BEFORE THE DIRECTOR OF COMMERCE AND CONSUMER AFFAIRS

OF THE STATE OF HAWAII

In the Matter of the Application of)) WAIANAE TELEVISION &) COMMUNICATIONS CORPORATION)) For Transfer of the CATV Permits) and Assets of TV Systems, Inc.)	DOCKET NO. 12-84-01 ORDER NO. 107

DECISION AND ORDER

On June 26, 1984, the duly appointed Hearings Officer submitted his Recommended Decision to the Director and the Recommended Decision was served on all parties. On June 28, 1984, Waianae Television and Communications Corporation ("Oceanic") submitted a letter requesting the Director to amend one of the conditions proposed in the Recommended Decision.

Having reviewed the Recommended Decision, Oceanic's June 28, 1984 submission, and other pertinent information in this case, the Director hereby adopts the Hearings Officer's Recommended Decision (attached hereto as Attachment 1) as the final Decision in this proceeding, with the following clarifications and exceptions:

1. City and County of Honolulu. The purposes cited in the Recommended Decision for the proposed two-way cable drops to Honolulu Hale and the Honolulu Municipal Building were suggested by the Office of Human Resources in testimony submitted in this proceeding. The suggested programming is not intended to be required by this Decision and Order. Under the provisions hereof Oceanic is to work with the City and County of Honolulu to provide the basic physical cable connections to the Oahu Civil Defense Agency in the Honolulu Municipal Building and to Honolulu Hale which will allow the various components of Honolulu's municipal government to receive or transmit the programming of their choice when they are ready to do so.

2. Equalization of rates. In its June 28, 1984 letter Oceanic requested amendment of the condition in the Hearings Officer's Recommended Decision which makes the equalization of rates and charges dependent, inter alia, on the company's offering of the pay channels Cinemax and Bravo to TVSI subscribers. Oceanic requested that the increase in rates be made independent of the schedule for offering Cinemax and Bravo. Oceanic states that since the hearings in this matter, TVSI has stopped carrying the Filipino language channel Mabuhay. As a result, Oceanic plans to use the vacated

channel to offer Cinemax to TVSI subscribers within thirty days of closing, rather than by the end of 1984, as previously proposed. This means that Oceanic's basic services and all pay services except Bravo will be offered to TVSI subscribers within sixty days of the transfer. Oceanic states that Bravo, which has the lowest subscribership of Oceanic's pay services, cannot be added until TVSI's equipment is upgraded to provide sufficient channel capacity to accommodate the service. This is expected to occur by the end of 1984. Oceanic requests no change in the other requirements of condition number 7 of the Recommended Decision. Therefore, the Director will allow the equalization of rates and charges to take effect following completion of all quality of service improvements and programming changes, except the offering of Bravo, which are outlined in condition number 7 of the Recommended Decision.

NOW, THEREFORE, IT IS HEREBY ORDERED THAT:

The Application of Waianae Television and Communications Corporation for transfer of the CATV permits and assets of TV Systems, Inc. is APPROVED with the following conditions:

1. By September 1, 1984, Oceanic shall submit to the Department its plans to educate its subscribers regarding the use of converters. The plan should include the dissemination of information discussed in Section VII of the Recommended Decision.

2. By October 1, 1984, Oceanic shall submit to the Department its plans for providing a cable television link to Honolulu Hale and to the Oahu Civil Defense Agency in the Honolulu Municipal Building.

3. By July 1, 1985, Oceanic shall submit to the Department its plans for:

   a. Offering non-entertainment cable services, especially services to the business community; and

   b. Handling the competition between must-carry and mandatory access requirements and pay services for the limited number of cable channels available.

4. By August 1, 1985, Oceanic shall submit to the Department an analysis of its financial condition upon completion of one year of merged operation, including as part of the analysis a summary of actual or projected savings due to economies of scale. Oceanic should exercise due diligence in seeking such economics.

5. By December 31, 1985, Oceanic shall complete all 30 construction projects described in the revised construction schedule, dated March 27, 1984. In

particular, Oceanic shall complete project number 18, the Waimanalo Farm Lots, in the first half of 1985.

6. By January 31, 1986, Oceanic shall submit to the Department its plans to increase its channel capacity to over 40 channels.

7. Equalization of rates and charges to TVSI subscribers shall not take effect until Oceanic has done the following:

a. Completed all programming changes detailed in items 1 through 4, Section III, "Programming," of the Recommended Decision;

b. Offered the premium channel Cinemax to TVSI subscribers; and

c. Completed quality improvement items 4 through 8, Section III, "Quality," of the Recommended Decision.

8. Oceanic will offer the premium channel Bravo to TVSI subscribers by the end of 1984.

9. Oceanic will explain to the Department in writing any delays in the programming and service improvement schedules set forth in Section III of the Recommended Decision which exceed thirty calendar days.

10. Oceanic is to submit, as part of its Quarterly Report, a review of community access programming, including the current utilization of the equipment, facilities and channel time, which channels are being used for such programming, and the extent to which requests for use of equipment, facilities and/or air time have been denied or pre-empted because of a lack of equipment, facilities or air time.

11. Oceanic shall submit a status report regarding all improvements proposed in its application as part of its Quarterly Report to the Department.

12. Oceanic shall provide installation and repair services to all subscribers on a six-day schedule similar to that now provided by TVSI to its subscribers.

13. Any exercise by Oceanic of the rights and privileges granted by a transfer of TVSI's permits will constitute agreement to these conditions.

Dated: Honolulu, Hawaii, July 5, 1984.

STATE OF HAWAII

By ______________________

Russel S. Nagata
Director of Commerce and Consumer Affairs

ATTACHMENT 1

BEFORE THE DIRECTOR OF COMMERCE AND CONSUMER AFFAIRS

OF THE STATE OF HAWAII

In the Matter of the Application of WAIANAE TELEVISION & COMMUNICATIONS CORPORATION For Transfer of the CATV Permits and Assets of T. V. Systems, Incorporated	)))))))	DOCKET NO. 12-84-01

RECOMMENDED DECISION

I. INTRODUCTION

On January 4, 1984, **WAIANAE TELEVISION & COMMUNICATIONS CORPORATION** ("Oceanic") filed an application with the Department of Commerce and Consumer Affairs ("Department") to be the transferee of the permits and other assets of T. V. Systems, Incorporated ("TVSI").

