

BEFORE THE DIRECTOR OF REGULATORY AGENCIES
STATE OF HAWAII

In the Matter of the Application)
)
for Transfer of the CATV Permits)
of TV Systems, Incorporated.)
_____)

DOCKET NO. 17-81-02

ORDER NO. 87

DECISION AND ORDER

On December 1, 1981, the duly appointed hearing officer submitted his written Recommended Decision ("RD") to the Director. The RD was served on all parties. Applicant was afforded a thirty-day period in which to file written exceptions to the hearing officer's RD. Applicant filed documents on December 30 and 31, 1981.

Having reviewed and considered the RD, the December 30 and 31, 1981 documents, the procedures adhered to, and the entirety of the record in this matter, I hereby adopt the hearing officer's RD (attached hereto as Attachment I) as the Final Order in this proceeding, except to the extent the RD is herein reversed, interpreted, or otherwise revised.

In his RD, the hearing officer found that there is no compelling public interest necessitating consent to the proposed transfer. He further found that approval of a transfer should be considered only if, prior to the approval, there were to be (1) significant improvements in the cable systems; (2) completion and extension of cable services and facilities to all potential subscribers within the cable permit area; (3) adoption of a system of providing converters to all cable subscribers; (4) development of practices and procedures for the improvement of subscriber services; and (5) implementation of a program for the cablecasting of local origination, access and ethnic programming.

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Applicant, in its Response to Recommended Decision argued that "the director should approve a transfer of the permit of a cable television permittee under Chapter 440G, HRS, unless there is a showing that such a transfer would be detrimental to potential and existing subscribers, or the public in general." Such a standard of review would be substantially different than that adopted by the Department (refer Order No. 79, page 3, dated March 20, 1981). Applicant also takes exception to the hearing officer's imposition of five conditions precedent to approval of the transfer of TVSI's permit. It is noted, however, that TVSI is willing to take on such conditions subsequent to approval of the transfer.

There are two decisional issues which have arisen between the RD and the Responses to the Recommended Decision, which shall be addressed herein: (1) the appropriate standard of review for applications for transfer, generally, and this transfer in particular, of cable permits; and (2) the establishment and enforcement of a mandatory converter policy for TVSI subscribers.

THE STANDARD OF REVIEW FOR THIS TRANSFER

In its response to the RD, TVSI urges a standard of review for transfers different than that previously adopted by the Department and now employed by the hearing officer. TVSI contends that the Director should approve transfers of permits unless there is an affirmative showing that such a transfer would be detrimental to potential and existing subscribers, or to the public in general.

Applying TVSI's proposed standard to the present proceeding, I find that the proposed transfer would be detrimental to the interest of potential and existing subscribers and to the public in general.

The detriment in question results from changes in the financial condition of the business entity providing basic cable communication services to TVSI subscribers. The changes in financial condition will result from:

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(1) A substantial increase in the cable company's reported cost of assets. For example, the valuation of net plant would increase from \$2,987,357 as of March 31, 1981 to \$13,437,780, upon a grant of approval;

(2) Valuation of existing assets on a "fair market" basis, which will result in a system valuation which is approximately four times net plant;

(3) Additional revenue requirements necessary to service the purchase price and the interest charges resulting therefrom; and

(4) Depletion of retained earnings available for cable expansion.

These changes are more significant than mere "reporting" changes. Ratepayers will ultimately shoulder the financial burden associated with the acquisition: a substantial increase in the rate base upon which increases in monthly and other charges may be based, and a reduced capacity of the existing company to utilize its cash flow, reserves and lines of credit to finance improvements and expansion of cable plant and services.

In the instant case, TVSI has admitted: (1) failure to provide its subscribers with continuous signals of an acceptable quality and quantity; (2) failure to construct cable facilities to all potential subscribers within the time limits prescribed by its cable permit; (3) failure to provide acceptable consumer services; and (4) failure to provide required access facilities. Under the provisions of Section 440G-9, HRS, such failures constitute grounds for revocation, alteration or suspension of cable permits. The permittee's system would be sold for approximately seven times the stated value of its net plant. Under the purchasers' proposed financing plan, existing and potential subscribers of TVSI ultimately would bear the full burden of the purchase price. Because the cost of the capital required to consummate the purchase is assumed by the permittee, rather than the equity holder, the purchase will be a "detriment to the public interest."

