusions of the FRC Report on this issue.

I. Conclusion

84. In light of the above discussion, the County finds the FRC Report’s adjustments to the Form 1235 calculations to be reasonable and appropriate.

²² FRC did not have access to this information from Comcast by tier of service, because Comcast refused to provide the requested historical information. *See* response to the County’s Second RFI, Question 10.

²³ It should be noted that this analysis follows Comcast’s assumption that revenues not related to the basic tier should be ignored, even though this could result in the paradoxical result that an overall system upgrade which yields far more new revenues than costs, actually *reducing* the amount the company needs to recover from basic subscribers, could nonetheless produce a basic rate *increase*. Here, again, the County takes a consciously conservative approach in applying the FCC’s rules.

²⁴ *See* FRC Report at 15 (“Comcast will in all likelihood experience increased advertising sales *from the current Basic Service line-up* over the life of the facilities and will therefore be over-recovering its costs from the Basic Service subscriber”) (emphasis added).

IV. ORDERING CLAUSES

IT IS THEREFORE ORDERED THAT:

85. Comcast's add-on rate to the maximum permitted rate for basic service is hereby set at \$0.19 per subscriber per month, for a maximum period of twelve years from the date of this Order, in accordance with FRC's Revised Rate Calculations.

86. As soon as possible, but in any event within sixty days from the effective date of this Order, Comcast shall make any rate reductions and refunds that may be necessary based on the add-on rate shown above, in accordance with 47 C.F.R. § 76.942(d), with interest computed at applicable rates published by the Internal Revenue Service for tax refunds and additional tax payments, pursuant to 47 C.F.R. § 76.942(e).

87. Pursuant to ER §§ 5.2 and 6.1(c), Comcast shall file with the County within ninety days from the date of this Order a certification, signed by an authorized representative of Comcast, stating whether Comcast has complied fully with all provisions of this Order, describing in detail the precise measures taken to implement this Order, including but not limited to whether any reductions or refunds were made pursuant to ¶ 86 herein.

88. Comcast shall not charge any Form 1235 add-on amount higher than the amount set herein.

89. Comcast may charge an amount less than the add-on amount indicated above, as long as such rate complies with applicable law and is applied in a uniform and nondiscriminatory manner, pursuant to federal, state, and local laws and regulations.

90. Pursuant to ER § 4.3, the add-on amount set herein is subject to further reduction and refund to the extent permitted under applicable law and regulations, as the same may be amended.

91. The findings herein are based on the representations of Comcast. Should information come to the County's attention that these representations were inaccurate in any material way, the County reserves the right to take appropriate action. This Order is not to be construed as a finding that the County has accepted as correct any specific entry, explanation or argument made by Comcast not specifically addressed herein.

92. The County reserves all of its rights with respect to rate regulation, including, but not limited to, any right it may have to reopen this rate proceeding, pursuant to ER § 4.3; to revisit the allocation described in Section III.G if Comcast should reduce the number of channels on the basic service tier; and to take any lawful action to ensure reasonable rates if the FCC orders, or permits, changes in the Form 1235 methodology.

93. This Order constitutes the written decision required by 47 C.F.R. § 76.936(a).

94. To the extent that the Executive Regulation would impose deadlines or hearing requirements more stringent than those observed with respect to this process, and waiver of such requirements would be consistent with applicable FCC regulations and would not cause substantial harm to any party, the County Executive hereby waives such requirements, pursuant to ER § 6.1(c).

95. This Order shall be effective immediately upon its approval by the County Executive, pursuant to ER § 4.1.

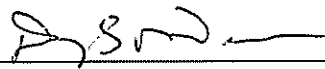


MONTGOMERY COUNTY EXECUTIVE ORDER

Offices of the County Executive • 101 Monroe Street • Rockville, Maryland 20850

Subject CATV Rate Regulation – FCC 1235	Executive Order No. 49-05	Subject Suffix
Originating Department Technology Services Office of Cable and Communication Services	Department Number 346001	Effective Date 3/01/ 2005


96. This Order shall be released to the public and to Comcast, and a public notice shall be published stating that this Order has been issued and is available for review, pursuant to ER § 4.1 and 47 C.F.R. § 76.936(b).



 Douglas M. Duncan
 County Executive

2/1/05

 Date

APPROVED AS TO FORM AND LEGALITY
OFFICE OF THE COUNTY ATTORNEY
 BY: 

 DATE: 2/23/05

ATTACHMENT 1: REPORT OF FRONT RANGE CONSULTING, INC.

**Final Report
On
The Add-on Rate
For
Basic Service
Pursuant
To FCC Form 1235
In
Montgomery County, MD
By
Comcast of Potomac, LLC**

Front Range Consulting, Inc. ("FRC") is pleased to provide Montgomery County, MD ("County") this final report on the Form 1235 filing submitted by Comcast of Potomac, LLC ("Comcast") to the County on or about April 1, 2004.

I. Report Synopsis

FRC recommends that Montgomery County adopt a Rate Order that sets the rate for the Form 1235 to be \$0.19. FRC bases its recommendation on its conclusion that the form as filed is an unreasonable basis on which to set a rate and that Comcast is not allowed to charge the add-on rate for Basic Service above the recommended rate of \$0.19. This recommendation is the result of an examination of the rate filing submitted by Comcast and the responses by Comcast to the County's Requests for Information ("RFI").

