

ATTACHMENT A

**A RESOLUTION TO ADOPT THE ACTION AUDIT
TIME WARNER CABLE RATE REPORT
Resolution No. 86/2004-05**

Whereas, the Board of Aldermen has reviewed the Action Audit Time Warner Cable Rate Report.

Now therefore be it resolved that the Board of Aldermen adopts the report as its own.

Action Audits, LLC

Town of Carrboro Review of Time Warner Cable's 2005 FCC Forms 1240,1235 and 1205 Rate Filing

December 3, 2004

REPORT

TO: Steven E. Stewart, Town Manager

FROM: Robert Sepe, President

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

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

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

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

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

**A Review of Time Warner Cable's 2005
FCC1240, FCC1235 & FCC1205
Rate Filing Seeking Approval to Set New Rates
for Regulated Cable Services
in the Town of Carrboro**

**Federal Community Unit
Identification Number:
NC0130**

December 3, 2004

FINDINGS

Time Warner Cable's FCC Cable Rate Filing: On September 30, 2004, Time Warner Cable (TWC) submitted a form FCC1240-Basic Cable Service Tier to set a new regulated rate for basic cable service. It requested to continue the rate set in its initial Federal Communications Commission (FCC) form 1235-Abbreviated Cost of Service Network Upgrade Charge filed five years ago. TWC also submitted a form 1205-Equipment and Installation Charges to set new regulated rates for equipment rental and installation services. These documents were submitted to the Town for approval.

TWC's *proposed* Maximum permitted rate for the Basic Service Tier (BST) in 2005 is \$11.30. Customers pay the BST plus the "Add-on" Cost of Service Network Upgrade Charge of \$1.15. TWC's proposed monthly combined rate is \$12.75 (see Table 2). The "selected" combined rate is \$12.75.

The next table chronicles changes in the regulated Basic Service Tier (BST) rate.

Table 1

Year	BST Rate	+/-	Delta
2000	\$8.66		
2001	\$10.68	\$2.02	23.33%
2002	\$11.09	\$0.41	3.84%
2003	\$11.76	\$0.67	6.04%
2004	\$11.86	\$0.10	0.85%
2005	\$11.30	(\$0.56)	-4.72%

Table 2

BST - MPR	Up Grade Charge	Combined MPR
\$11.30	\$1.45	\$12.75

TWC reported 4414 current customers and is expected to increase its customer base by year end to 4480 households¹.

¹Form 1240, Module B

The following table shows the proposed selected or 'discounted' Basic Service Tier rate inclusive of the "Add-on" upgrade recovery charge for various communities served by TWC in North Carolina.

Table 3
BST Combined Selected Rates

Community	Price
Apex	\$12.75
Carrboro	\$11.30
Chatham County	\$10.40
Chatham County	\$13.10
Clayton	\$10.80
Durham County	\$13.50
Durham County	\$10.40
Fuquay-Varina	\$11.20
Garner	\$10.50
Hillsborough	\$10.40
Holly Springs	\$11.20
Knightdale	\$10.60
Lumberton	\$8.27
Morrisville	\$11.10
New Hanover County ²	\$6.81
Orange County	\$13.60
Orange County	\$13.30
Oxford	\$10.70
Pittsboro	\$13.50
Raleigh	\$11.55
Smithfield	\$11.20
Wake County: Apex	\$11.10
Wake County: Cary	\$11.20
Wake County: Fuquay-Varina	\$11.10
Wake County: Garner	\$10.60
Wake County: Holly Springs	\$11.10
Wake County: Knightdale	\$10.80

² NHC is served by Time Warner Cable and Charter Communications. Each has a county wide franchise and a requirement to compete for customers in situations where communities want service from the other operator.