Public hearings were held to allow the public to participate in regulatory decision-making:

April 23, 1984	State Capitol Auditorium
April 24, 1984	King High & Intermediate School Cafetorium
April 25, 1984	Kaimuki Regional Library Auditorium
April 26, 1984	Enchanted Lake Elementary School Cafetorium
April 27, 1984	Moanalua High School Cafetorium

Notices of the hearings were published in newspapers of statewide circulation on April 8 and April 16, 1984. All oral and written testimony offered at the public hearings and received by the Department is included in the record.

On May 2, 1984, an economic hearing was held in the Board Room of the Department of Commerce and Consumer Affairs, 1010 Richards Street, Honolulu, to examine Oceanic's technical, financial and administrative staff. A verbatim transcription of this hearing is included as part of the record of these proceedings.

II. LAW

Hawaii Revised Statutes (hereinafter "HRS") §440G-10 sets forth the authority of the Director to approve the transfer of a CATV permit. That section provides, in pertinent part:

> No CATV permit may be assigned, sold, leased, encumbered, or otherwise transferred without the prior written consent of the director. Such consent shall be given only upon a written application therefor on forms to be prescribed by the director. The forms shall require from both the transferor and the proposed transferee substantially the same information as required by section 440G-6. The application shall also contain information concerning the consideration to be paid and such other matters as the director may deem appropriate or necessary, and shall be signed by both the transferor and the proposed transferee.

In the examination of transfer applications, the Department has been guided by the criteria provided in HRS §440G-8(b), relating to the issuance of new CATV permits. That section provides:

> The Director, after a public hearing as provided by this Chapter, shall issue a CATV permit to the applicant when he is convinced that it is in the public interest to do so. In determining whether a CATV permit shall be issued, the Director shall take into consideration, among other things, (1) the public need for the proposed service or acquisition, (2) the ability of the applicant to offer service at a reasonable cost to the subscribers, (3) the suitability of the applicant, (4) the financial responsibility of the applicant, (5) the ability of the applicant to perform efficiently the service for which authority is requested, and (6) any objections arising from the public hearing, the CATV Advisory Committee, or elsewhere.

III. PUBLIC NEED FOR TRANSFER

Approval of transfers of operating permits ideally should be beneficial to the transferor, the transferee, the consumers of the basic services, and the public interest, generally. When the terms of the transfer are reasonable and there is a reasonable prospect for improvements in the system, then the transfer approval may be considered favorably.

TVSI first requested approval for the transfer of its permits to another entity on December 1, 1981. At that time the Director denied the transfer, stating that "the proposed transfer would be detrimental to the interest of potential and existing subscribers and to the public in general."

In this application, TVSI states that in early 1983 TVSI's owners and officers "carefully examined their capabilities to add the kinds of innovative services which promise to ultimately stabilize the cost of basic CATV services and accommodate the orderly growth and expansion of their system. Management concluded that it would begin negotiations with a well-financed, responsible and responsive entity whose reputation and performance had been tested in Hawaii."

It is apparent that should this application be denied, TVSI will again look for a suitable transferee. It is clear that the owners of TVSI no longer wish to continue to provide cable services in light of their limited capacity to meet growing public and governmental demands and expectations. Thus, the question is really whether Oceanic is a suitable transferee.

Construction Activities

HRS Chapter 440G was enacted in 1970 on the fundamental premise that "rapid and orderly expansion of cable television systems would be of great benefit to the people of the State of Hawaii." As of January 1984, TVSI had completed construction of its basic cable plant for its permit areas. TVSI had built about 550 miles of cable plant and its only unbuilt area, Waimanalo Farm Lots, is subject to aid-to-construction charges. Oceanic has completed over 1,000 miles of cable plant.

As of January 1984, Oceanic's cable system passed 165,455 homes and served 98,490 subscribers, for a subscriber penetration rate of about 60%. As of November 1983, TVSI's cable system passed 70,431 homes and served 43,095 subscribers, for a subscriber penetration rate of about 61%.

Future Construction

In March 1984, Oceanic submitted a proposed post-transfer construction schedule to the Director. The schedule shows 30 additional construction projects, representing 129.89 miles of cable plant, to be completed by the end of 1985. This will add a total of 8,516 housing units to Oceanic's pool of potential subscribers. Of Oceanic's proposed construction projects, 11.2 miles and 170 housing units (comprising the Waimanalo Farm Lots) are part of TVSI's service area.

Oceanic has completed in excess of 1,000 miles of cable plant and TVSI about 550 miles, for a total of 1,550 miles. The 129.89 miles yet to be constructed represent about 8% of the total proposed plant, while the additional 8,516 potential subscribers represent about 3.5% of the combined number of homes to be passed by Oceanic and TVSI.

Though TVSI has fulfilled its construction commitment, one rather large service area, the Waimanalo Farm Lots, has not been cabled and presently requires aid-to-construction charges before service will be provided. The capital costs of constructing the cable plant in the Waimanalo Farm Lots is insignificant when compared with the total investment of the Oceanic/TVSI combined plant, but is significant when compared with only the TVSI plant investment. Upon approval of the transfer, Oceanic intends in the first half of 1985 to construct cable plant to the Waimanalo Farm Lots without requiring aid-to-construction charges.

<u>Quality and Quantity of Cable Services</u>

TVSI now employs TEXSCAN Vital Signs status monitoring equipment to check the performance of amplifiers on the main video transmission trunks that deliver video to the windward headends in Kaneohe and Punaluu. Oceanic uses ALPHA Technologies equipment as a status monitoring system for its standby power supplies. Though both use TEXSCAN RF transmission equipment, their software is not compatible. Moreover, because Oceanic uses Sylvania amplifier equipment, it plans to use status monitoring equipment to be developed by Sylvania for its amplifiers. Oceanic intends to install a universal status monitoring system for its entire cable system.