Notwithstanding this recommendation identified above, FRC strongly believes that Comcast does not need to use the Form 1235 process in order to recover its costs of this upgrade. Comcast is currently recovering much, if not all, of its costs related to the upgrade in the County from advanced services such as digital cable and cable modem services. Over the life of these upgraded facilities, Comcast will recover all of its costs of



this upgrade; any additional recovery of the recommended rate from Basic Service tier subscribers will allow Comcast to earn more than its necessary rate of return on this investment.

Comcast has the burden of proof to support its proposed rate as reasonable. Comcast has failed to provide credible data to support the reasonableness of its proposed rate. In fact, if Comcast was allowed to charge their proposed rate of \$2.42 per subscriber per month for the life of the upgraded facilities, Comcast would significantly over recover its costs associated with the upgrade and would earn an excessive return on its investment. FRC was prevented from investigating the potential return on the entire upgrade by Comcast because of its refusal to supply necessary financial and operating data. FRC believes that had it been able to prepare the investigation, it would have been able to show that Comcast will be able to earn a full return on and of its investment in the upgrade from revenues collected from un-regulated services like digital, cable modem services and potentially telephony services like VoIP without any Basic Service rate increase.

II. Scope of Report

FRC was engaged by the County's telecommunications counsel, Miller & Van Eaton, P.L.L.C. ("MVE"), to assist with technical and financial aspects of the County's review of Comcast's Form 1235 filing. FRC was asked to review this filing, to prepare RFIs regarding the underlying data used by Comcast in preparing these filings, to analyze the Comcast's responses to the RFIs, and to prepare a final report on the appropriateness of the filed rate. The County, through MVE, has asked that FRC base its report on the information gathered from Comcast as of the date of this report.

III. FCC Form 1235

III (A). Background

The FCC released its Form 1235 on February 27, 1996. In the FCC Public Notice of the Form 1235, the FCC stated:

FCC Form 1235 is an abbreviated cost-of-service form that permits cable operators to recover the costs of significant upgrades that provide benefits to subscribers of regulated cable services. Under FCC Form 1235, cable operators seeking to raise rates to cover the costs of an upgrade submit only the costs of the upgrade instead of all current costs. The upgrade costs are then added to the rates permitted under the benchmark and price cap approach to the extent they would otherwise be unrecoverable.

For a cable operator to receive such rate increases, the Commission requires: (1)



that the upgrade be "significant" and require added capital investment, such as expansion of the bandwidth capacity, conversion to fiber optics or system rebuilds; (2) that the upgrade actually benefit subscribers through improvements in the regulated services subject to the rate increase; (3) that the upgrade rate increase not be assessed until the upgrade is complete and providing benefits to subscriber of regulated services; (4) that the operator demonstrate its net increase in costs, taking into account current depreciation expense, projected changes in maintenance and other expenses, and changes in other revenues; and (5) that the operator allocate its costs to ensure that only costs allocable to the subscribers of regulated services are imposed upon them. FCC Form 1235 permits cable operators to show that they have met these requirements.

Since the release of the Form 1235 in February, the FCC has not changed any of the instructions to the Form 1235 but has asked in its Notice of Proposed Rulemaking (NPRM) (FCC 02-177, released June 19, 2002):

The Commission was concerned that the benchmark/price cap rates might not provide sufficient revenues to attract capital for upgrade in some cases and that the cost-of-service alternative was unduly burdensome. In light of the breadth of unregulated services that can now be delivered over cable systems, including CPST, we seek comment on whether we should continue to allow operators to file abbreviated cost-of-service showings.

As of the date of this report, the FCC has not yet released an Order on this NPRM.

III (A) (1). State of Cable Systems in 1996

As the FCC has acknowledged in its NPRM, cable systems today are vastly different than the cable systems of 1996. Most cable systems in 1996 were analog systems that in order to offer more programming services had to have available additional analog bandwidth. In this 1996 world, the rate regulation scheme in place allowed a very few pennies of additional non-programming revenues to accrue to the operator for increase regulated bandwidth. The Form 1235 allowed the cable operator to effectively increase the few pennies to substantially more. Since the Form 1235 was released, cable systems have evolved into a two-interactive system supplying one-way analog video, digital video, high speed Internet access and traditional switched and VoIP telephony services.

For example, in 1996 a typical cable bill of \$30.00 for basic and cable programming services would allow the subscriber to view 50 or more analog channels. Yet today, the cable company can receive the same revenue stream from a subscriber by providing high speed internet service which uses only a fraction of the bandwidth the cable services on the system uses. In this way the cable operator enjoys a much higher return on its investment for the high speed internet service than it does from the analog video service



when measured as a percentage of system bandwidth used. In economic terms the marginal profit of providing unregulated digital services which make more efficient use of the cable system bandwidth is substantially greater than providing additional analog services. It is no wonder that we see the continued migration away from analog delivery of all new programming services.

This is precisely the policy problem raised by the FCC in its NPRM and one of the analytical issues which must be considered in reviewing the Form 1235 as currently constructed. FRC believes that information about the additional revenue streams from un-regulated services being offered on the Montgomery County cable system would have shown that these services are producing sufficient revenues to pay for 100% of the costs of the cable system upgrade. This data would show that Comcast does not need additional revenues from the Basic Service Tier in order to fully and completely recover its upgrade costs. Comcast has refused to provide that information which prevents that analysis. FRC has instead relied on reasonably available public information to demonstrate that Comcast cannot justify any more than \$0.19 per month to be assigned to Basic Service tier subscribers.