Wake County: Morrisville	\$11.10
Wake County: Raleigh	\$10.20
Wake County: Rolesville	\$11.00
Wake County	\$12.60
Wake County: Wake Forest	\$11.00
Wake County: Wendell	\$11.10
Wake County: Zebulon	\$10.30
Wake Forest	\$11.00
Wendell	\$11.10
Wilson	\$12.40
Zebulon	\$10.50
Average Selected Rate	\$11.47

Rationale: The guiding principle of the Cable Act of 1992,³ is to protect subscribers from unreasonable rates by ensuring that cable rate levels are equivalent to rates that would be charged in the presence of effective competition.⁴ Anecdotal evidence of rates examined in six matched pair markets by the GAO⁵ where Cable Operators face true effective wireline competition reveals that rates in these communities are between 15% and 41% lower⁶ than in communities where single providers offer service "at-the-curb." The GAO reported offered that cable operators tend to lower their rates when they face competition from another wireline provider.⁷

The FCC's rate-making process (forms 1240, 1235 & 1205) was originally designed to adjust for defacto monopoly conditions and yield a rate that would be found in the competitive wireline marketplace.

³Specifically, the 1992 Cable Act requires the Commission's regulations "shall be designed to achieve the goal of protecting subscribers of any cable system that is not subject to effective competition from rates for the basic service tier that exceed the rates that would be charged for the basic service tier if such cable system were subject to effective competition." Communications Act, § 623(b)(1), 47 U.S.C. § 543(b)(1)

⁴As the FCC stated in its first rate rulemaking order: "The priority established in the Act is clearly to protect the interests of subscribers. An important focus for both basic tier and cable programming service rates, consistent with providing system operators a fair return, is the establishment of rate levels equivalent to rates that would be charged in the presence of effective competition. The criteria to be applied in setting both basic tier and cable programming service rates include a comparison with 'the rates for cable systems, if any, that are subject to effective competition.'" See Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, 8 FCC Rcd 5631 at para 8 and footnote 10 [April 1993 Report and Order].

⁵Wire-Based Competition Benefitted Consumers in Selected Markets, United States General Accounting Office, February 2004.

⁶GAO Report Highlights, February 2004 at page 1.

⁷GAO Report, February 2004 at page 30.

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

Analysis of the Proposed Rate Adjustments

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

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

The form 1240 Form must be filed with the local franchise authority ninety (90) days before the rates are scheduled to take effect and may be filed no more frequently than annually. The form 1240 rate filing method represents a departure from the quarterly method of updating cable rates, in that it allows cable operators to estimate their future costs for a 12 to 24-month period: this is referred to as the projected period.⁸ The form 1240 allows operators to recover prior period expenses, referred to as the true-up period. If a cable operator incorrectly estimates its costs for a projected period, it must correct those estimates by using the true-up process in the next rate filing.

Inflation Adjustment: In its form 1240 rate filing, TWC applied an inflation factor of 2.84% for the last 9-months of the 2004 true-up period, because that was the official rate published by the FCC.

Franchise Related Expenses(Public Access or I-Net): TWC reported no franchise related expenses for 2005. Franchise related costs incurred by the operator may include such expenses as public, government and education access facilities and equipment, signal transportation, headend accommodations as well as Institutional Network related expenses.

⁸FCC Form 1210 Forms allow for the recovery of past costs, only, not future costs. Future costs are recoverable through the use of the FCC Form 1240 Form only.

Programming Cost Adjustment: TWC will collect for the projected period ~ \$1.02 monthly, per subscriber, during 2005 for anticipated BST external costs, most of which are attributable to programming costs. Various cable operators have advised that program service providers customarily increase service fees annually. TWC attributes its programming cost changes to what it must pay for each service offered. However, this amount is relatively low compared to upper cable tier service programming costs. Some of the BST program services included in the BST service group offered by TWC are obtained at little cost because they are either "must-carry" broadcast television stations, public, government or education access channels or "shop-at-home" services. The exceptions are WGN and News 14 Carolina.

FCC Regulatory Fees: The Federal Communications Commission collects a "Regulatory Fee" from cable operators to fund the FCC's regulatory oversight of cable television matters. Although, remitted to the FCC by the cable operator, the regulatory fee is paid by cable television subscribers.

The FCC permits cable operators to internalize or externalize the regulatory fee. The fee has risen to 70-cents and is collected incrementally (~\$.06/month) from cable television subscribers. These revenues are not subject to franchise fees or other taxes and must be remitted to the federal government to compensate the FCC for the cost of operating the Media Bureau.⁹ An examination of the monthly bills sent to cable customers determined the fee is external to the monthly BST rate, hence it is excluded from the rate treatment process.