Both Oceanic's and TVSI's cable plants are now primarily limited to transmission of up to 270 MHZ (30 channels). Oceanic proposes to rebuild its system in two phases. Phase I would increase the upper limit of transmission to 300 MHZ (35 channels) by the end of 1984 and Phase II would increase transmission up to 330 MHZ (40 channels) by the end of 1985. Oceanic intends to increase TVSI's channel capacity on "as close to the same schedule as is practically possible," upon approval of the transfer.

The Hearings Officer recognizes that, with present technology, plans for expansion beyond 40 channels will probably require enormous amounts of capital. However, the Department is also aware of Oceanic's near full utilization of all currently usable channels. Plans must be made to handle the future competition between must-carry and mandatory access requirements and pay services for the limited number of cable channels available.

In the 1982 quality of service hearings, TVSI agreed that one factor contributing to its number of outages was the lack of a preventive maintenance program. TVSI indicated it had primarily been concerned with constructing new plant and not with maintaining its existing cable system. TVSI has since instituted a preventive maintenance program; however, it is not as extensive as Oceanic's. Oceanic's preventive maintenance program has been in effect for a number of years. It includes regularly scheduled electronic measurements and adjustments, mechanical examination of network components to anticipate physical plant failures, and the "burn-in" of new active equipment before installation to improve reliability. Oceanic intends to include TVSI's plant in its preventive maintenance program.

Pre-Transfer Activities

In anticipation of the approval of its transfer request, Oceanic has begun or completed the following improvements:

1. Expansion of computer capacity to accommodate TVSI's subscriber information;

2. Increase in the number of incoming telephone lines to handle the expected increase in customer and repair service calls;

3. Increase in the number and type of radio equipment to allow for quicker and more efficient contact with technicians in the field;

4. Institution of employee educational programs;

5. Development of four programs to either continue, maintain or improve the existing level of customer satisfaction by: (1) dividing the total service area into smaller geographic areas, each with a separate area manager; (2) developing a customer user manual to be given to all new subscribers that provides basic information regarding Oceanic's services and procedures; (3) creating a public affairs department; and (4) measuring viewer satisfaction through research studies;

6. Construction of a new facility to accommodate all of Oceanic's current operational needs as well as those resulting from the acquisition of TVSI; and

7. Addition of 15 new employees to the customer and repair service departments as well as training of TVSI personnel on Oceanic's equipment and procedures.

Post-Transfer Activities

As the public hearings made abundantly clear, the application involved herein has created substantial expectations in TVSI subscribers as to changes that will occur in the service they receive.

Programming

Oceanic's projected schedule for the equalization of programming between current TVSI subscribers and current Oceanic subscribers is as follows:

Within two months after acquisition:

1. TVSI subscribers will receive the following additional basic service channels: Cable Headline News, Channel 17 (local origination), the Program Guide Channel and the Community Programming Channel.

2. TVSI subscribers will receive in stereo the channels currently provided Oceanic subscribers in stereo. TVSI subscribers will also receive The Movie Channel in stereo.

3. TVSI subscribers will also be offered the Playboy channel and pay-for-view specials.

4. TVSI subscribers will receive HBO on a tape-delayed basis. This will result in programs being shown in the time frames in which they were originally intended to be viewed. For example, R-rated, adult-oriented films will be shown in the latter part of the evening.

By the end of 1984

5. TVSI subscribers will be offered Oceanic pay channels Cinemax and Bravo.

Following the transfer, Oceanic subscribers may be offered The Movie Channel (currently offered only to TVSI suscribers) either alone or in combination with another channel. TVSI subscribers may lose (if they have not already lost) both Voice of Korea and Mabuhay, channels which present programming directed at the Korean and Filipino communities. Oceanic and TVSI are encouraging discussions between Fuji Network (now offered by TVSI) and Nippon Golden Network (now offered by Oceanic) to consolidate programming from the two services into one. This combined service would then be offered all subscribers in the Oceanic/TVSI system.

Quality

Oceanic proposes to improve the quality of service provided to TVSI subscribers by doing the following:

1. Upgrading the TVSI cable system in two phases to increase the channel capacity from 30 channels to 40 channels by the end of 1985;

2. Re-routing the trunk cables in certain parts of TVSI's service areas to make the system less vulnerable to vandalism and vehicle accidents;

3. Expanding TVSI's preventive maintenance program to increase system reliability;

4. Providing real-time response to addressable converter transactions and pay-per-view event requests by the end of the year;

5. Expanding business office hours to six days a week, 8:00 a.m. to 8:00 p.m., Monday through Friday, and 11:30 a.m. to 8:00 p.m., Saturday, by the end of the year;

6. Expanding computer and telephone hardware and software capabilities to provide better customer service by the end of the year;

7. Installing an automated audio response system to provide a quick and convenient method for subscribers to inquire about their account balances or to modify their services by the end of the year; and

8. Reassigning TVSI channel numbers to correspond with current Oceanic numbering to eliminate ghosting on VHF Channels 11 and 13 experienced in the Kaimuki/Kapahulu area.

Oceanic hopes to offer Oceanic/TVSI subscribers a converter with remote and parental control capabilities by the end of 1984.

IV. ABILITY OF APPLICANT TO PERFORM SERVICE AT REASONABLE COST

Reasonableness of Rates

Oceanic's schedules 1, 2, and 3 provide pro forma projections for Oceanic and TVSI separately as well as Oceanic/TVSI combined for 1984, 1985 and 1986. Revenue projections for installation, advertising, pay-TV, pay per view, hotel pay, and other are the same in schedules 1, 2, and 3. Only revenues projected for basic service differs, based on monthly composite rates of $7.80, $11.00, and $12.00, respectively. Furthermore, the following expenses are directly related to cable revenues: (1) copyright fees (7.99% of basic revenues), (2) franchise fees (1% of basic revenues plus installation revenues), (3) bad debt (2.5% of total revenues), and (4) excise tax (4% of gross revenues).

Schedule 1 shows that with a composite basic rate of $7.80, Oceanic projects negative pretax incomes of $936,376 for 1984 and $125,314 for 1985. In 1986, Oceanic would see its first positive pretax income of $869,787. Projections for TVSI and TVSI/Oceanic combined show all negative pretax income at this basic rate.