III (A) (2). Recovery Period of the Form 1235

The period during which the Form 1235 add-on rate can be included in subscriber's bills depends on the average useful life of the physical facilities included in the upgrade. For the Montgomery County system, Comcast has used a 12 year life. Comcast has not yet taken any of the Form 1235 increase nor has Comcast stated when this twelve year period begins and ends.

III (A) (3). Timing of the Form 1235 Filing

Comcast has completed an upgrade in 2002 which was begun in 1998 by the former cable operator. The Form 1235 can be filed by a cable operator for any upgrade completed after May 15, 1994 so long as the upgrade meets the minimum technical specifications. In this case, Comcast has filed the Form 1235 two years after the upgrade was complete and providing new revenue opportunities to Comcast and additional services to the subscribers in the County. Comcast does not explain why it waited two years to file its request for the upgrade-related rate increase. Presumably, Comcast was recovering some portion of its costs of the upgrade from its non-regulated service from 2002 until the present. If Comcast needed additional revenues from its regulated services to justify the investment in the upgrade, FRC presumes, Comcast would have filed for this add-on rate increase several years ago.

III (B). Data Analyzed

FRC was provided with information from the County consisting primarily of submissions



prepared by Comcast. They included:

- Comcast's filing (FCC Form 1235) submitted April 1, 2004;
- County's Tolling Order on April 16, 2004;
- RFI # 1 submitted to Comcast on April 20, 2004;
- Comcast's response to RFI # 1 on May 17, 2004;
- RFI # 2 submitted to Comcast on July 9, 2004;
- Comcast's partial response to RFI # 2 on July 22, 2004;
- Comcast's final response to RFI #2 on July 30, 2004
- Comcast's supplemental response on August 5, 2004; and
- County's Accounting Order on September 13, 2004.

FRC also was provided an analysis of the detailed plant upgrade costs by the County's outside engineering firm, Columbia Telecommunications Corporation. FRC also reviewed the FCC Form and Instructions regarding the Form 1235.

III (C). RFI Responses

The County issued two data requests to Comcast with regards to the Form 1235. The first request was dated April 20, 2004 and the second was dated July 9, 2004. Comcast responded on May 17, 2004 to the first request and on July 22, 2004 and July 30, 2004 Comcast responded to the second request.

In Comcast's response to the first request, Comcast has indicated its failure to fully prepare the Form 1235. Request number 9 asked:

Please provide the actual and estimated "Other Cable Revenues" (e.g., advertising revenues, leased access revenues, etc.) over the life of the plant categories shown on Worksheet C of the Form 1235.

Comcast responded:

There are no revenues of this type to be included in the Form 1235 filing. The instructions to the Form 1235 filing state "Line 10 – Other Cable Revenues. Include the projected annual net increase or decrease in ancillary revenues due to the implementation of the upgrade, such as leased commercial access revenues, billing and collection revenues, advertising revenues and commissions." As noted in Response 1235-7, there were no new channels added to the regulated basic (B1) service level as a result of the upgrade. Therefore, there were no new channels for which additional advertising revenues would be generated.



The County requested Comcast to provide the projection of ancillary revenues as a result of the upgrade again in RFI #2, question 10 where the County asked "The instructions do not limit the ancillary revenues to those resulting from new channels added to the system, but rather to the 'net increase and decrease in ancillary revenues.'" Comcast responded in part by stating:

The number of channels comprising the B1 tier after the rebuild did not change. Therefore, there are no new ancillary revenues associated with the system upgrade.... The instructions to the RFI are inconsistent with what the Form 1235 requires and what the FCC has stated is required by the Form.

Comcast has at this point still provided no projection of ancillary revenues attributable to any tier of service including the Basic Service tier (B1).

Comcast has likewise ignored the FCC instructions and precedents with regards to the projection of plant operating and support increases and decreases as a result of the upgrade. The original submission by Comcast included a zero amount for each of these line items. The County asked Comcast in RFI #1, question 14:

Please provide any analyses, studies of similar investigations which Comcast undertook with respect to the projected "Change in Plant Related Operating Expenses" and "Change in Plant Related Support Expenses" for inclusion on its Form 1235.

Comcast responded:

Comcast continually reviews and benchmarks its technical operating expenses through its budgeting and monthly financial review process. **The rebuilt plant is more stable and has reduced the labor time spent on customer quality and reliability issues.** At the same time, the rebuilt plant has allowed Comcast to deploy better, more advanced and more complicated products to our customers. These new products are more sensitive to minor disruptions in signal strength, increasing the need for more rigorous maintenance schedules. **Our current analysis shows that the rebuild has allowed Comcast to redirect its Line/System tech to higher level node "tuning" type activities and away from issues of hard line cable integrity and Amp cascade adjustments.** The amount of labor required to manage the plant is essentially the same as it was prior to the completion of the upgrade project. Comcast is now able to use its existing workforce to provide more services, better services and more advanced services to our customers. (emphasis added)



Two points are evident from this response: (1) quality and reliability costs have decreased and (2) Comcast made NO study of these costs as part of its submission of the Form 1235 filing.