If TWC collects the full 6-cents¹⁰ monthly, cable television subscribers will contribute around \$3090¹¹ in regulatory fees to the Federal government during the projected period. There are 67 million cable television subscribers in the United States which pay the annual 70-cent regulatory fee to the Federal Government. This amounts to \$46.9 million annually to fund the FCC's cable television regulatory enforcement activities.

Franchise Fees: The County levies a 5% franchise fee which is "grossed up" to 5.25% on cable program services.

Government Accounting Office Report: Nationally, rate hikes across most viewed cable tiers averaged 6%. However, in markets where there is head-to-head wireline competition, rates are 15% to 41% less than in those markets without competition. GAO report¹² noted that the cost of programming increased 34% during the past three years.

⁹The Cable Service Bureau was folded into the Media Bureau in a recent FCC reorganization.

¹⁰TWC collects 5-cents monthly as observed on subscriber statements.

¹¹~4414 cable customers * \$.70= \$3090

¹²GAO Report Highlights, February 2004 at page 1.

FCC Form 1235 Cable System Upgrade Costs

In 1999, TWC submitted a form 1235 Cost of Service (COS) for the Cable Network Upgrade to justify the \$1.45 fee that is added to the BST MPR, the BST Cost of Service rates.¹³ FCC rules permit cable operators to recover system bandwidth upgrade capital investments for fiber optic cable and related equipment by distributing the costs among the cable tiers, e.g., BST, cable program service tier (CPST), new product tiers (NPT), Other Services, etc.

The FCC's rules allowed the original allocation¹⁴ to be calculated by program service tier. Under this scheme, a 20-channel BST group would occupy 120 MHz of bandwidth, a 35-channel CPST group would occupy 210 MHz of bandwidth and so forth. The original allocation convention **did anticipate** other uses for the cable spectrum.¹⁵

A fundamental principle of the FCC's rate regulation rules is to ensure that the rates for regulated services do not include the costs attributed to unregulated services. For example, under the abbreviated Cost of Service rules for system upgrades, cable operators are required to comply with four conditions before they can charge an additional fee for capital improvements. One such condition is that the operator must comply with the FCC's cost allocation rules **which bar of allocation of costs of unregulated service to regulated services**. This principle is particularly obvious in the Commission's Cost of Service Report and Orders as indicated below.

¹³ May 30, 2003:FCC Form 1235 Cost of Service Filing for Cable Network Upgrades.

¹⁴ Form FCC1235 dated October 1, 2003.

¹⁵See FCC Rule §76.924 Allocation to service cost categories

(e) Allocation to service cost categories.

(1) For cable operators electing cost-of-service regulation, investments, expenses, and revenues contained in the summary accounts identified in paragraph (d) of this section shall be allocated among the Equipment Basket, as specified in §76.923, and the following service cost categories:

(I) Basic service cost category. The basic service category, shall include the cost of providing basic service as defined by §76.901(a). The basic service cost category may only include allowable costs as defined by §§76.922(g) through 76.922(k).

(ii) Cable programming services cost category. The cable programming services category shall include the cost of providing cable programming services as defined by §76.901(b). This service cost category shall contain subcategories that represent each programming tier that is offered as a part of the operator's cable programming services. All costs that are allocated to the cable programming service cost category shall be further allocated among the programming tiers in this category. The cable programming service cost category may include only allowable costs as defined in §76.922(g) through 76.922(k).

(iii) All other services cost category. The all other services cost category shall include the costs of providing all other services that are not included the basic service or a cable programming services cost categories as defined in paragraphs (e)(1)(I) and (ii) of this section.

