BEFORE THE DIRECTOR OF COMMERCE AND CONSUMER AFFAIRS

STATE OF HAWAII

In the Matter of the Application of HONOLULU TELEVISION & COMMUNICATIONS CORPORATION, dba PACIFIC CABLEVISION For Amendment of Its Rates and Charges.	DOCKET NO. 16-82-02 ORDER NO. 92

FINAL DECISION AND ORDER

I. Introduction and Procedures

On January 7, 1982, the Applicant, HONOLULU TELEVISION & COMMUNICATIONS CORPORATION, dba PACIFIC CABLEVISION, filed its Application for Amendment of Rates and Charges (hereinafter "Application").

Honolulu Television and Communications Corporation is the parent organization of Oceanic Cablevision and Pacific Cablevision. In the following discussion, where the subject matter refers to concerns affecting both Oceanic and Pacific permit areas, facilities and operations, "HTC" shall be referenced. In matters relating only to the Pacific Cablevision permit area, facilities and operations, reference will be to "Pacific." In discussions relative only to Oceanic Cablevision, the reference will be to "Oceanic."

By letter dated January 29, 1982, Pacific amended its Application to include a revised schedule of "Rates and Charges" that would result in a new monthly subscription rate for basic residential cable service of $10.45 (an increase of $3.45, from $7.00 to $10.45).

Subsequently, Pacific's application was assigned to a duly appointed Hearings Officer for the purposes of conducting hearings, compiling an evidentiary record, and formulating a Recommended Decision (hereinafter "RD") to be submitted to the Director of Commerce and Consumer Affairs (hereinafter "Director") for her consideration.

Pursuant to Hawaii Revised Statutes, Section 440G-7, and after notice, a public hearing was conducted on May 19, 1982. An additional public hearing was held on July 29, 1982, at which time subscribers and the public were afforded a second opportunity to present views and comments.

A pre-hearing conference was held on July 22, 1982. As a result of the pre-hearing conference, representatives of HTC and the Cable Television Division staff of the Department of Commerce and Consumer Affairs (hereinafter "Staff") agreed that the following issues were to be addressed and resolved:

a. Are the basic rates and charges proposed by Pacific Cablevision reasonable?

b. Is the reduction of the initial installation fee for cable services from $75 to $30 reasonable?

c. Is it reasonable to equalize Pacific's rates, fees, and charges to those of Oceanic?

d. Is it reasonable to include set-top converters as an integral and requisite component of a cable TV distribution system?

The possibilities of waiving the economic hearing and entering into a stipulated, jointly-proposed RD were discussed. On August 12, 1982, Pacific submitted a proposed Stipulated RD to the Hearings Officer for his consideration. It not being acceptable, the Hearings Officer filed his RD with the Director on September 10, 1982.

On September 20, 1982, Pacific submitted comments opposing several recommendations made by the Hearings Officer. Pacific submitted additional comments on October 19, 1982. Essentially, Pacific opposes the Hearings Officer's definition of "basic cable services" and the recommended method of allocating joint costs between "basic cable services" and "other services". Pacific claims that the recommendations "were not the subject of any of the public statements, company testimony, economic hearings, formal or informal discussions, or Cable Television Division staff input."

II. Summary of Findings

Upon review and consideration of the entire record in this proceeding, the Hearings Officer's RD shall be adopted in part and modified or reversed in other parts.

Adopted are the Hearings Officer's recommendations (1) to equalize Pacific's rates with those of Oceanic's, and (2) to include the set-top converters in Pacific's used or useful plant.

Rejected are the Hearings Officer's definition of "basic cable services" and the related cost allocation concepts. Said recommendations are not adequately supported by the record. Parties to the proceeding did not have an adequate opportunity to address the factors upon which the Hearings Officer based his recommendations. As such, it remains unclear whether or not Pacific and its subscribers would be adversely impacted by the implementation of the RD.

III. Specific Recommendations

The following specific recommendations (some of which have been edited) are accepted by the Director:

A. Fairness of Rates and Charges

Historically, the determination of what constitutes a fair rate for basic cable television has been difficult to assess under the traditional public utility ratemaking standards. Several factors account for this difficulty. First of all, the nature of the service is acknowledged as non-essential. Further, a cable TV company does not enjoy the natural monopoly that many of the public utilities do today. Cable TV's most immediate "competitor" is with free direct off-air signal television stations. For subscribers, CATV must compete with movie theaters, closed circuit programs, and live entertainment.