The County again asked Comcast to provide support for the inclusion of zero (0) on these line items in RFI #2, questions 14 and 15. Comcast responded:

Comcast has not performed any analysis to isolate the change in Operating and Support Costs associated with the rebuild. As noted in Responses to RFI 2-15, Comcast is spending considerably more to maintain the plant, although, operating costs have remained at a constant level. Maintenance expenses have increased from \$831,000 in 2000 to \$2,600,000 in 2003 and estimated \$3,100,000 in 2004. Total net labor costs for the system were \$10,800,000 in 2000 and will be approximately \$10,600,000 in 2004. (emphasis added)

While it is clear Comcast possesses the required data, Comcast confirmed that it did not prepare any analysis in support of its filing.

Comcast was also asked to support its inclusion of zero on the Form 1235 with respect to "Other Cable Revenues." In RFI #1, question 9, the County asked:

Please provide the actual and estimated "Other Cable Revenues" (e.g., advertising revenues, leased access revenues, etc.) over the life of the plant categories shown on Worksheet C of the Form 1235.

Comcast responded:

There are no revenues of this type to be included in the Form 1235 filing. The instructions to the Form 1235 filing state "Line 10 – Other Cable Revenues. Include the projected annual net increases or decreases in ancillary revenues due to the implementation of the upgrade, such as leased commercial access revenues, billing and collection revenues, advertising revenues and commissions." As noted in Response 1235-7, there are no new channels added to the regulated basic (B1) service level as a result of the upgrade. Therefore, there were no new channels for which additional advertising revenues would be generated.

The county also followed up on this response in RFI #2, question 10 but Comcast again failed to produce any of the data requested. Like with the operating and support expenses, Comcast has confirmed that it did not prepare any analyses in support of its filing with regards to these two areas.



III (D). Identified Issues

FRC has identified several issues with the Form 1235 as filed by Comcast. The issues related to both the manner in which Comcast filed the Form 1235 and resulting potential revenues that Comcast will receive over the life of the upgrade. Overall, Comcast has prepared a filing that, based on the information available to FRC from the public domain, FRC reasonably projects will over-recover the fair and reasonable allocation of the revenue requirements related to this upgrade from the Basic Service Tier. Comcast has provided no information which refutes this conclusion. FRC estimates this over recovery will allow Comcast to earn a return on the allocated investment far in excess of a presumptively reasonable return of 11.25 percent.

Additionally, FRC estimates that Comcast should be expected to over recover its cost of the upgrade from other video services like CPST.

The identified issues are:

- Comcast has not eliminated the historical embedded investment in the cost of the physical facilities being recovered in the current Basic Service Tier rate;
- Comcast has not included the necessary offset in its determined rate base for accumulated depreciation and accumulated deferred income taxes;
- Comcast has not considered the necessary reduction in its rate base due to the accumulation of depreciation and deferred income taxes over the useful life of the facilities;
- Comcast has not included any interest expense in determining its income tax gross-up;
- Comcast has not analyzed nor directly allocated upgrade investment that is not used by the Basic Service Tier services;
- Comcast has not considered subscriber growth, and the related increase in revenues, over the life of the upgraded facilities;
- Comcast has not included the required plant maintenance, support and other revenue offsets in its filing; and
- Comcast has not properly assigned/allocated its revenue requirements to the Basic Service Tier based on the actual benefits received from the upgrade by the Basic Service Tier.



Each of these issues will be discussed below.

III (D) (1). Embedded Investment

The current benchmark and cost-of-service rate methodology for setting the underlying Basic Service rate is meant to allow the operator to recover its expenses and embedded investment dedicated to Basic Service. The Form 1235 instructions do not address the embedded investment as the embedded investment is already being recovered in the Basic Service rate by the Form 1240. The operator should account for part of the upgrade costs as offsets to retired assets which are removed from service because of the upgrade. Allowing the operator to include the full amount of the upgraded investment without offsets to the pre-existing embedded investment will allow the operator to over recover in the combined Basic Service rate and the Form 1235 add-on rate.

The FCC has addressed the issue of the embedded investment in a recent Falcon Cable Systems Order (DA 99-237) in San Luis Obispo, CA. The FCC stated:

The benchmark system presumes that the rate charged allows recovery of capital costs. Therefore, the subtraction of retired assets on an actual costs basis is appropriate. (footnote omitted)

Comcast in response to the County second RFI, question 12 stated:

As noted in response 1235-11, RFI #1, approximately \$31.3 million in assets have been removed from the respective general ledger accounts in connection with the old cable system that we wrecked out during the rebuild project. These assets were fully depreciated and did not have any salvage value.

Based on Comcast's response and the FCC precedent in the San Luis Obispo Order, FRC recommends that the \$84 million investment be reduced by the \$31.3 million retirement of the old system. Based on the FCC precedent, the current Basic Service rates already include a recovery of this \$31.3 million investment.

III (D) (2). Rate Base Offsets

Capital costs are the largest single component of the revenue requirements determined from the Form 1235. The proper identification of the components of the Rate Base needs to be explicitly identified in order to allow the cable operator to gain only a *return on and of* the qualified capital investments over the life of the upgrade.

The FCC has stated in the San Luis Obispo Order:



Although the FCC Form 1235 is a streamlined form, it is still based on cost of service principles. (DA 99-237, ¶ 7)

General cost of service principles require the regulated entity to offset the gross book value of the investment by the accumulated depreciation reserve and also accumulated deferred income taxes.