In its original 1993 Cost of Service Notice of Proposed Rulemaking, the Commission stated:

We also solicit comment on whether we could establish an abbreviated cost of service showing for significant prospective capital expenditures [upgrades] used to improve the quality of service or to provide additional services....The recovery of these costs would also need to comply with our cost allocation requirements, particularly to ensure that **only the costs allocable to regulated services are imposed on subscribers.**¹⁶

In its 1994 Cost of Service Report and Order, the Commission repeats this standard:

Our cost of service requirements seek to exclude from rates any costs that exceed what would have been incurred in a competitive environment or **that are not related to regulated services.**¹⁷

...In the Notice, we sought comment on establishing an abbreviated cost of service alternative for [upgrades]...We stated that any cost recovery must comply with our cost allocation requirements, **to ensure that only the costs allocated to regulated services are imposed on subscribers to those services.**¹⁸

In its 1994 Report and Order, the FCC then established cost allocation categories which separated regulated and unregulated services:

...we are requiring that...cable operators shall allocate costs among the equipment basket and the following service cost categories: basic service, cable programming service, **non-regulated cable programming services, other cable activities and non-cable activities.**¹⁹

¹⁶*In re: Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, Notice of Proposed Rulemaking, MM Docket 92-215, Released July 16, 1993 at ¶75. [1993 Cost of Service NPRM]

¹⁷1994 Cost of Service Order at ¶18

¹⁸*Id.* at ¶280

¹⁹*Id.* at ¶36. (During the time of this Rulemaking, all services except basic and CPST were considered nonregulated services)

(In its 1996 Final Cost of Service Report and Order, the FCC reduced these categories to basic service, cable programming service and “all other” services.²⁰ Basic and cable programming service tiers were the regulated service tiers at that time.)

In its 1994 Cost of Service Report and Order, as part of its specific discussion of upgrade cost of service filings, the FCC reiterated the separation of regulated from unregulated cost principle:

To justify an increase in the rates for regulated services, the operator will be required to demonstrate that the capital investment actually will benefit subscribers through improvements in the regulated services subject to the rate increase. **This requirement will help assure that operators do not abuse the abbreviated filing option by requiring regulated service customers to pay higher rates to fund upgrades that actually only benefit other services.**²¹

And fifth, as we said in the Notice, the operator must also allocate the net increase in costs in conformance with the cost allocation rules for cost of service showing, **to assure that only costs allocable to regulated services are imposed on subscribers of those services.**²²

In its 1996 Final Cost of Service Order, the Commission reiterated this principle:

As noted, the interim rules also allow the operator to recover all operating expenses normally incurred by cable operators in the provision of regulated cable service. **An operator may not recover through regulated rates other expenses, such as costs associated with non-regulated service, lobbying expenses or club memberships.**²³

In this same Order, the Commission specifically clarified the requirement that costs attributed to cable plant in service must be allocated between current regulated and unregulated services.

²⁰*In re: Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service*, MM Docket 93-215, Second Report and Order, First Order on Reconsideration, and Further Notice of Proposed Rulemaking, Released January 26, 1996 at ¶121. [1996 Final Cost of Service Order]

²¹1994 Cost of Service Order at ¶287.

²²*Id at* ¶290.

²³1996 Final Cost of Service Report and Order at ¶11.

The Commission also clarifies that plant in service **must be allocated between regulated and unregulated services based on a reasonable measure of the current usage of that plant.**²⁴ ... Accordingly, for our final rules, we will make this point explicit and will amend the interim rule to specify that **tangible plant must be used and useful in the provision of regulated cable services in order to be included in the rate base. This will ensure that the rate base for regulated cable service only includes plant used for such regulated cable service, and that subscribers to regulated tiers are not forced to subsidize plant that is used solely for premium services.**²⁵

In addition, we recognize that what constitutes a reasonable measure of current usage of the tangible plant depends on the circumstances. We believe that in many cases a reasonable measure would be a straight channel ratio. In other words, if any operator provides programming over a total of 40 channels, 32 of which are BST and CPST channels and eight of which are premium and pay-per-view channels, the operator must allocate 80% of its plant to regulated cable service and 20% to unregulated service.²⁶

TWC proposes to continue to charge the same \$1.45 monthly fee set five years earlier on form 1235 to recover Network Upgrade costs. The “upgrade” charge is added to the BST-MPR to create the combined Maximum Permitted BST regulated rate (See Table 2). Cable operators, such as TWC, believe that once the initial rate is set, it never changes nor is ever adjusted, for example, to reflect customer growth during the intervening 5-years.