Other than competitive factors, cable television technology has rapidly developed to the extent that much of the initially constructed plant is near obsolescence -- making difficult the valuation of depreciated plant-in-service.

From a financial perspective, many cable TV companies have, as yet, failed to establish an acceptable capital structure. (Refer Docket No. 17-75-01.) HTC is heavily leveraged -- its test-year long-term debt is approximately 95% of its test year rate base. (Refer Appendix B.)

Finally, many new unregulated cable offerings -- such as pay TV and alarm service --create an added difficulty in allocating costs and plant-in-service between the regulated and non-regulated sectors.

In the RD, the Hearings Officer attempted to undertake a separations process by defining terms, and assigning costs. While his effort was laudatory, such attempts need to be undertaken with the cooperation of the industry. In order to properly allocate costs, the evolution of the causes of the costs must be understood. Without a fair method of separating these costs presently available to the regulator, the rate of return for only the regulated portion of the service cannot be accurately computed. This is especially true when non-regulated revenues are significant: in the instant case, non-regulated revenues are over 40% of the total revenues. While a 16.03% rate of return on rate base would be excessive for mature public utilities, considering the fact that much of HTC's debt floats with unpredictable prime rates, coupled with the leveraging in HTC's capital structure, the 16.03% rate of return cannot be said to be excessive.

Because of these difficulties, both Pacific and Staff presented analyses of HTC's operations, combining Oceanic and Pacific regulated operations with its non-regulated operations. For purposes of this case, such analysis is satisfactory. First, HTC has merged the operations and finances of Oceanic and Pacific. Secondly, non-regulated and regulated operations of HTC basically utilize the same cable network and personnel. Third, a fair method of allocating costs between regulated and unregulated operations was not presented in evidence in this case. Fourth, if upon analysis, it were demonstrated that the "separated results" show that the requested rate increase would result in an unreasonable return to HTC basic services but not to HTC as a whole (including non-regulated operations), the rates for the regulated services of Pacific could not be said to be unfair to the public.

After allowing for certain ratemaking adjustments and corrections, and after annualizing the Staff's ten-month test period results, the results exhibited in Appendices A and B show that the Company's earnings are not at an unreasonably high level.

In the final analysis, no single factor is determinative. While return on investment -- and, more particularly, return on equity -- weighs heavily, such factors as quality of service, extent of programming, lack of customer complaints, and actual and potential competition (including free, over-the-air signals) are also considered. So long as a company's rates provide only an opportunity to earn a reasonably computed current cost of capital, the regulator cannot say that a company's proposed rates are unreasonably high. Hopefully, HTC's analysis (to be filed pursuant to CATV Order No. 88, dated July 7, 1982) will provide a reasonable prospect that future rate proceedings may address the enjoyable and engaging prospect of rate reductions for cable customers, rather than rate increases.

In light of the foregoing analysis and discussion, it is herein found that the rates proposed by the Company are reasonable.

B. Merger of Operation of Oceanic and Pacific for Purposes of Regulatory Reporting Requirements

Other than individual permits, no significant differences exist between Oceanic's and Pacific's operations to justify requiring the two permittees to be treated as separate regulated entities. Pacific's franchise is geographically located within metropolitan Honolulu, as is much of Oceanic's franchise area. Operationally and financially, the permittees have merged into a single entity --HTC. Since HTC's acquisition of Pacific, Pacific's cable network has gradually been upgraded to a level on par with that of Oceanic's and the level and quality of service between Pacific and Oceanic will be equalized once the use of set-top converters are approved for Pacific. Therefore, HTC shall hereafter treat its Oceanic and Pacific operations as a single entity, unless otherwise ordered.

C. Mandatory Set-Top Converters

By Order No. 87 (dated January 18, 1982, Docket No. 17-81-02) the Director ordered the termination of the generic investigation into a statewide converter policy which was instituted in Docket No. 00-78-01, and therein determined that regulatory policy concerning the use of converters should be addressed on a company-by-company basis. This Application is the second case addressing the use of converters involving a particular company.

In its Application, Pacific proposes to make the set-top converter an essential part of the CATV distribution system. As such, the costs associated with the converters -- which are proposed to be provided each and every subscriber -- are integrated into the rates for cable services applicable to all subscribers.

As discussed below, Pacific's request to add mandatory set-top converters for all of its Pacific subscribers is approved, with the caveat that -- for ratemaking purposes -- the costs associated with the installation and maintenance of the converters will be shared equitably by the subscribers of both the regulated and the non-regulated services.