Thus, even assuming TVSI's proposed standards for review, it is decided that the hearing officer's decision is proper. Notwithstanding that conclusion, the Department is maintaining the standard of review consistent with Section 440G-8(b), HRS, and Order No. 79.

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CONVERTERS

On June 15, 1978, the Director initiated a formal investigation into the use and tariffing of converters. Since 1978, other permittees, including Applicant, have gained experience working with converters. Recent technological developments with converters have resulted in uses in addition to that of controlling off-air interference and expansion of channels, e.g. addressing and controlling access of all or parts of cable programming, expanding capacity, and reducing operating expenses associated with maintenance, service, installations and disconnections.

Due to each company's unique characteristics, such as (1) operations, (2) number of subscribers needed to support additional services, (3) availability of programming, (4) available resources, and most importantly, (5) market demands, it is deemed most appropriate that regulatory policy concerning the use of converters be addressed on a company-by-company basis. TV Systems, Incorporated, therefore, shall submit, within 60 days of this order, a specific plan for converters, on the assumption that a full mandatory converter policy is required. Attached hereto and intended to be included as a part of this Order is Exhibit A, which sets forth the type of information, as a minimum, which is to be included in TVSI's submittal.

NOW, THEREFORE, IT IS HEREBY ORDERED THAT:

1. The Application of CABLESYSTEMS HAWAII, INC./TV SYSTEMS, INC. filed on April 16, 1981 is hereby DENIED;
2. CATV Docket No. 00-78-01 (Converter Policy) is terminated; and
3. TVSI shall submit the above-described policy statement on converters by March 21, 1982.

DATED: Honolulu, Hawaii, January 18, 1982.


Mary G. F. Bitterman
Director

EXHIBIT A

1. Who will be providing the converters to the following types of subscribers?
 - a. Basic subscribers only.
 - b. Pay subscribers.
2. What capitalized cost and expenses are to be considered in determining changes in monthly charges due to the converter and associated hardware? Will the increase be the same for multiple outlets?
3. If addressable converters are to be utilized for pay services, what capitalized cost and expenses are to be apportioned to basic cable services?
4. If deposits are considered, provide a policy for:
 - a. Determination of deposit amount.
 - b. Determination of who shall be required to provide deposits.
 - c. Determination of whether deposits shall be required for multiple outlets.
 - d. Determination as to when a deposit is to be returned.
 - e. Determination of change in deposit if for pay services addressable converters are to be used.
 - f. Determination of interest on deposits.
5. If addressable converters are to be utilized for pay services, will a pay subscriber receive addressable converters for all outlets in the case of subscribers having multiple outlets? Should the answer be affirmative, will the subscriber be required to pay additional monthly charges for each outlet as well as possibly higher deposits for each even though he may wish certain services at only a particular outlet.
6. If addressable converters are used for pay services and subscriber terminates pay services only, will the addressable converter be replaced with a standard converter? If no, will the subscriber be charged the higher monthly cost for the addressable converter and possibly higher deposit.
7. Does the company entertain the idea of charging for the installation or removal of converters? If yes, provide circumstances.

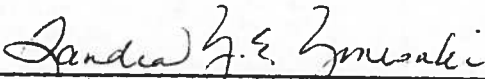
CERTIFICATE OF SERVICE

Service of Order No. 87 was made by personal delivery to TV Systems, Incorporated; and by certified mail, return receipt, to the following on this 19th day of January, 1982.

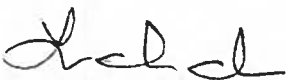
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Cades, Schutte, Fleming & Wright
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Mr. Robert S. Howard
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Mr. Donald W. Reynolds
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P. O. Box 410
Las Vegas, Nevada 89101



Sandra Y. E. Yonesaki



For TV Systems, Incorporated

BEFORE THE DIRECTOR OF REGULATORY AGENCIES
OF THE STATE OF HAWAII

In the Matter of the Application)
)
for Transfer of the CATV Permits)
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DOCKET NO. 17-81-02

RECOMMENDED DECISION

SUMMARY

It is herein recommended by the duly designated hearing officer that the Director DISAPPROVE the transfer of the three permits currently issued to TV Systems, Incorporated ("TVSI").