Schedule 2 shows that with an $11.00 composite basic rate, Oceanic projects a positive pretax income for 1984, 1985 and 1986, while TVSI separately still shows a negative pretax income for the same years. The TVSI/Oceanic combined projections show positive pretax income of $2,229,065, $3,153,079 and $4,373,459 for 1984, 1985 and 1986, respectively.

Schedule 3 shows that with a $12.00 composite basic rate (a rate which includes the proposed increases in TVSI's charges), TVSI would show a positive pretax income in 1986. The TVSI/Oceanic combined projections show pretax incomes of $3,352,627, $4,912,945 and $6,225,043 for 1984, 1985 and 1986, respectively.

To test the reasonableness of the proposed rates, an analysis was conducted to evaluate:

1. Whether the proposed rates would provide sufficient funds to meet all financial commitments; and
2. Whether the proposed rates would be fair to the subscriber.

In addition to the amounts included in its schedules 1, 2, and 3, Oceanic's post-transfer financial commitments would include projected additions to plant and principal repayments for advances from its parent, American Television Communications Corporation ("ATC"), due to its purchase of TVSI. For the purpose of this analysis, minimal expenditures for plant additions were taken to be the amounts of projected capitalized expenses. Also, principal repayments to ATC on advances were assumed to be equal payments over the remaining seven years of Oceanic's current permit.

	1984	1985	1986
Plant Additions	$3.7 million	$ 4.4 million	$4.7 million
Principal Repayments			
Due TVSI		$ 2.4 million	$1.9 million
Due ATC	$3.2 million	$ 3.2 million	$3.2 million
Totals	$6.9 million	$10.0 million	$9.8 million

Assuming a 50% tax rate, Oceanic (after its purchase of TVSI) can only meet these minimal commitments at a $12.00 composite rate, using funds from depreciation and amortization. Actual post-transfer cash requirements for plant additions could cause cash shortages in the first several years. However, there is no repayment schedule for advances made by ATC and neither interest nor principal repayments have been required. Additionally, Oceanic states that ATC will continue to advance funds needed for plant improvement and debt service. (See section VI). Consequently, it appears Oceanic's cash requirements can be met with a $12.00 composite rate, i.e., with approval of the increased charges proposed for TVSI subscribers.

To evaluate whether the $12.00 proposed rate is fair to the public, the Hearings Officer reviewed the projected operating results after all financial commitments were met to determine if excessive returns would be generated. Oceanic's current post-acquisition projections do not allow for a return to stockholders, and therefore show no excessive returns. However, although the expenses projected in schedules 1, 2, and 3 seem realistic, the Hearings Officer believes that economies of scale will in time either result in lowering the cost of operation or decreasing the rate of increase in cost of operation on a per subscriber basis. Oceanic's projections do not include savings due to economies of scale. Thus, although the Hearings Officer believes the requested rates are reasonable at this time, the Hearings Officer suggests that, should the transfer be approved, the Department review Oceanic's financial condition in one year to reevaluate the reasonableness of the rates.

Increased Rates to TVSI Subscribers

Order Nos. 99 and 102 are pertinent to this subject. Order No. 99 suspended an order of investigation of TVSI's quality and quantity of services based on TVSI completing its Master Plan. The Master Plan described actions TVSI would take to expand and improve its services. It required technical modifications and improvements that included replacement of trunk amplifiers, replacement of certain components of the distribution plant, rebuilding of video lines and addition of standby power supplies. It also required operational changes such as carrying broadcast stations "off-channel," reorganizing technical staff to start preventive maintenance and radiation monitoring, and starting programs to improve customer relations and communication. The last action to be completed was to provide converters to each subscriber. With these improvements, TVSI applied for a rate increase. The Director, in Order No. 102, approved an interim rate of $10.45 for basic monthly service and $2.75 for additional monthly outlet charges. As part of the present application, Oceanic has requested approval of increases in TVSI's approved rates to bring them into parity with Oceanic's existing rates, i.e., increases of $1.00 for basic service and $0.50 for additional outlets.

In return for these increases, Oceanic has stated that TVSI subscribers will receive the following:

1. Increased basic services;
2. Increased offerings of pay services;
3. Offerings of pay-per-view events;
4. Stereo sound for HBO, MTV, and The Movie Channel;
5. HBO on a tape-delayed basis, so that it is shown during the hours it was meant to be seen;
6. An upgrading of channel capacity from 30 channels to 40 channels;
7. A more reliable cable system through re-routing certain trunk cables to reduce system vulnerability to vandalism and vehicle accidents;
8. An expanded preventive maintenance program to increase system reliability;
9. An automated audio response system to provide a quick and convenient method for subscribers to effect changes in service;
10. The expansion of business office hours to include evenings and Saturdays;
11. The reassignment of channels to eliminate ghosting on VHF channels 11 and 13 experienced in the Kaimuki/Kapahulu areas;
12. Access to a newly-completed community access studio; and
13. Financial support of ATC, a Time, Incorporated subsidiary.

Based on the benefits described above, the Hearings Officer believes the proposed increases in rates for TVSI subscribers are reasonable.

V. APPLICANT'S SUITABILITY AND ABILITY TO PERFORM SERVICE EFFICIENTLY

By Order Nos. 79 and 96, the Department approved the acquisition of the Oceanic group and Cablevision, Incorporated by ATC and its subsidiaries, Honolulu Television and Communications Corporation and Waianae Television and Communications Corporation. In these decisions, the Department imposed conditions relating to construction, studio facilities, local origination programming, and systems parity with other ATC cable systems. Oceanic has met, or has shown significant progress toward meeting, all of these conditions.

<u>Construction</u>

Oceanic continues in substantial compliance with the construction schedule contained in Cable Order Nos. 79 and 96.

As of April 1984, Oceanic had extended its facilities to 96% of potential subscribers in its permit areas.

<u>Studio Facilities and Programming</u>

As stated in Cable Order No. 96, Oceanic continues to make progress in developing origination programming to serve the needs of the various subgroups in its permit areas. The effort Oceanic has made to serve the various ethnic-oriented and human services programmers was evidenced in the support of Oceanic's application given by these programmers and community organizations.