The advantages of the converters are several: converters expand the twelve available VHF channels on a standard television set; converters provide a convenient mechanism for a cable company to offer optional pay services to its subscribers by providing a means of selectively addressing and controlling access to particular channels of the cable system; and converters provide the added advantage of eliminating a variety of interference problems.

In short, reliance on converters is beneficial to and enhances both pay and basic cable services. Here, the evidence shows that its introduction is dictated both by consumer demand for pay services, as well as being required to provide basic cable services. Since both of Pacific's services benefit, both must share its costs.

In making the determination of the appropriate treatment of converters for basic cable services for this Company in this case, the following major technical, economic and public interest factors have been considered:

Governmental Requirements:

1. The FCC requires that all off-air television signals of a particular minimum strength in a cable company's franchise area be carried on an equal basis (known as "must carry" signals).
2. The State of Hawaii rules relating to the Hawaii Cable Television Systems Law require the following:[1/]
   a. The immediate availability of at least 20 television broadcast channels for cable service. (Rule 16-131-20)
   b. The maintenance of three access channels for public, government, and educational use. (Rules 16-131-32, -33, and -34)
   c. The required addition of channels whenever the available access channels are close to saturation. (Rule 16-131-36)

Technical Reasons:

1. Co-channel interference due to strong off-air television signals or other transmissions.[2/]
2. Interference caused by leakage of television local oscillator energy into the cable distribution system.
3. "Image" interference to other cable channels.
4. Adjacent channel interference appearing in certain broadcast television sets not equipped with adjacent channels traps.
5. The need for providing an interface for two-way communications.

Economical Reasons:

1. Additional programming creates additional incentives to attract new subscribers.[3/]
2. The "addressability" feature of converters gives the operator the capability of connect/disconnect without having to physically travel to a subscriber's residence, thus reducing operational costs.

3. The use of converters to de-scramble cable service channels, thereby deterring signal theft and increasing basic cable service subscriptions.

In consideration of the above-mentioned factors, it is concluded that Pacific be permitted to install set-top converters, which will be required for all of Pacific's subscribers, as part of HTC's cable distribution system. Therefore, Pacific shall install mandatory set-top converters for all of its subscribers as part of its cable TV distribution system. When an appropriate cost allocation method is selected and refined, costs associated with the converters may be assigned between regulated basic cable and non-regulated services.

Based on the foregoing considerations, Applicant shall:

1. File tariffs making all of Pacific's rates, charges and terms of service identical to those of its Oceanic operation;
2. Install set-top converters for all Pacific's subscribers as an integral part of its cable TV distribution system; and
3. Merge its operations and finances with Oceanic as one unit. In all future applications and regulatory matters, HTC and Pacific shall file as a single entity, known henceforth as HTC.

All requirements set forth in Director's Order No. 88 in Docket No. 29-82-04 dated July 7, 1982 are incorporated herein by reference and made a part of this Order.

Pacific may implement the rate changes approved by this Order only after all Pacific subscribers (1) are being provided the mandatory set-top converters, and (2) are actually receiving all of the programming available to Oceanic's customers.

DATED: Honolulu, Hawaii, 16 December 1982

STATE OF HAWAII

Mary G. F. Bitterman
Director

FOOTNOTES

1/ Without converters, a cable system may practically use only the 12 VHF channels on a standard television set (Channels 2 through 13). The current FCC "must carry" channels for the Pacific area are KHON (Channel 2), KITV (Channel 4), KGMB (Channel 9), KHET (Channel 11), and KIKU (Channel 13). The FCC has also licensed a new off-air television station to be named KSHO (Channel 26, a UHF channel). KSHO is another "must carry" channel and is scheduled to be placed in service before the end of 1982. Once KSHO goes on the air, HTC will be required to carry a total of six off-air television channels on its cable system. This leaves only six of the twelve channels on Pacific.

Another five of the twelve channels are unavailable for use due to "direct pickup" off-air interference from strong off-air VHF television channels. If cable programming is transmitted using the same carrier frequencies as the off-air VHF channels, "ghosting" or other interference may result. Thus, HTC is not utilizing carrier frequencies of Channels 2, 4, 9, 11, and 13. As a result, only a single channel is available on a standard television set for other programming.

HTC presently provides a public access channel as required by the State Cable Television rules, along with a local origination channel required of HTC by the State as part of its basic cable service. Without a converter, the local origination channel and the public access channel are not available to Pacific subscribers.