There is nothing in the FCC’s cost of service rules, rulemakings, or the 1235 instructions, which state that the form 1235 is filed “only once” and that the “add-on” rate calculated at that point in time continues in perpetuity. In fact, such action contradicts the FCC’s general cost of service rules which proceed on the basis of annualized revenues and expenses and require revaluations for accumulated depreciation. The “only” item which is filed once is the final cost of the upgrade. The FCC’s cost of service rules require that this capital expense become the starting point for the recovery of these costs, and that going forward the factors which vary include the proportion of cable system bandwidth used for regulated and unregulated services, and the customer count. The principle underlying the cost of service rules is to ensure that regulated cable service

²⁴*Id.* at ¶37.

²⁵*Id.*

²⁶*Id.* at ¶38

subscribers are not paying for unregulated service costs. The rules are designed to “exclude from [regulated] rates, any costs that exceed what would have been incurred in a competitive environment or that are not related to regulated services.”²⁷ Costs are therefore allocated between regulated and unregulated services, so that regulated subscribers are not charged for benefits they do not receive.²⁸ Costs are divided into three categories “basic service (BST),” “cable programming service (CPST),” and “all other,”²⁹ the latter two which now represent unregulated services.

Because the largest portion of an operator’s rate base is its plant in service, the FCC developed a “used and useful” standard to ensure that regulated subscribers pay for only those portions of plant that are used and useful in the provision of regulated cable services.³⁰ If a cable operator chooses to recover its investment in such used and useful plant, it must remove from the rate base any accumulated depreciation,³¹ in addition to which the FCC provided depreciation schedules.³² Plant determined not “used and useful” is deemed “excess” capacity, and operators are only permitted to include excess capacity in the ratebase “if it is fully constructed plant that will be used to provide *regulated* services within 12 months.”³³

TWC was not required to file a form 1235, but it chose to do so to overcome the capital recovery ceiling imposed by federal government pursuant to the “Social Contract.”³⁴ Because TWC included upgrade capital expense recovery (the form 1235 “Add-on” charge) as

²⁷See 1994 Report and Order at ¶18, page 10.

²⁸“As noted, the interim rules also allow the operator to recover all operating expenses normally incurred by cable operators in the provision of regulated cable service. An operator may not recover through regulated rates other expenses, such as costs associated with non-regulated service, lobbying expenses, or club memberships. 1996 Cost of Service Final Report and Order at ¶11.

²⁹See 1996 Cost of Service Final Report and Order at ¶121, page 50. This is a reduction from the 5 categories created in the 1994 Report and Order: “BST”, “CPST” “non-regulated cable programming service”, “other cable activities” and “non-cable activities.”

³⁰See 1994 Report and Order at ¶26

³¹See 47 CFR 76.922 (6)(I)

³²See 1994 Cost of Service Report and Order, Attachment B, 1996 Cost of Service Final Report and Order, Attachment C.

³³See 1996 Cost of Service Final Report and Order at ¶26.

³⁴See Time Warner Social Contract, FCC 95-478 at ¶1-5. The FCC adopted the Social Contract on November 30, 1995 to provide rate stability, improve the quality of cable service, and provide TWC incentive to upgrade its cable systems and make other improvements. Under its terms, Time Warner was to invest \$4 billion to upgrade its domestic cable systems over the life of the Social Contract and any such investment recovery was capped at \$1 per year (cumulative to \$180/customer) over its 5-year term. In addition, the Social Contract was to resolve over 900 rate cases against TWC and approximately \$4.7 million plus interest to TWC customers.

part of its 2005 rate filing, TWC must file this form consistent with the FCC's cost of service rules. These rules assume the cable plant will be properly revalued for accumulated depreciation, and that projected operational costs, bandwidth allocations, and number of regulated service subscribers reflect the operator's most recently completed fiscal year.

For this reason, the consultant has concluded that the upgrade capital expense recovery charge proposed by TWC does not comply with the FCC's cost of service rules and the ratemaking process for regulated rates.

FCC1205 Equipment & Installation Rates

Time Warner calculated the form 1205 maximum permitted equipment³⁵ and installation³⁶ rates by aggregating its costs across all TWC systems in the USA; this type national filing is permitted by the FCC. The 2001 year costs were aggregated on a regional basis.³⁷

Table 4

Year	HSC	+/-	%
2001	\$28.39		
2002	\$35.83 ³⁸	\$7.44	26.21%
2003	\$37.62	\$1.79	5.00%
2004	\$37.50	\$-0.12	-0.32%
2005	\$37.81	\$0.31	0.83%

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

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

³⁷Time Warner is treated as a single company for FCC 1205 rate-making purposes. TWC files a single FCC 1205 throughout the United States with over 3000 local franchise authorities, LFAs, to establish uniform rates for equipment and installation charges.

