

by the current scheme of rate regulation in two ways. First, the comments suggest that our rate rules do not adequately take into account the higher costs of doing business, and particularly the higher costs of capital, faced by smaller companies. Second, many operators claim that our rules place an inordinate hardship upon them in terms of the labor and other resources that must be devoted to ensuring compliance. Such comments suggest that some operators may be facing the dilemma of desiring to impose rates that our cost-of-service rules may well permit, but at the same time being averse to risking the resources that a cost-of-service showing entails since they cannot be guaranteed that the showing will be successful. In crafting the relief we adopt today, we have attempted to alleviate both the substantive and the procedural burdens of which smaller cable companies complain.

35. We are particularly sensitive to the motion that smaller systems face disproportionately higher costs. In adopting rate rules, the Commission is required to consider operator-specific cost data. Thus, any scheme we adopt must take into account the cost data of the individual operator and give the operator the opportunity to recover its actual, reasonable costs. To some extent, however, the inclusion of operator-specific data in our scheme of rate regulation conflicts with the goal of simplifying the regulatory process. Establishing permitted rates on the basis of precise and detailed data entails more work for the operator that must compile that information from its own records and reproduce it in accordance with whatever forms and formulas we devise. For example, we have estimated that it takes 60 hours to complete the simplified cost-of-service form, FCC Form 1225, which requires operators to provide substantial data regarding the

costs incurred in operating the system. Such regulation also imposes a burden on regulatory authorities that must review the data. We note that in many cases small local franchising authorities have scarce resources to review complicated cost-of-service filings. Yet to the extent we lessen the regulatory burden on operators and franchising authorities by reducing the amount of data that must be assembled and reviewed to calculate permitted rates, we are also concerned that we have confidence that the operator's rates are reasonable.

36. Having reviewed the criteria identified by Congress as being relevant to the establishment of rate regulations, we have created a formula for generating permitted rates that entails as small a burden as possible while still producing a rate that reflects with reasonable accuracy the operating costs and capital investments of the operator. The formula can be expressed as follows:

$$\text{Per channel per subscriber rate} = \frac{\text{Annual operating expenses} * + (\text{Net rate base} * \times \text{rate of return})}{\text{Number of regulated channels} \times \text{Number of subscribers}}$$

\* For regulated services only

This formula is designed to establish the annual per-channel per-subscriber revenue requirements of the regulated system. The formula permits a regulated cable company to set a per-channel per-subscriber rate that will both cover operating expenses and provide a reasonable return on investments. Such a recovery is necessary to guarantee the operator the opportunity to attract new capital, promote innovation, and cover all essential costs of operating a cable system. The new method can be used to justify existing rates, or establish new rates, regardless of what rate regulation has been used in the past. Operators may rely on previously existing information, such as tax forms or company financial statements, rather than recreating financial calculations.

37. To ensure that the per-channel revenue requirement is reasonable, all operating costs must be covered. Therefore, wages, salaries, programming, advertising, electricity, maintenance, depreciation, amortization and all other relevant costs are included in the total operating expenses. This is not an exhaustive list, however, and operators may recover other reasonable and legitimate costs of provide service. As under our standard benchmark and cost-of-service regulations, when calculating operating expenses the

operator must take into account only those expenses related to providing regulated channels. Congress specifically provided that regulation of rates for the basic service tier ("BST") should take into account general operating costs only to the extent those costs are allocable to basic service. With respect to regulation of both BST and CPST rates, inclusion of costs related to unregulated services would distort the revenue requirement for the regulated channels and equipment, since there are no restrictions on the discretion of cable operators in establishing rates for unregulated services. More specifically, inclusion of costs related to the provision of unregulated services could result in those services being subsidized by revenues from regulated channels. Clearly, Congress did not intend such a result. However, to further our goal of minimizing regulatory burdens, we are granting small cable systems owned by small cable companies substantial flexibility to fairly allocate costs between BST, CPST, equipment and unregulated services. We further stress that, when the requested rate does not exceed \$1.24 per channel, the burden will be on the franchising authority to show that the operator was unreasonable in making allocations such as these.

38. The net rate base is included in the formula to reflect net investment. The net rate base consists of the depreciated value of property. It provides the proper basis for calculating a fair rate of return on investment. For the reasons stated in the preceding paragraph, only assets associated with providing regulated services may be included in the calculation of the net rate base. However, the operator shall have substantial flexibility in calculating its net rate base. The presumptions and restrictions applicable to standard cost-of-service proceedings shall not apply. Thus, for example, we will not presume it unreasonable to include in the rate base start-up losses that exceed the first two years of operating expenses. Having isolated a category of systems for whom our standard rules need to be relaxed due to the particular characteristics of those systems, we seek to ensure that those systems will be permitted to establish rates in accordance with such characteristics, rather than in accordance with characteristics of cable systems generally.

39. Likewise, we will not presumptively exclude intangibles such as acquisition costs from the net rate base. In the Cost Order, 59 FR 17975 (April 15, 1994) we presumptively