The FCC has recognized the problem with respect to the inclusion of the accumulated depreciation reserve in its June 2002 Notice of Proposed Rulemaking (FCC 02-177) where it states:

We also propose to modify the FCC Form 1235 so that rate base recoveries will be limited to an operator's average upgrade investment over the life of the upgrade rather than its total investment over the life of the upgrade. Although the rate form currently permits operators to earn a rate of return on their total upgrade investment throughout the life of the upgrade, operators are also allowed to recover depreciation expenses annually. As a result, operators have been able to continue recovering a rate of return on investment that has already been recovered through depreciation.

Based on this recognition and general cost of service principles, any funds provided by the ratepayer (*i.e.*, depreciation expense) or provided by other sources (*i.e.*, deferred income taxes) should be included as reductions to the rate base on which Comcast is entitled a *return on and of*.

Comcast, because of this new investment, is able to utilize the income tax benefits of the IRS regulations in order to reduce its income tax expenses. The source of this income tax benefit is the acceleration of the depreciation expense for income tax purposes. The IRS regulations allow the operator to use significantly more depreciation expenses (tax depreciation) than what the company reports for financial statement purposes (book depreciation). As the ratepayer is paying rates based on the book depreciation expense, the accumulated benefits that the operators receive from the IRS regulations must also be reduced from the net investment before the *return on* calculation is completed.

Over the useful life of the investment, the accumulated deferred income taxes will net to zero, as in the later years, the tax depreciation expense is less than the book depreciation expense. As this occurs, the operator has to pay additional taxes to the IRS for which the operator gains the benefit in the early years. The calculation of the accumulated deferred income tax must be made by taking the difference between tax and book depreciation and multiplying that difference by the combined federal and state income tax rate. That result is then added to the accumulated balance which is subtracted from the net investment. The accelerated tax rates used for income tax purposes were provided by Comcast in response to RFI 2-11.



Additionally, Comcast's predecessor in interest began this upgrade in 1998 and Comcast finished the upgrade in 2002. As the plant was being activated in steps, the upgraded investment should have been closed to plant in service from an accounting perspective. Therefore, Comcast should have been depreciating the investment since 1998 and the net investment as of year end 2003 would not be the gross investment of \$84.4 million. The revised Form 1235 calculates the net investment as of December 2003 for determining the Form 1235 add-on rate.

III (D) (3). Useful Life

Comcast will over-recover its costs of the upgrade over the useful life of the upgrade unless the calculation is modified to consider the useful life of the investment.¹ The Form 1235 allows the operator to assign a portion of the upgrade investment (and associated expenses including a return on investment) and add the resulting rate to the Basic Service tier over the useful life of the upgrade. Comcast has claimed a 12 year useful life of this upgrade. With this long depreciable life, Comcast is allowed to recover its *return of* (operating expenses, depreciation and income taxes) and *return on* (return on investment – rate of return).

The revenue requirements calculated for each year of the useful life are necessary for Comcast to be prevented from over-recovering costs from the Basic Service subscriber. For example, the revenue requirement for Basic Service decreases from almost \$1.3 million in 2003 to just over \$100 in 2014. If Comcast's filing approach of using just the first year revenue requirements was adopted, Comcast would recover 12 times the \$1.3 million for Basic Service or approximately \$15.6 million when it only needs to recover approximately \$8.4 million from Basic Service. Using Comcast's approach, Comcast would over-recover from the Basic Service subscriber \$7.2 million (approximately \$32 per subscriber).

FRC believes that in addition to calculating the revenue requirements over the entire useful life of the facilities, the revenue requirements need to be net present valued in order to develop a rate applicable to the Basic Service tier over the entire useful life. The calculation methodology is shown on the revised Form 1235 attached to this report.

III (D) (4). Interest Expense

The calculation of the revenue requirements under cost-of-service ratemaking typically allows the entity to consider income taxes on the return element. Income taxes are based

¹ The FCC has recognized this problem in its NPRM MB 02-144 ¶37)



for a corporation on the earnings of the corporation after operating expenses including depreciation and interest expenses. Cost-of-service attempts to set rates on a prospective basis, therefore, the typical approach used by regulators is to assess income taxes based on the projected earnings of the corporation, expressed as a percentage return on the equity (book value, not including debt) of the entity. In the case of the Form 1235, the FCC has set and Comcast has used the overall rate of return on equity and debt at 11.25%. The individual debt and equity components of the rate of return are not known.

In order to properly assess the return component, the operator must be able to determine the amount of the return component subject to income taxes. The FCC has faced a similar problem on the income tax gross-up in its Form 1205. The Form 1235 does not follow that same methodology. Instead the Form 1235 asks the operator to identify the interest expense associated with the upgrade. Comcast has not included any interest expense under the pretext that Comcast has not incurred any new debt associated with the upgrade. Comcast's response to RFI #1, question 13 was:

Comcast did not specifically incur any bank debt or use other means of financing, to fund the Montgomery County upgrade project. The funds used for this project were provided by Comcast as part of the annual capital budget for the Montgomery County system. Therefore, we did not include any interest expense in the Form 1235 rate-base calculation.