³⁸Company-wide national USA aggregation ~ 3000 franchises

Time Warner calculated the form1205 maximum permitted equipment³⁹ and installation⁴⁰ rates by aggregating its costs across the USA. Time Warner has not aggregated on a regional basis since 2001.⁴¹

The following table chronicles changes in form1205 equipment and installation rates since 2001.

Table 5

FCC1205	2001 NC	2002 USA	2003 USA	2004 USA	2004 USA	Delta
Remote Control	\$0.28	\$0.35	\$0.35	\$0.34	\$0.33	(\$0.01)
Addressable 1	\$4.26	\$8.49	\$7.34	\$7.99	\$8.82	\$0.83
Non-addressable 2	\$0.93	\$0.68	\$0.59	\$0.68	\$0.76	\$0.08

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

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

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

⁴¹Time Warner is treated as a single company for FCC 1205 rate-making purposes. TWC files a single FCC 1205 throughout the United States with over 3000 local franchise authorities, LFAs, to establish uniform rates for equipment and installation charges.

Table 6

Average Hours* per Installation	2001 NC	2002 USA	2003 USA	2004 USA	2005 USA	Delta	
Un-wired Home Installation	0.96	1.20	1.22	1.26	1.16	-0.10	-10.42%
Pre-wired Home Installation	0.84	0.85	0.85	0.88	0.77	-0.11	-13.10%
Additional Connection at Time of Installation	0.55	0.54	0.53	0.50	0.50	0.00	0.00%
Additional Connection Requiring Separate Installation	0.73	0.85	0.84	0.88	0.80	-0.08	-10.96%

*time in hours is expressed as decimal equivalents

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

A Local Franchising Authority (LFA) is authorized to review the operator's rate forms to determine whether the operator's proposed rate increase for installation and lease of equipment comports with those rules. If the proposed rate is accurately calculated pursuant to the Commission's regulations, using accurate information, the rate is deemed reasonable and lawful under the 1992 Cable Act.⁴²

Upper Tier CPST Rate Regulation Expiration

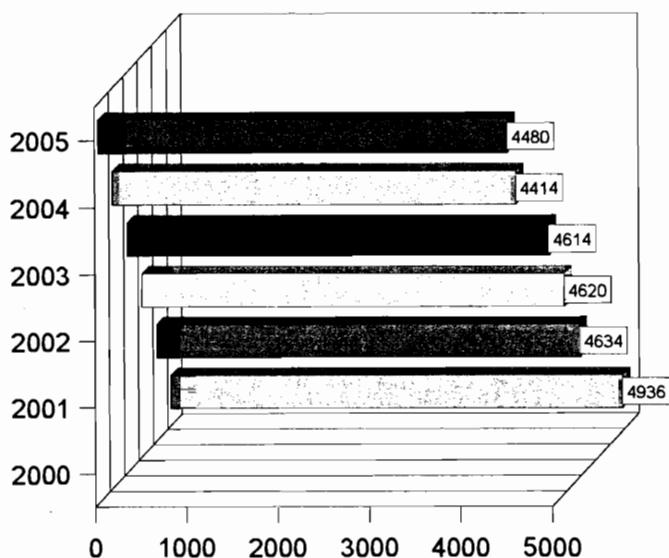
A sunset provision within the Telecommunications Act of 1996 terminated upper cable service tier regulation on March 31, 1999. Since then, the cable operator is allowed to change upper service tier rates at will upon thirty (30) days notice to the franchise authority and subscribers.

⁴²47 U.S.C. § 543(b).

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Subscriber Trends

Time Warner believes its customer base will be 4480 customers at year end.