Recent construction and acquisition of facilities have done much to rectify the concerns the Department expressed in Cable Order No. 96, relating to the inadequacy of studio and access facilities for a cable system the size of Oceanic. The recent construction of Oceanic's 1,700 square foot local origination studio, together with its supporting editing facilities, should encourage the development of informative local origination programming to meet the needs of specific groups of Oceanic's subscribers.

<u>Oceanic as a Leader in the Cable Industry</u>

During the economic hearing on this application, Oceanic reported:

1. It continues to be the leader among ATC systems in the use of computers for managerial and operational activities. Examples of Oceanic's use of the computer have been the development of the audio-response system for telephonic communication with the company and the use of micro-computers for forecasting and financial planning.

2. It continues to be the leader among ATC systems in channel utilization. Oceanic's growth in channel usage is best seen is in its need to expand from 31 to 36 usable video channel capacity. Oceanic plans to meet this need by the end of 1985, through modification of its cable system.

3. Oceanic continues as the only ATC system capable of providing pay-per-view services to hotel guests.

4. It is experimenting with providing Keyfax and other two-way cable services to businesses and other subscribers.

5. It is the largest system in the United States which provides every subscriber with a converter.

6. It is experimenting with fiber optics and other technologies in the delivery and transmission of its signals.

VI. FINANCIAL RESPONSIBILITY

Oceanic is a subsidiary of ATC, a multi-systems operator serving approximately 2.4 million subscribers in 464 municipalities in 31 states. ATC is a wholly-owned subsidiary of Time, Incorporated. Time is a publishing and communications conglomerate with reported annual revenues of approximately $2.7 billion and total assets of approximately $2.3 billion.

The purchase price for TVSI is $32 million, subject to adjustments for: (1) the number of system subscribers, (2) advance payments and accounts receivable, (3) prorations, (4) reimbursement of certain expenses, and (5) deposits assumed. At closing, Oceanic must pay TVSI 25% of the purchase price in cash. The remaining 75% will be payable to TVSI at a rate of 9% simple interest per annum during the first two years, 9-1/2% per annum during the third year, 10-1/2% per annum during the fourth year, and 12% per annum during the fifth and sixth years. Repayment of principal begins in the second year. Principal payments of 10% will be made in the second, third and fourth years, with 20% of the principal due the fifth year and the remaining 25% the sixth year. All obligations and liabilities of TVSI incurred before closing will remain TVSI obligations and liabilities, except that Oceanic will assume TVSI's non-assignable obligations under certain franchises, cable television contracts, and real property agreements.

Oceanic has stated that Time will provide the financial resources necessary to purchase TVSI. ATC will advance Oceanic $8 million in cash for closing at prime rate interest, with no scheduled repayment. The remaining 75% of the purchase price will be in the form of an Oceanic/ATC/Time note. Time will unconditionally guarantee punctual payment of the note, principal and interest. As previously stated in section IV, at a composite rate of $12.00, and with advances from ATC, Oceanic should be able to meet its financial commitments.

Approval of this transfer application does not constitute a finding that the price paid for the assets of TVSI is fair or reasonable. The price and methods of payments may be considered in future rate proceedings.

VII. PUBLIC ISSUES

Community Access Programming

Oceanic's current level of community access/local origination programming received substantial support from the public at the hearings. Those who spoke on this issue recommended approval of this application in part because such programming would then have island-wide reach. The Hearings Officer agrees that Oceanic has moved to respond to community access needs and there are first-rate facilities now available to interested groups and persons.

There was, however, some concern expressed as to whether use of the community access channel would shortly reach the saturation point. At the economic hearings, Oceanic assured the Department that the community access channel and local origination facilities were not fully utilized at this point. However, Oceanic stated that if that stage were reached, time was available on other channels, especially on those pay channels which are currently used for only a portion of the day.

The provision of significant community access programming has always been one of the Department's strongest priorities, and is one of the most significant indicators of a franchisee's intent to operate in the public interest. Oceanic is therefore encouraged to expand its present community access programming, both in terms of availability of channel time and in terms of equipment and facilities that can be used by community groups and other interested persons. As part of an effort to ensure that community access programming remains an integral part of the operation of Oceanic's franchise, Oceanic should be required to address the access issue in its quarterly status report to the Department.

City and County of Honolulu

The City and County of Honolulu specifically requested that Honolulu Hale and the Honolulu Municipal Building (for the Oahu Civil Defense Agency) be connected to the cable television system including the provision for programming originating from those sites. The purpose of such connection would be to allow for civil defense information, City Council meetings, public hearings, informational presentations, debates, press conferences and town meetings to originate from the municipal complex.

The Hearings Officer would expect the franchisee to make arrangements to complete the connection as soon as possible. While the City and County acknowleges that it is not ready to produce programming at this point, the potential benefits from such programming are so substantial that the connection should be in place whenever the City and County is ready. To this end, Oceanic should be required to report to the State on its progress toward wiring the two buildings in the municipal complex.

<u>Converters</u>

The use of converters continues to be a major source of controversy in the communities served by TVSI. By Order No. 99, the Director required TVSI to provide converters to each of its subscribers.

It became clear during the public hearings in this matter that subscribers are still confused about the use of converters. The following questions regarding converters arose during the public meetings:

1. **Was the last rate increase granted TVSI solely to pay for converters?**
   The rate increase was approved because of increases in costs associated with operating the cable system. Further considerations involved capital expenditures necessary for making improvements to the cable system and for providing converters to all basic subscribers.

2. **Why is a converter needed if a subscriber has a "cable-ready" television set?**
   Converters are devices allowing a standard television set to receive 30, 40 or more television channels. Furthermore, converters are designed to eliminate or reduce certain deficiencies of some television sets and act as an interface between subscriber-owned equipment and the cable system. Although the Department has ordered TVSI to provide converters to all of its basic subscribers, subscribers do not have to use the converter provided by TVSI. However, if the subscriber's television set causes interference with other subscribers, the cable operator may require that the subscriber's set be disconnected from the cable system. The Department's intention in requiring company-owned converters is to

place the burden for replacing obsolete equipment on the cable operator rather than the consumer and to ensure that the characteristics of the equipment are known and controlled by the system operator.