Based on the record compiled to date, there is no compelling public interest necessitating consent to the transfer; indeed, if transfers were to be granted, the management and operation of TVSI's systems would remain in the same hands, without in any way increasing the potential for improvements in the systems' problem areas.

In the case of TVSI, it is recommended that a transfer occur only if: (1) there were to be significant improvements in the cable systems; (2) completion and extension of cable services and facilities to all potential subscribers within the cable permit area; (3) adoption of a system of providing converters to all cable subscribers; (4) development of practices and procedures for the improvement of subscriber services; and (5) implementation of a program for the cablecasting of local origination, access and ethnic programming, is well underway.

INTRODUCTION

On April 16, 1981 CableSystems Hawaii, Incorporated/Cable Theater, Inc. filed an application with the Director of Regulatory Agencies ("Director") to be the transferee of the permit and other assets of TV Systems, Incorporated.

To afford the public an opportunity of participating in regulatory decisionmaking, a public hearing on this application was held on September 22, 1981 at the Hawaii State Capitol Auditorium commencing at 7:00 P.M. Notice of the hearing was published in newspapers of statewide circulation on September 4 and 15, 1981. Testimonies and comments were offered by nine individuals at this hearing.

The Departmental cable staff on September 28, 1981 undertook an informal inquiry into the justifications submitted by Applicant in support of the transfer, as well as the concerns, complaints and discussion presented by witnesses at the public hearing.

GUIDING PRINCIPLES

The regulatory powers of the Department regarding the transfer of CATV permits are set forth in Section 440G-10, H.R.S., which requires that the transferor and the proposed transferee make written application to the Director and that the information in such application be substantially the same as the information required in an original application for a permit (refer Section 440G-6, H.R.S.), together with information concerning the consideration to be paid and such other matters as the Director may deem appropriate or necessary. Section 440G-6 directs the Department to obtain information regarding:

"...the citizenship, character, and financial, technical, and other qualifications of the person seeking to operate the CATV system and complete information as to the principals and ultimate beneficial owners... with full disclosure as to the true ownership of the facilities to be employed in rendering service, as to the source of funds for the purchase, lease, rental, and installation of such facilities... and as to his ability to extend service at a reasonable cost to the potential subscribers in the proposed service area. Each application shall set forth the rates to be charged, the services to be offered, the facilities to be employed, the general routes of the wires, cables, conduits, or other devices used in the redistribution of signals, the service area or areas, the commencement and completion dates of construction of the CATV system, and the proposed date service will be available to the areas named." (Emphasis added.)

While Section 440G-6, H.R.S., directs the Department to require certain information from each applicant in his application, it is Section 440G-8(b), H.R.S., which establishes the requisite criteria to be considered by the Director

prior to issuing a permit. In the instant case, permits have already been issued -- but to TVSI. The real question to the Department is whether or not it is in the public interest to transfer ("re-issue," if you will) the permit to the proposed transferee, Cable Theater.

"The director, after a public hearing as provided in 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, the public need for the proposed service or acquisition, the ability of the applicant to offer service at a reasonable cost to the subscribers, the suitability of the applicant, the financial responsibility of the applicant, the ability of the applicant to perform efficiently the service for which authority is requested, and any objections arising from the public hearing, the CATV advisory committee, or elsewhere." Sec. 440G-8(b), H.R.S. (Emphasis added.)

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 approvals shall not be withheld. The transfers proposed herein promise neither improved service nor earlier completion of construction. When one asks what public good is to be derived from an approval of this application, the response is in the negative.

PLACING THIS APPLICATION INTO CONTEXT

Chapter 440G, H.R.S., 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."