Recommendation

The Consultant recommends that The Town:

1. Find that Time Warner Cable's proposed form 1240 maximum permitted Basic Service Tier rate compliant because it was calculated in accordance with the FCC's rules.
2. Find that Time Warner Cable's proposed continued reliance on its initial form 1235 to set the maximum permitted Network Upgrade charge for the current period non-compliant because it is not calculated in accordance with the FCC's cost of service rules.
3. Find that Time Warner Cable's proposed form 1205 maximum permitted Equipment and Installation charges compliant because they were calculated in accordance with the FCC's rules.

Proceeding

The franchise authority must either approve or deny the operator's FCC form 1240, form 1235 and form 1205 on the basis of whether the requested rates are reasonable. This determination must be based upon a finding of fact.

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

To be valid, the Rate Order must be:

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

It is appropriate for public comment to be heard, as related to the various rate issues, at the next scheduled Town Board meeting to deliberate this matter. Although a statutory public hearing is not required, it is customary and good public policy to call for public comment in these matters. The comment period may be publicized by issuing a press release to the print and electronic media or announced in other appropriate ways. Time Warner Cable must be notified of the public meeting and advised to have a representative present to respond to the findings contained in this Report and any questions elected and appointed Town officials and the public may pose.

**TOWN OF CARRBORO**

NORTH CAROLINA

WWW.TOWNOFCARRBORO.ORG

December 9, 2004

Mr. Paul Baccellieri
Vice President Finance
Raleigh Division
Time Warner Cable
101 Innovation Avenue, Suite 100
Morrisville, North Carolina 27560

Dear Mr. Baccellieri:

Our cable consultant, Bob Sepe, has completed his review (enclosed) of Time Warner Cable's proposed 2005 cable service rates and finds the FCC1235 rates non-compliant. Because the Town of Carrboro is interested in resolving this matter at the local level, we are willing to delay formal action to permit TWC to voluntarily recalculate its form 1235 so that it complies with the FCC's cost of service rules and to provide the summary financial information requested in the Rate Order.

Upon receipt of this information, our consultant will review it for compliance. If he determines that the information complies with the FCC's cost of service rules, a revised rate order will be prepared and brought before the Board of Aldermen.

Alternatively, TWC may choose to withdraw the form 1235 "add-on" charge from the BST rate, whereupon, a revised rate order will be prepared approving just the FCC form 1240 and form 1205 rates.

Please let me know how you plan to proceed prior to December 17th. Thank you for your consideration.

Sincerely,


Steve Stewart
Town Manager

cc: Bob Sepe, Action Audits
Richard White



December 15, 2004

Via: First Class Mail

Mr. Steven Stuart
Town Manager
Town of Carrboro
301 West Main St.
Carrboro, NC 27510

Dear Mr. Stuart:

We are in receipt of a copy of a report prepared by the Town's rate consultant, Action Audits, LLC, ("AA") recommending that the Town reject Time Warner Cable's ("TWC") inclusion of its previously approved Form 1235 network upgrade add-on charge to the Basic Service tier ("BST") rate beginning January 1, 2005. Unfortunately, this is the latest instance in which AA has recommended a course of action that is plainly at odds with the rules and regulations of the Federal Communications Commission.

We strongly urge the Town to ignore the unsupported recommendation of AA and instead approve the proposed BST rates for 2005. Any rate order adopted by the Town, and based upon the recommendation of AA, will result in an appeal to the FCC. Such an appeal is an unfortunate diversion of the time and resources for all of us. Perhaps more importantly, such a rate order will be reversed by the FCC just as all previous TWC rate orders recommended by AA have been reversed.

Background

On or around October 1, 2004, we filed with the Town a set of FCC forms justifying our BST, equipment, and installation rates to become effective January 1, 2005. Specifically, we submitted a Form 1240 ("annual update form") and a copy of the Form 1235 network upgrade add-on calculation that the Town had approved in 1999. Under the FCC's rules, the maximum rate that we are permitted to charge for the BST is the sum of the Form 1240 rate and the previously approved Form 1235 rate.

In its report and associated draft rate order, AA finds that our Form 1240 calculation complies with the FCC's rules, but recommends that the Town deny TWC the right to include the previously approved Form 1235 network upgrade charge. According to AA, our Form 1235 does not comply with FCC rules because it has not been updated to reflect certain operational changes occurring since the form's initial filing and approval in 1999. AA cites changes such as changes in the number of subscribers and/or the proportion of the system's bandwidth used for regulated and unregulated services.