3. **Why can't a subscriber receive only those channels that he chooses to receive?**

   To provide subscribers with the choice of limiting the channels he receives, the cable operator must be able to control the subscriber's reception of each cable channel. Two methods now used are trapping and scrambling of signals. When a cable system carries only a few channels, trapping is possible. The trapping method prevents selected cable signals from reaching the subscriber's home. However, when a cable system carries a large number of cable channels, as is the case with Oceanic or TVSI, a scrambling system becomes a necessity. With a scrambling system, all signals are sent to a subscriber's home, but certain channels are scrambled and require an addressable converter to be viewed. The present addressable converters do not have the number of security codes necessary to give each individual cable channel its own addressability. Therefore, with present equipment it is not possible for subscribers to receive only selected channels.

4. **What is Oceanic doing to solve the loss of certain remote control functions on television when a standard converter is used?**

   Oceanic is aware of the need for replacing remote functions now lost. This summer, a new converter with remote and parental control capabilities will be evaluated for reliability and ease of operation. Oceanic hopes to offer such a device to its subscribers by the end of 1984.

5. **Does Oceanic plan to scramble its basic service cable channels as it has in parts of Makiki? This scrambling interferes with the use of video cassette recorders.**

   Scrambling of basic service as well as pay service channels does affect the usefulness of a video cassette recorder ("VCR"). As is the case whenever channels are scrambled, an addressable converter must be installed between the cable drop and a VCR to descramble the scrambled channels the subscriber wishes to view and record. Since addressable converters only descramble one signal at a time, only that channel can be viewed amd recorded. This prevents a subscriber from recording a scrambled channel while viewing another scrambled channel. In order to watch and record different scrambled channels at the same time, a subscriber needs to have more than one outlet with an addressable converter. An additional effect of connecting a converter between the cable drop and a VCR is that present addressable converters cannot be programmed to change channels at various times on different days. This configuration therefore defeats the ability of VCRs with such capabilities to record programs on different channels automatically. It also defeats remote and programmable channel changing capabilities, since the VCR must remain tuned to channel 3 and the converter must be used to change channels. (The same is true for televisions with remote control capabilities.)

System-wide scrambling of all or part of basic services would affect subscribers who own VCRs as well as those who own remote control televisions and would require the Director's approval. A decision would only be given after hearings were held and an analysis performed to determine the impact of the proposed scrambling.

There is a continuing need to educate the subscribers in the TVSI franchise areas about the use of converters. The Hearings Officer recommends that Oceanic undertake a program to educate its subscribers as to the reasons for using a converter.

Additional Outlets

At the public hearings, subscribers testified that they viewed additional cable outlets as being equivalent to additional telephone outlets. Since they are not charged for extension telephone outlets, cable subscribers questioned why they were subject to a monthly charge for additional cable outlets. Subscribers expressed their belief that the charge for additional cable outlets was excessive.

In response, Oceanic stated that a more equitable way to view the additional cable outlet charge was to consider it a reduced monthly charge for additional basic service. Although it was evident at the public hearings that this explanation was not well-received, the Hearings Officer finds that there are significant differences between added telephone outlets and added cable outlets which justify some charge for additional cable outlets.

The first major difference is one of utility. Both cable and telephone outlets are wired in parallel and tied to a single drop line. However, when a subscriber uses his telephone, all other outlets simultaneously carry the same conversation. A second individual cannot use an extension telephone to make a separate call while another instrument is in use. In cable systems, however, each outlet allows simultaneous access to any of the subscriber's basic cable services. In other words, while one person is watching one television program, another may watch a different channel at a second outlet. Thus, additional cable outlets, unlike additional telephone outlets, all have the same utility as far as basic service is concerned.

Another difference between additional telephone and cable outlets involves signal level. Because of the characteristics of cable distribution systems, the signal level in a subscriber's home is reduced each time an outlet is added. Oceanic's system is designed to provide a signal level at a subscriber's drop sufficient to allow for two outlets. However, if a subscriber requires three or more outlets in his home, it may be necessary for the company to add equipment to the distribution system to ensure that the signal level at each of the outlets will meet Federal Communications Commission and State technical standards. This is not the case for additional telephone outlets. A telephone subscriber may add three or four extensions to his home before there is a deterioration of service (telephones may not ring, or may ring erratically). The cost of providing extra cable outlets is also increased by the inclusion of converters for these outlets.

Additional cable outlets also mean that there is more subscriber-owned equipment (e.g., televisions, VCRs) attached to the cable system. Since Oceanic does not charge for repair calls, even when customer equipment is at fault, the added equipment due to extra outlets increases the company's exposure to costs for repair and maintenance.

For these reasons, the Hearings Officer believes that additional cable and telephone outlets are distinguishable and that monthly charges for additional cable outlets are not unreasonable.

Monopoly

"Monopoly" can be defined as follows:

> A privilege or peculiar advantage rested in one or more persons or companies, consisting in the exclusive right (or power) to carry on a particular business or trade, manufacture a particular article, or control the sale of the whole supply of a particular commodity. A form of market structure in which one or only a few firms dominate the total sales of a product or source.
>
> Black's Law Dictionary 908 (rev. 5th ed. 1979).

The application in this case would result in an entity which provides cable television service to 96% of Oahu's homes. Concern about the monopolization of such services by a single company was raised at the public hearings. This is also a concern that the Hearings Officer has had since the initiation of these proceedings.

Oceanic has throughout this matter contended that monopoly questions are not a major issue in this case. Oceanic argued that the cable television permits granted by the Department pursuant to HRS Chapter 440G create monopoly situations in each permit area, since individual consumers receive cable service from only one company. Oceanic argued further that monopoly questions should not be of substantial concern because the permits granted to cable television companies are for a fixed duration of twenty years under HRS §440G-8(d) and at the end of that period adjustments can be made if necessary.