In the case of TVSI, on August 12, 1971, the Director approved its application for additional service areas with the condition that it complete within twenty-four months the construction of cable facilities to provide service to all potential subscribers within its permit area. August 12, 1973 came and went with much of the permit areas remaining unbuilt. TVSI, on April 11, 1975, requested approval from the Director for an increase in its monthly rates. On November 6, 1975, the Director denied the request citing the following:

- (1) The quality and dependability of service provided by TV Systems, Incorporated was erratic and below prevailing standards in the industry;
- (2) TV Systems failed to complete construction to all potential subscribers within its permit area cable services;
- (3) TV Systems had failed to even attempt to provide origination programming; and
- (4) TV Systems had failed to provide institutional access as required by its permit.

TV Systems, on November 17, 1975, requested a hearing on the denial of its request for a rate increase. After numerous hearings, the Director, on May 2, 1978, approved an increase in rates, on the condition that the construction of cable facilities be completed by December of 1980 -- to all potential subscribers in the TVSI permit areas (except for approximately 270 isolated and remote homes in Windward Oahu); and extension of cable facilities to all schools and institutions.

Projections show a total of 6,700 existing homes or homes to be built in TVSI's areas not yet served by cable facilities. Assuming the growth for Year One, i.e. 700 new homes, is similar to that of Years Two through Five, the potential number of homes along the 41.6 miles of plant yet to be constructed would be about 6,000. This figure represents the potential number of subscribers that should have had cable services by December of 1980.

The Cable Division has consistently received more complaints relative to the quality and dependability of TVSI services than the total received on all of the other cable systems in the State combined. The complaints received are relative to: (1) off-air interference of cable signals; (2) frequent outages in service for the Windward Oahu system; (3) misrepresentations in and failure to install cable systems and facilities within promised time schedules; (4) converter policy; (5) credit and payment policies; (6) inability to get into telephonic contact with TVSI; (7) discourtesy and incompetence of TVSI personnel; and (8) quality and quantity of program services available on the TVSI system.

The need to alleviate this situation required TVSI to creatively seek solutions to these complaints, and to submit plans to the Cable Division for approval. What was never done by TVSI, but what should have been done by TVSI, and what shall be done by TVSI before reconsideration of this denial of TVSI's request to sell or transfer its permits, are the following:

1. Completion of construction to provide cable services to all potential subscribers within its permit areas;
2. Provision of converters and other means of alleviating off-air interference to cable signals;
3. New headends in Windward Oahu;
4. Improved trunk distribution lines and facilities;
5. Stand-by power for distribution facilities;
6. Improved procedures and scheduling for installation of consumer cable facilities;
7. Training programs for the improvement of customer relations and technical services;
8. A vastly improved system for communicating with consumers, e.g., answering service, program directory, public relations, etc.; and
9. New and expanded program services which meet the needs and requirements of TVSI's subscribers.

TV Systems is experiencing interference problems in parts of its system due to the Company's utilization of "on channel" frequencies. Interference due to "off-air" reception can be controlled by (1) use of converters; (2) use of A-B switches; and (3) conversion of local broadcast to unused VHF channels. Only through the use of converters will the company be able to both eliminate "off-air" interference problems as well as increase the number of channels for additional services. (Economic Transcript, pages 45 through 52.)

Though the Applicant states it is not adverse to providing converters as part of its basic service to all subscribers, it intends to require a security deposit equal to the full cost of the converter. Allowing for full deposit for converters will transfer the burden of capital investment from the company to the subscribers.

Security deposits should be limited to only those with inadequate credit experience and be limited in time for return with an interest payment tied to prime rate. Any projections for rate changes based on additional investments for converters should properly be part of a rate proceeding rather than a part of this application.

In light of the above, and the proposed \$7 million investment over the next five years for addressable taps and standby power, the Applicant must re-evaluate its present plans and consider an addressable converter system that will both control subscribers' access to programming and allow a standard TV set to receive all cable channels.

SUITABILITY OF APPLICANT

TVSI proposes a sale of the major interest of the cable system to Donrey, Inc. (37-1/2%) and Howard Publications, Inc. (37-1/2%). Management and operation of the cable system will be under the direction and control of the present shareholder, president and general manager, Mr. Lloyd Char. The high cost of financing the purchase of the cable system (approximately \$22.5 million) and the pay operations (approximately \$6 million) inhibits creative approaches to the solution of present cable system facilities and service problems. The expected preoccupation of cable system operators with the generation of profits necessary for the installment payment of purchase price and financing costs will probably affect programming and other service initiatives and expansion.