Discussion

The Town is legally obligated to follow the FCC's rules and decisions governing the calculation of these rates. Here, there is no question that if the Town rejects our previously approved Form 1235 add-on charge and requires the calculation of an "updated" Form 1235 rate, it will be taking an action that is simply inconsistent with the FCC's rules and decisions.

Form 1235 allows TWC to recover costs incurred in connection with "significant" upgrades of our cable television system over the life of the upgrade. The network upgrade add-on charge calculated under Form 1235 is intended to supplement the Form 1240 "annual update form" calculation. The Form 1240 does not account for upgrade costs, but rather is used by TWC to make yearly adjustments to our rates to reflect the addition, deletion, or movement of regulated channels, and increases or decreases in certain "external" costs such as inflation, programming costs and FCC regulatory fees.

The Form 1240 is typically prepared, filed and reviewed every year. AA would similarly require the Form 1235 to be updated and reviewed annually. But the FCC has made it quite clear that the preparation, filing and review of Form 1235 is a one-time event based on a "snapshot" of the system at the time the upgrade was completed. In this regard, we direct your attention to the following:

- The recent decision in *Time Warner Cable (Durham, NC)*, 19 FCC Rcd 14851 (MB, 2004), where the Commission expressly noted that the Form 1235 network upgrade add-on charge "is not recomputed or re-approved each year that it is available."¹
- FCC decisions in which the FCC itself relied on previously approved Form 1235 filings in resolving cable programming service tier complaints²
- FCC decisions holding that "only one FCC Form 1235 is to be filed following the completion of the upgrade project"³
- FCC decisions referring to that filing as the "final" Form 1235⁴
- FCC decisions rejecting a cable operator's use of updated customer data in its Form 1235 calculation.⁵

¹ This clear directive by itself illustrates that AA is simply wrong. We don't know how the FCC could be anymore clear.

² See, e.g., *Bresnan Communications Company (Riceboro, GA)*, 16 FCC Rcd 16460, 16462 (CSB, 2001).

³ *Marcus Cable Associates, L.P. (Fort Worth, TX)*, 14 FCC Rcd 7124, 7126 n.15 (CSB, 1999).

⁴ *Marcus Cable Associates, L.P. (Glendale, CA)*, 13 FCC Rcd 22314, 22316 n.15 (CSB, 1998).

Perhaps most tellingly, even NATOA (of which Mr. Sepe is a member) itself has recently acknowledged that the FCC rules do not require cable operators to refile Form 1235 each year. See "White Paper on FCC Form 1235" prepared for NATOA by Front Range Consulting, Inc. and filed with the Commission in MB Docket No. 02-144 (Oct. 7, 2004).

AA fails to cite even a single statement, instruction, or ruling by the FCC that would support its contention that we must recalculate our Form 1235 filings on an annual basis. This silence speaks volumes: if the FCC rules required annual Form 1235 updates, one would expect there to be at least one instance in which the FCC had referred to that requirement. In short, there is not a single statement to support the AA position. There is overwhelming authority illustrating that AA is simply wrong – once again.

In conclusion, the FCC's rules and decisions absolutely preclude the Town from rejecting our previously-approved Form 1235 network upgrade charge. The FCC has not hesitated to reverse other rate orders where AA has pursued other unsupported positions, including the order at issue in the *Durham* case cited above.⁶ Experience clearly demonstrates that, if the Town follows AA's recommendation, it will be the Town's taxpayers and TWC's customers that will bear the cost of the appeal and remand that inevitably will follow.

We strongly urge the Town to follow the FCC rules and approve our proposed maximum permitted rate calculation for 2005, including the previously-approved Form 1235 charge.

If there are any questions regarding this matter, please do not hesitate to contact me directly.

Very truly yours,



Gary R. Matz

GRM/ja

cc: Brad Phillips – Time Warner Cable, Raleigh Division
Paul Baccellieri – Time Warner Cable, Raleigh Division

⁵ *Id.*

⁶ See also *Time Warner Cable (Smithfield, NC)*, 18 FCC Rcd 738 (MB, 2003).