This approach leads to Comcast requesting essentially an all equity return being grossed-up for income taxes. This allows Comcast to gain an above-average return when it has significant debt leverage. FRC has included interest expense consistent with the income tax gross-up used in Comcast's Form 1205 (*i.e.*, 1.944% of net assets). In this way Comcast is only allowed to get an income tax gross-up for the non-debt portion of its capital structure.

III (D) (5). Direct Assignments

In response to the County's RFI #2, question 1, Comcast provided the County with a CD containing the entire individual accounting entries related to the upgrade in the County. While this CD² did not contain all of the invoices as some of the construction was completed by the previous owner, it did provide useful information regarding the Comcast construction. The County asked its outside engineers, Columbia Telecommunications Corporation (CTC), to review this data to be sure that Comcast did not include in the \$84.4 million of construction costs any inappropriate costs. CTC's review was limited to a review of this initial CD and the information contained on it.

² Comcast submitted a second CD but FRC is unable to determine if this second CD is additional data augmenting the first CD or redundant data contained on the first CD. Therefore, FRC has not analyzed this second CD in order to be conservative in the direct assignment recommendation.



CTC was able to determine that Comcast has included the following items that FRC has determined should be directly assigned. Those items are:

<i>Item</i>	<i>Amount</i>
I-Net Construction (Labor)	\$779,214
Tap Audit (Labor)	\$2,277,246
Materials – I-Net	\$118,864
Materials – Reverse Equalizers	\$105,954
Total	\$3,281,278

Based on these identified amounts, FRC has directly assigned these costs included in the \$84.4 million to the “all other category” as they are not used and useful in providing Basic Service. The analysis done by CTC did not involve all of the accounting entries comprising the \$84.4 million. If the County had been provided all of that information, the amount of the direct assignment would arguably have been greater. For example, CTC has noted that it could not identify any labor costs specific to the return path facilities (cable modem and digital services) but is sure that there are real labor costs associated with the return path. FRC believes that the CTC determination is very conservative and could be much larger if FRC and CTC were able to get access to all of the accounting data for the 1998 and 1999 construction efforts.

III (D) (6). Customer Growth

Comcast has not provided any projection of customer growth over the useful life of the upgrade. Exclusion of any projection of customer growth will allow Comcast to over-recover its costs of the upgrade. Since 2001, the County has experienced population growth at about 1.5% per year and Comcast has increased its homes passed by a similar amount over the same period. While subscriber growth has not followed that trend, FRC believes it is reasonable that as Comcast improves its competitive position and offers new advanced services, that subscriber growth will increase. FRC believes that a 0.5% per year growth rate is reasonable over this 12 year period and has included that in the analysis.

III (D) (7). Allocation to the Basic Service Tier

The allocation of common costs among the service categories in cost-of-service filings is a controversial issue. The Form 1235 allows for the assignment of direct costs to service tiers but Comcast did not directly assign any costs. The allocations have historically been done on the number of 6 MHz channels available in the upgraded system. The use of a channel allocation basis may not reflect the real benefits that each service tier receives from the upgrade.

Comcast has used a ratio of the number of 6 MHz channels on Basic Service and Cable



Programming Service to the total number of 6 MHz channels available on the upgraded system. While this methodology has been approved by the FCC in some very early Form 1235 decisions, FRC believes that this allocation method may not be the best basis in the current environment. Subscribers and local authorities both are concerned that the only apparent benefit to the Basic Service subscriber is some hypothetical benefit of increased reliability and picture quality. Comcast has assigned to the Basic Service approximately 28 percent of the overall revenue requirements. This 28 percent assignment appears to significantly outweigh the reliability and quality increases.

FRC believes a weighted allocation basis should be based on: (1) 50 percent on the number of 6 MHz channels available on the system and (2) 50 percent on the number of incremental 6 MHz channels added to the system as a result of the upgrade. Using this weighted basis should allow the Basic Service subscribers to pay for the reliability and quality suggestions and also for any increased channels being added to Basic Service.

Further, the Form 1235 as currently configured assumes the allocation to Basic Service will remain static over the life of the upgrade. Basic Service could increase or decrease in size based on the wishes of Comcast and, if not reflected in the revised allocation basis, could lead to an over-recovery of the upgrade if Basic Service is reduced. FRC recommends that the County specifically reserve its rights to lower the Form 1235 add-on rate to the extent Comcast reduces the number of Basic Service channels below the current level of 35 channels.

III (D) (8). Plant Maintenance, Support and Other Revenue Offsets

As the Form 1235 filing made by Comcast will be added on to the yearly recalculation of the Basic Service rate, the filing needs to include a projection of increased to decreased operating costs of the life of the upgrade. Comcast as described in § III (C) above did not include the required projections.

The instructions to the Form 1235 required Comcast to project incremental/decremental plant operation and support expenses caused by the upgrade.³ These costs are supposed to be calculated over the useful life of the upgrade and present-valued back to year 1. Because Comcast did not comply with the Form 1235 instructions and providing the necessary supporting data, FRC has estimated these cost savings using the best available information. FRC projects that Comcast has saved approximately \$940,000 from 2000 through 2004, using the general CPI increases from the Bureau of Labor Statistics.⁴ FRC believes that there are additional savings for the basic service tier as Comcast has admitted that efforts are being re-directed to the advanced services away from the basic service tier (see response to RFI #2, question 15). FRC has included the conservative

³ See instructions for lines 5, 6 and 10 of the Form 1235 Instructions.