Initially, it should be noted that Oceanic's contention that the franchise system that has been implemented under HRS Chapter 440G effectively creates a monopoly structure is correct. With the exception of a portion of Kauai, no two cable operators have franchise areas which overlap. Nowhere in the State (including Kauai) can a subscriber choose which franchisee will serve his or her home. Thus, there is a de facto monopoly condition. State-created or supported monopolies do enjoy substantial protection from federal anti-trust laws. See, e.g., Parker v. Brown 317 U.S. 341 (1943) (permitting California to control the production, pricing and marketing of raisins). Such State action is also essentially exempt from the provisions of HRS Chapter 480, Hawaii's principal anti-trust law. See Big Island Small Ranchers Association v. State 60 Haw. 228, 236 588 P.2d 430, 436 (1978) (HRS Chapter 480 is not explicitly applicable to the State and unless sovereign immunity is waived, the State is not subject to its provisions). Such conclusions do not however end the matter.

Under HRS §440G-8(b), a CATV permit is to be issued when the director "is convinced that it is in the public interest to do so." While this sub-section goes on to enumerate certain measures to determine the public interest, those measures are not meant to be exclusive. Thus, even if the State creates or supports a monopoly situation and cannot be sued because of such for creating certain monopolies, that does not mean that the State should not examine carefully the extent to which any particular permitted monopoly serves the public interest. Given the size of the entity that would be created by this application, the question of whether this particular monopoly serves the public interest must be examined.

In this case there are three primary areas of concern with regard to this application: the reduction in the present "competition," the elimination of potential competition, and the barriers to entry which may be created.

Reduced "Competition"

As Oceanic correctly points out, each cable system on Oahu serves a separate franchise area and there is thus no direct competition. Nonetheless, one common thread which ran through the hearings was comparison by consumers of the quality of Oceanic's system as contrasted with the problems in TVSI's system.

With the 96% concentration that would result from the approval of this application, the consumer (and to some extent the Department) will lose an effective reference point for judging the quality of the cable service provided. This is not an insignificant loss as the existence of two large cable systems on Oahu has heretofore provided a system of checks and balances between the major systems.

Eliminating Potential Competition

In the current cable market, no consumer on Oahu is served by more than one cable company. Nonetheless, the franchises granted by the Department are non-exclusive and with the permission of the Department, any cable system could offer services in another cable system's area. While that has not as yet occurred on Oahu, the potential for such action is significant. Given the size of the investment needed to start a cable company, the best potential competitor to an existing system is another existing system which would only need to expand its facilities rather than build an entirely new system.

On Oahu there are currently two large cable systems, each of which is theoretically capable of building into the other's franchise areas. If an area were not being well-served, this expansion capability would have important public benefits. A merger of these two large systems would have the practical consequence of eliminating the major source of competition. While there are two other cable companies operating on Oahu (Kaiser TelePrompter in Hawaii Kai and Clearview on Hickam Air Force Base), neither has the larger systems' capabilities to expand its service area significantly.

Barrier-to-Entry

As noted above, the cable television permits granted by the State are non-exclusive and it is possible for a new firm to seek permission to serve an area which is already being served. The proposed merger would increase the barrier to entry of new firms in two ways.

Firstly, the easiest way for a new firm to enter the cable television market is to buy an existing system and use it as a basis for expansion. On Oahu, the only two systems which present substantial expansion opportunities are (as discussed in the last section) Oceanic and TVSI. If these two companies are merged, a new company would only have the options of attempting to acquire, and building off of, Kaiser TelePrompter or Clearview, each of which serve much smaller franchise areas.

Secondly, any new company attempting to start operations will, if the application is approved, face the daunting prospect of competing with a company which serves 96% of Oahu's homes. The likelihood of new entrants is substantially decreased by this level of market concentration.

In the Hearings Officer's view, there are clearly grounds for concern about the impact of granting this application. The merger of the two largest cable systems on Oahu will decrease significantly any competition which exists, or could exist, in the Oahu cable television market. The question thus becomes to what extent the anti-competitive effects of this merger represent significant harm to the public interest. While, as discussed earlier, federal and state antitrust laws do not directly apply in this matter, the analysis used in construing those laws is instructive.

In Island Tobacco Co., Ltd. v. R.J. Reynolds Tobacco Company, 63 Haw 289, 309-310 627 P.2d 260, 274 (1981), the Hawaii Supreme Court stated as follows:

> The offense of monopoly under S2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market and (2) the wilful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident. United

States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966). In concept, the "relevant market" is the area in a line of commerce where effective competition exists and where monopoly power might be exercised. Its definition in a given situation entails the determination of a "geographic market" and a "product market." Brown Shoe Co. v. United States, 370 U.S. 294, 324 (1962); United States V.E.I. duPont de Nemours & Co., 353 U.S. 586, 593 (1957). As HRS §480-9 condemns efforts "to monopolize any part of the trade or commerce in any commodity in any section of the State," a violation of the State law also must be predicated upon proscribed conduct in a relevant, two dimensional setting.

For the purposes of this case, the geographic market is clearly the island of Oahu. The more crucial question is presented in defining the product market involved.

The Relevant Product Market

The rapid development of technology has made the definition of a relevant market difficult. It is clear, however, that the relevant product market cannot be limited solely to cable television systems licensed under HRS Chapter 440G. Instead, following the guidance of Island Tobacco, supra, the inquiry must focus on the "area in a line of commerce where effective competition exists." Because the cable industry is involved in an area where technology is developing at an extremely fast pace, that inquiry must take into account competition which will exist in the near and foreseeable future.

When asked at the hearing to define the relevant product market in which it competes, Oceanic stated that that market included broadcast television, theaters, videotapes and video cassette rentals, SMATV ("Satellite master antenna television," which essentially involves the use of a satellite antenna system with programming fed to individual consumers by a private cable line), DBS ("Direct broadcast satellite," which essentially involves the reception of satellite signals by small roof-top satellite antennas or dishes), MDS ("Multipoint distribution service," which essentially involves using microwave transmission to roof-top antennas rather than cables or wire) and personal computers. This definition of the relevant market was essentially accepted in Satellite Television & Associated Resources, Inc. (STAR) v. Continental Cablevision of Virginia, Inc. (E.D.Va. March 26, 1982) [1982-2 Trade Cas. (CCH) [64,733] aff'd 714 F.2d 351 (4th Cir. 1983) [1983-2 Trade Cas. (CCH) ¶ 65,541], a case involving an unsuccessful challenge by a SMATV company of exclusive contracts which the cable television company had entered into with apartment building owners.