The continued centralization of decisionmaking in a single individual (President and General Manager, and shareholder, Lloyd Char) will undoubtedly continue to present serious problems. It is anticipated that additional travel requirements imposed upon the President and General Manager on matters of cable expansion and mainland cable operations will likely result in a deterioration in the management and operations of the Hawaiian cable system. Little effort has been expended to develop an organizational structure which is capable of operating a complex and multi-faceted cable communications system, able to deal with the new technologies and new services which should now be available to TVSI's customers. Plans for the future for companies based in Hawaii and the Mainland are non-existent. Expansion in the field of cable communications by communications

conglomerates has generally resulted in synergisms among print broadcast, and cable communications. The majority shareholders of the proposed venture will treat cable passively and primarily as an investment opportunity rather than diversification into new cable technologies.

Donrey, Inc. and Howard Publications, are involved in newspaper publications in towns and small cities. Consequently, they do not possess the major news bureau system resources of major newspaper chains such as the Times Mirror and the New York Times which can supplement and enrich the potential for cable news and other programming services in cable systems such as TVSI.

The Donrey newspaper organization is the publisher of the Hawaii Tribune Herald, the daily newspaper serving the island of Hawaii. However, it does not anticipate that there will be an active involvement of Tribune Herald personnel with Cable Theater and its operations.

FINANCIAL CONDITION

On May 2, 1978, TVSI was granted a two part rate increase conditioned upon the completion of construction of cable communication facilities throughout its cable permit area. TVSI has implemented all parts of the allowed rate increase. A rate differentiation now exists between its two major service areas -- \$7.25 for the Honolulu side of the system, and \$7.80 for the Windward side of the system.

In fiscal 1981, TVSI enjoyed gross profits of \$526,029 on revenues of \$3,657,576, representing a 25.4% return on owner's equity of \$2,072,645. It appears reasonable to assume that the basic relationship between profits and revenues will be maintained in the immediate future, all other considerations remaining the same.

The high degree of profitability of TVSI and its affiliate companies, coupled with its relatively small indebtedness, has enabled it to use "cash flow" as the principal means of financing systems construction and other capital improvements. TVSI's reliance on cash flow as a prerequisite for construction has been a major area of difference between the Division and the Applicant. Reliance on "cash flow" rather than financing, as the principal means of financing the

construction of the system, has been the principal cause of the long delays in completing the construction of the cable systems throughout TVSI's permit areas. It has also been the reason why the operator has not been able to create and maintain a cable system with dependable quality cable communication signals and service. Hesitancy in providing converters which would alleviate "off-air interference" and which would allow subscribers to receive all cable services which they are paying for may be traced to this reliance on "cash flow" for financing expansion and improvements in the cable system.

APPLICANT'S ABILITY TO PROVIDE SERVICE AT REASONABLE RATES

For purposes of analyzing this application under the criteria set forth in Section 440G-8(b), H.R.S., the ability of applicant to offer services at reasonable cost to the subscribers and the ability of the applicant to perform efficiently the service for which authority is requested are essentially the same criterion, and therefore will be analyzed together in this section.

The sale price for TVSI's cable system is \$22,480,500, subject to adjustments based upon the net worth of the company and the number of bona fide CATV subscribers. An additional \$6,000,000 is to be paid for the stock for Cable Theater, Incorporated, the pay television affiliate of TVSI.

At closing, \$3,180,500 will be the initial payment for TV Systems with a deferred balance of \$19,300,000 to be paid over a five year period. For the first three years, \$2,600,000 principal and the annual interest on the remaining deferred balance of 9%, 9.5% and 10.5% will be paid to the TVSI sellers. In the fourth and fifth year, \$5,200,000 and \$6,300,000 principal payments with 12% interest will complete payment to TVSI's sellers.

The \$22,480,500 sale price and the interest payments necessary to finance the deferred payment will require substantially increased revenues to both finance the system's purchase, as well as to finance the expansion and improvement of the cable system and its services.

TVSI's Exhibit IR-D shows a depreciation and amortization expense for Year 1 of about \$2,000,000 of which IR-E shows that about \$284,000 amortization

expense for franchise cost, \$1,591,100 depreciation expense for restated plant amount of \$13,434,700 for TV Systems purchased assets, and \$61,000 depreciation expense for new construction.