⁴ See inflation calculator on www.bls.gov. Calculation made as of September 2004.



estimate of \$940,000 in its revised Form 1235.

The Form instructions require Comcast to offset from the revenue requirements any additional sources of revenues projected to be received by Comcast. The primary source of such revenue offsets are advertising sales. Comcast suggests that they will experience virtually no additional advertising sales because no new channels were added to Basic Service. Comcast will in all likelihood experience increased advertising sales from the current Basic Service line-up over the life of the facilities and will therefore be over-recovering its costs from the Basic Service subscriber. FRC has been provided with no information from Comcast in support of inclusion of zero advertising revenues on the Form 1235. FRC has used the best available information in order to project additional Other Cable Revenues over the life of the upgrade. FRC reviewed Comcast's reports on the total other cable revenues from January, 2000 through June, 2002. Comcast has experienced an annual growth rate in this category of 7.72% per year. FRC did not have access to this information by tier of service. FRC has projected that the Other Cable Revenues will grow at this 7.72% over the life of the upgrade resulting in an annual increase of \$430,183 in the first year of the upgrade.

IV. Results

Based on the issues identified in § III above, FRC has recomputed the impact of each adjustment. The FRC recomputed results are:

<i>Issue</i>	<i>As Filed / As Adjusted</i>	<i>Change</i>	<i>FRC Adjusted</i>
Embedded Investment	\$2.42	(\$0.90)	\$1.52
Rate Base Offsets	\$1.52	(\$0.46)	\$1.06
Useful Life	\$1.06	(\$0.22)	\$0.84
Interest Expense	\$0.64	(\$0.02)	\$0.62
Direct Assignments	\$0.62	(\$0.04)	\$0.58
Customer Growth	\$0.58	(\$0.01)	\$0.57
Plant Operating & Support	\$0.57	(\$0.10)	\$0.47
Other Cable Revenues	\$0.47	(\$0.09)	\$0.38
Allocation to Basic Service	\$0.38	(\$0.19)	\$0.19

For example, Comcast filed for a Basic Service increase of \$2.42; by just eliminating the Embedded Investment in the calculation, FRC computes a reduction of \$0.90 resulting in a revised rate for Basic Service of \$1.52. Taking the revised \$1.52 and including the recommended rate Base Offsets, FRC computes a reduction of \$0.46 resulting in a revised Basic Service rate of \$1.06.



Based on these analyses, FRC recommend that the MPR for the Form 1235 be set at \$0.19. Attachment A to this report contains the summary pages for Form 1235 resulting in the \$0.19 MPR.

V. Recommendations

FRC recommends that the County issue a rate order that:

- Revises the MPR generated by the Form 1235 from \$2.42 to a new MPR of \$0.19; and
- Sets the recovery period to begin January 1, 2005 through December 31, 2016.