That market definition has been the subject of some criticism as being overly broad. See 2 C. Ferris, F. Lloyd and T. Casey, Cable Television Law ("Ferris") ¶ 24.09[2],

p. 24-24 (1983). Those authors go on to suggest a variety of formulations of the relevant market including the total cable television market and the total cable-SMATV-STV-MDS market. (STV or "subscription television" involves the broadcast, usually by a UHF or VHF television station, of a scrambled signal which is decoded by the subscriber using equipment provided by the STV company.)

For the purposes of the review of the application in this case, the Hearings Officer believes that only two relevant markets can be considered—the entertainment market formulation urged by Oceanic and the more limited cable-SMATV-STV-MDS-DBS market which is suggested in Ferris, supra. Viewing the merged entity (Oceanic and TVSI) in either relevant market leads, however, to the same conclusion. There is simply too much competition and ongoing technological innovation in this field for any participant to feel comfortable or secure. Oceanic testified that at least some of these alternate services could be provided at rates comparable to cable subscription rates. Further, it is clear that the use of some of these alternatives by certain users (such as apartment or condominium buildings) would probably be less expensive. While it may well be that cable television will continue to hold the most dominant position, the competition provided by other forms of entertainment should ensure competitive rather than monopolistic behavior by Oceanic. (Because this is not in fact an anti-trust case, the record does not contain, nor need it contain, precise figures on the market shares that each competing system currently has or can be expected to have in the near future. In evaluating the monopoly question in terms of the public interest requirement in HRS Chapter 440G, it is sufficient that alternative delivery systems are in fact capable of directly competing with Oceanic and that they are doing so or are likely to do so in the near future. The Department is aware of the growth of these alternative delivery systems in Hawaii and is confident that they represent real and substantial competition to Oceanic.)

The "Arrogance of Power"

At one hearing, a speaker urged caution with regard to this application because of what he felt was a potential "arrogance of power" in the merged entity. While the specific example used by the speaker (a department-approved scrambling of basic service channels in the Makiki area of the current Oceanic franchise) is not involved in the present matter, the potential discussed by the speaker is one of which the Department and the applicant must be ever-mindful.

The entity that would result from the combination of Oceanic and TVSI would have essentially island-wide reach. It would therefore become a dominant entertainment business and a potentially dominant telecommunications business. The potential for "arrogance" is inherent in such a situation and requires even greater vigilance by both the regulator and the regulated.

In a very real sense, the approval of this application is an experiment. Can the island of Oahu be well-served by essentially one cable franchise? Can quality be maintained in a system of this size? Will the merger raise the level of service TVSI subscribers currently receive without a loss to current Oceanic subscribers? Oceanic has presented a strong case that it can manage the larger system and approval of the application will therefore be recommended. However, if the transfer is approved, the Department must carefully monitor Oceanic's activities in the coming years to ensure that the "power" which Oceanic obtains through this merger is not exercised in a manner which either harms consumers or fails to give sufficient weight to the consumer interest. In the Hearings Officer's view, while big is not necessarily bad, the larger the entity, the greater the potential for individual consumers to be seen as less significant and the greater the harm that can be caused by such an entity. The Department's current faith in Oceanic and its commitment to consumer interests must therefore be tempered with the knowledge that the provision of cable television services on Oahu must be even more carefully monitored in the future.

VIII. RECOMMENDATIONS

The Hearings Officer recommends the approval of the requested transfer of TVSI's permits to Oceanic and the equalization of rates and charges, subject to the following conditions:

1. By September 1, 1984, Oceanic shall submit to the Department its plans to educate its subscribers regarding the use of converters. The plan should include the dissemination of information discussed in Section VII hereof.

2. By October 1, 1984, Oceanic shall submit to the Department its plans for providing a cable television link to Honolulu Hale and to the Oahu Civil Defense Agency in the Honolulu Municipal Building.

3. By July 1, 1985, Oceanic shall submit to the Department its plans for:

a. Offering non-entertainment cable services, especially services to the business community; and

b. Handling the competition between must-carry and mandatory access requirements and pay services for the limited number of cable channels available.

4. By August 1, 1985, Oceanic shall submit to the Department an analysis of its financial condition upon completion of one year of merged operation, including as part of the analysis a summary of actual or projected savings due to economies of scale. Oceanic should exercise due diligence in seeking such economics.

5. By December 31, 1985, Oceanic shall complete all 30 construction projects described in the revised construction schedule, dated March 27, 1984. In particular, Oceanic shall complete project number 18, the Waimanalo Farm Lots, in the first half of 1985.

6. By January 31, 1986, Oceanic shall submit to the Department its plans to increase its channel capacity to over 40 channels.

7. Equalization of rates and charges to TVSI subscribers shall not take effect until Oceanic has completed all programming changes detailed in items 1 through 5, Section III, "Programming," and quality improvement items 4 through 8, Section III, "Quality." Any delays in the schedule set forth in Section III which exceed thirty days shall be explained to the Department in writing.

8.. Oceanic is to submit, as part of its quarterly reports, a review of community access programming, including the current utilization of the equipment, facilities and channel time, which channels are being used for such programming, and the extent to which requests for use of equipment, facilities and/or air time have been denied or pre-empted because of a lack of equipment, facilities or air time.

9. Oceanic shall submit a status report regarding all improvements proposed in its application as part of its Quarterly Report to the Department.

10. Oceanic shall provide installation and repair services to all subscribers on a six-day schedule similar to that now provided by TVSI to its subscribers.

11. Any exercise by Oceanic of the rights and privileges granted by a transfer of TVSI's permits will constitute agreement to these conditions.

Robert A. Alm

ROBERT A. ALM
Hearings Officer

June 26, 1984