Furthermore, implementation of the State requirement of an additional two channels for governmental access and educational access, will require additional channels which can only be provided by set-top converters. Finally, HTC is providing a number of additional free cable programming as part of its basic cable services -- services which are unavailable to Pacific cable subscribers without set-top converters.

2/ At the public hearing, the strongest concern relating to the Application was voiced by representatives of the Aina Haina community related to the strong interference encountered by subscribers from a FCC licensed public FM broadcast station (KHPR). Set-top converters will eliminate the interference caused by KHPR.

3/ Although the FCC has prohibited state rate regulation of pay television programming, it is in the public interest to have such additional programming available for cable subscribers, not only to satisfy the demands of those subscribers for the programs, but also to have pay television share the cost of the cable television system. Cost sharing with pay services enables basic cable service rates to be profitably minimized. Hence, allowing HTC to provide additional channel capacity and services in its cable television system to attract new basic and pay TV subscribers will create a larger revenue base which is in the interest of the basic subscriber.

APPENDIX A

TEST PERIOD
RESULTS OF OPERATIONS

	10-Month Ending Jan. 31, 1982	Annualized x 12/10
REVENUES		
Basic Monthly	$ 6,559,712	
Installation	561,866	
Advertising	276,897	
Pay TV	5,116,601	
Other	61,793	
SUBTOTAL	$ 12,576,869	
"New" Converter Subscribers (represents increase in rates)	87,980	
"Existing" Converter Subscribers (50¢ rate increase)	304,367	
TOTAL REVENUES	$ 12,969,216	$ 15,563,059
EXPENSES		
Direct Operating Expenses	$ 3,100,542	
General & Administrative Expenses	2,528,195	
Origination Expenses	717,048	
Advertising	128,551	
Marketing	702,183	
SUBTOTAL	$ 7,176,519	$ 8,611,823
Other		
Depreciation	$ 2,357,611	$ 2,829,133
Amortization	362,688	435,226
Interest	2,424,944	2,909,933
Other	(36,927)	(36,927)
SUBTOTAL	$ 5,108,316	$ 6,137,365
Additional Excise Tax	$ 15,694	
Additional Converter Expenses	10,836	
Additional Converter Depreciation Expenses	12,928	
SUBTOTAL	$ 39,468	$ 47,362
TOTAL EXPENSES	$ 12,324,303	$ 14,796,550
Net Profit Before Taxes	$ 644,913	$ 766,509
Income Tax (@ 50%)	322,457	383,255
Net Profit After Taxes	$ 322,456	$ 383,254
Interest	2,424,944	2,909,933
	$ 2,747,400	$ 3,293,187

RATE OF RETURN ON RATE BASE $\frac{3,293,187}{20,543,778} = 16.03\%$

APPENDIX B

RATE BASE

	Ending Jan. 31, 1982
Gross Plant Fixed Assets	$ 24,891,466
Accumulated Depreciation as of 3/31/81	7,981,958
	$ 16,909,508
Plant Additions to 1/31/82	3,567,938
	$ 20,477,446
Annualized Depreciation	2,829,133
	$ 17,648,313
Working Cash (1/12 of Operating Expenses)	717,652
	$ 18,365,965
Adjustments	
Addition of Capitalized Leases	2,404,413
Less Amortization	226,600
ADJUSTED RATE BASE	$ 20,543,778
LONG-TERM DEBT	$ 19,517,680
LONG-TERM DEBT TO RATE BASE	95.0%

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Order No. 92 was served upon the following by personal delivery on this 17th day of December, 1982:

Jeffrey N. Watanabe, Esq.
Kobayashi, Watanabe, Sugita & Kawashima
Hawaii Building, Suite 814
745 Fort Street
Honolulu, Hawaii 96813

Honolulu Television and Communications
2669 Kilihau Street
Honolulu, Hawaii 96819
Attention: Mr. Don Carroll, President

Copies were served by mailing the same, postage prepaid, to the following on this 17th day of December, 1982:

Lance Inouye, Esq.
2831 Awaawaloa Street
Honolulu, Hawaii 96819

Aina Haina Community Association
c/o 5246 Kalanianaole Highway
Honolulu, Hawaii 96821

Edwin K. S. Liu

KOBAYASHI, WATANABE, SUGITA & KAWASHIMA

By Tammy K. Suekawa

HONOLULU TELEVISION AND COMMUNICATIONS

By