Insistence by Applicant that the system be valued on a "fair market" basis rather than "original cost less depreciation" (net plant) basis for rate proceedings, is indicative of a desire that the cost of transfer of ownership of the cable system be borne by cable subscribers rather than by the new owners. Valuation on a "fair market" basis" will result in a systems valuation which is approximately four times net plant.

Applicant defends the use of its alleged fair market valuation for its system of \$13,434,700 and related depreciation expense on the basis that such valuation is necessary to establish a sufficient reserve for future replacement of plant. It argues that without such a valuation, significant increases in rates may be necessary in the future. (Economic Transcript, pages 17, 18, 48, and 49.) TVSI's plant and equipment accounts (as of March 31, 1981) show a depreciated value of \$2,987,357.

Contrary to Applicant's concept of its purpose, depreciation accounting is intended as a means of recovering from taxation and rate bases the capital expenditures invested in physical plant contributing to the production of revenues and is not intended as devices for financing replacement of expended resources. Depreciation is charged to operating expenses in order to record the cost of property consumed in providing service, irrespective of whether such property is replaced.

Depreciation expenses or charges for utility services in Hawaii are calculated on an original cost basis which are constant; whereas, depreciation charges based on replacement costs or fair market value, fluctuate annually with rising or falling prices. Such fluctuations are not necessarily fair to the company or consumers in times of economic uncertainty and change.

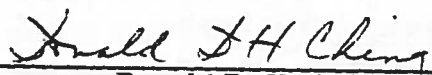
In Schedule 1 of Exhibit IR-E, Applicant, in response to staff questioning, has indicated that it will not include franchise amortization cost as justified cost in future rate request applications. (Economic Transcript, pages 48 and 50.)

Applicant's Exhibit H, Revision 1, indicates a projected need for rate increases for basic services of \$1.20 in the first year and \$1.00 for the second year. Pay service charges will be raised by \$1.05 in July 1981.

Applicant's projected rate increase results from the need for \$1,000,000 in Year One to cover depreciation and amortization expenses resulting from the restatement of assets of TV Systems to fair market value. Exhibit IR-D, Expenses Projections, also shows increased interest expense of over \$1,500,000 for Year 1 resulting from the cost of financing the deferred balance of \$19,300,000. The two items increase the expenses to be paid by present and future subscribers by over \$2,500,000 due to the transfer of the permit. As indicated above, the interest on the deferred balance will not be included for ratemaking purposes, and also, for ratemaking purposes, original cost rather than fair market value is the basis for calculating depreciation expenses in Hawaii. Consequently, allowable expenses should be reduced by over \$2,500,000 in the first year.

The deferred balance and interest payments of approximately \$4,000,000 annually for the next five years by Cable Theater to the sellers of TVSI will discourage additional investment in the company for capital expenditures except through cash flow in excess of repayment requirements. The consequent conditions must be imposed to insure that (1) facilities are available to all potential subscribers within the permit area; (2) provisions are made for the reconstruction and improvement of existing cable and other facilities; (3) facilities are constructed to meet all permit conditions; and (4) the Company's operations meet service and other needs of its subscribers.

DATED: Honolulu, Hawaii, December 1, 1981.



Donald D. H. Ching
Designated Hearing Officer

CERTIFICATE OF SERVICE

Service of the foregoing Recommended Decision in Docket No. 17-81-02 was made by personal delivery to the following on this 1st day of December, 1981:

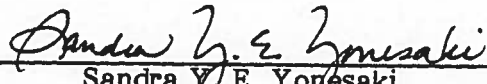
TV Systems, Incorporated (3)
2130-D North King Street
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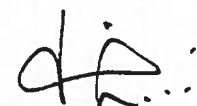
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Service to the following was made by mail, postage prepaid, on this 1st day of December, 1981:

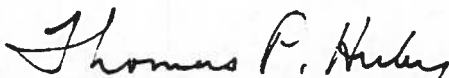
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Sandra Y. E. Yonesaki



For TV Systems, Incorporated



For Thomas P. Huber, Esq.