Montgomery County FCC Form 1235

Summary for BST

Revenue Requirement Calculations	2003	2004	2005	2006	2007	2008	2009	2009	2010	2011	2012	2013	2014
1. Rate Base													
a. Gross Plant, Property & Equipment	\$ 6,981,473	\$ 6,981,473	\$ 6,981,473	\$ 6,981,473	\$ 6,981,473	\$ 6,981,473	\$ 6,981,473	\$ 6,981,473	\$ 6,981,473	\$ 6,981,473	\$ 6,981,473	\$ 6,981,473	\$ 6,981,473
b. Accumulated Depreciation	\$ 2,020,500	\$ 2,602,290	\$ 3,104,079	\$ 3,763,869	\$ 4,347,658	\$ 4,929,448	\$ 5,511,237	\$ 6,093,026	\$ 6,674,815	\$ 7,256,604	\$ 7,838,393	\$ 8,420,182	\$ 9,001,971
c. Accumulated Depleted Income Taxes	\$ 1,968,204	\$ 1,892,171	\$ 1,822,029	\$ 1,751,887	\$ 1,681,745	\$ 1,611,603	\$ 1,541,461	\$ 1,471,319	\$ 1,401,177	\$ 1,331,035	\$ 1,260,893	\$ 1,190,751	\$ 1,120,609
d. Net Rate Base	\$ 3,022,771	\$ 3,270,014	\$ 2,674,696	\$ 2,102,942	\$ 1,622,919	\$ 1,142,891	\$ 662,739	\$ 187,109	\$ 280,221	\$ 377,361	\$ 474,511	\$ 571,661	\$ 668,811
2. Return on Investment													
a. Rate of Return Percentage	11.23%	11.23%	11.23%	11.23%	11.23%	11.23%	11.23%	11.23%	11.23%	11.23%	11.23%	11.23%	11.23%
b. Computed Return on Upgrade Rate Base (Line 1d x Line 2a)	\$ 437,937	\$ 367,077	\$ 300,923	\$ 236,693	\$ 184,570	\$ 132,448	\$ 74,367	\$ 21,199	\$ 31,463	\$ 42,311	\$ 53,160	\$ 64,008	\$ 74,857
3. Allowance for Income Taxes													
a. Federal Income Tax Rate	35.00%	35.00%	35.00%	35.00%	35.00%	35.00%	35.00%	35.00%	35.00%	35.00%	35.00%	35.00%	35.00%
b. State Income Tax Rate	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%
c. Computed Return on Upgrade Rate Base (Line 2b)	\$ 437,937	\$ 367,077	\$ 300,923	\$ 236,693	\$ 184,570	\$ 132,448	\$ 74,367	\$ 21,199	\$ 31,463	\$ 42,311	\$ 53,160	\$ 64,008	\$ 74,857
d. Interest Expenses Related to Upgrade (Worksheet A, Line 9a)	\$ 80,937	\$ 68,693	\$ 56,449	\$ 44,205	\$ 31,961	\$ 19,717	\$ 7,473	\$ 4,914	\$ 2,355	\$ 1,806	\$ 1,257	\$ 7,000	\$ 1,750
e. Distribution (Non-C Corp. Filers Only)													
f. Contributions (Non-C Corp. Filers Only)													
g. Return Amount Subject to Income Tax	\$ 356,900	\$ 298,071	\$ 244,474	\$ 192,488	\$ 142,609	\$ 90,681	\$ 66,894	\$ 47,226	\$ 29,008	\$ 20,505	\$ 12,853	\$ 6,258	\$ 5,100
h. Income Tax Allowance	\$ 233,598	\$ 196,191	\$ 160,476	\$ 126,232	\$ 97,322	\$ 74,458	\$ 52,321	\$ 37,052	\$ 22,652	\$ 15,711	\$ 9,677	\$ 4,979	\$ 3,975
4. Projected Net Impact of Upgrade on Operating Expenses													
a. Plant Related Operating	\$ (131,600)	\$ (130,400)	\$ (143,907)	\$ (152,343)	\$ (157,961)	\$ (167,939)	\$ (176,237)	\$ (184,433)	\$ (192,629)	\$ (200,825)	\$ (209,021)	\$ (217,217)	\$ (225,413)
b. Plant Related Support													
c. Depreciation Expense	\$ 381,790	\$ 381,790	\$ 381,790	\$ 381,790	\$ 381,790	\$ 381,790	\$ 381,790	\$ 381,790	\$ 381,790	\$ 381,790	\$ 381,790	\$ 381,790	\$ 381,790
5. Net Revenue and Income Adjustments Related to Upgrade (Worksheet A, Line 12a)	\$ (60,236)	\$ (64,072)	\$ (67,882)	\$ (71,719)	\$ (75,579)	\$ (79,456)	\$ (83,351)	\$ (87,274)	\$ (91,225)	\$ (95,204)	\$ (99,211)	\$ (103,246)	\$ (107,309)
Upgrade Revenue Requirement	\$ 1,061,439	\$ 942,005	\$ 826,197	\$ 717,093	\$ 626,689	\$ 540,466	\$ 464,619	\$ 398,260	\$ 341,910	\$ 292,904	\$ 250,390	\$ 214,467	\$ 183,423

Part III - Allocation of Upgrade Revenue Requirement to Basic Service Tier

	2003	2004	2005	2006	2007	2008	2009	2009	2010	2011	2012	2013	2014
1. Upgrade Revenue Requirement * (Part II, Line 8)	\$ 1,061,439	\$ 942,005	\$ 826,197	\$ 717,093	\$ 626,689	\$ 540,466	\$ 464,619	\$ 398,260	\$ 341,910	\$ 292,904	\$ 250,390	\$ 214,467	\$ 183,423
2. Number of Subscribers	219,763	220,862	221,966	223,070	224,174	225,278	226,382	227,486	228,590	229,694	230,798	231,902	233,006
3. Annual Revenue Requirement Per Subscriber (Line 1 / Line 2)	\$ 4,830	\$ 4,266	\$ 3,728	\$ 3,215	\$ 2,794	\$ 2,398	\$ 2,047	\$ 1,738	\$ 1,478	\$ 1,261	\$ 1,078	\$ 924	\$ 787
4. Monthly Network Upgrade Add-on (Line 3 / 12) - Maximum allowed rate	\$ 400	\$ 355	\$ 311	\$ 268	\$ 233	\$ 199	\$ 170	\$ 145	\$ 123	\$ 105	\$ 89	\$ 77	\$ 65
Levelized Fixed Charge Calculation													
1. Discount Rate	5.00%												
2. Present Value Factor (PV)	1.0000	0.9234	0.8700	0.8208	0.7752	0.7329	0.6937	0.6574	0.6238	0.5927	0.5639	0.5364	0.5102
3. Total System Inter. Cost Per Basic Sub Per Month	\$ 400	\$ 355	\$ 311	\$ 268	\$ 233	\$ 199	\$ 170	\$ 145	\$ 123	\$ 105	\$ 89	\$ 77	\$ 65
4. PV - Total Cost / Sub / Mo. by Year	\$ 400	\$ 328	\$ 282	\$ 241	\$ 204	\$ 171	\$ 141	\$ 114	\$ 93	\$ 77	\$ 64	\$ 53	\$ 44
5. Net Present Value - Total Cost / Sub / Mo	\$ 1,750	\$ 1,425	\$ 1,100	\$ 775	\$ 450	\$ 125	\$ 150	\$ 275	\$ 400	\$ 525	\$ 650	\$ 775	\$ 900
6. PV Factor	0.9868												
7. Levelized Total System Inter. Cost / Sub / Month	\$ 400	\$ 355	\$ 311	\$ 268	\$ 233	\$ 199	\$ 170	\$ 145	\$ 123	\$ 105	\$ 89	\$ 77	\$ 65