BEFORE THE DIRECTOR OF COMMERCE AND CONSUMER AFFAIRS

OF THE STATE OF HAWAII

In the Matter of the Application of **DERBY CABLEVISION, INCORPORATED** For Amendment of Its Rates and Charges.	)	DOCKET NO. 20-82-01 ORDER NO. 95

DECISION AND ORDER

SUMMARY

DERBY CABLEVISION, INCORPORATED ("Derby") is granted limited approval to increase its rates and charges. The proposed rates are approved for the following reasons:

1. The level of the proposed rates does not appear unreasonable. Projections by both Derby and the Department of Commerce and Consumer Affairs ("Department") show losses for 1983 and 1984. The reasons for the losses are discussed, infra, pp. 4 to 12.
2. Derby will provide "new" services to its subscribers.

The rates as proposed, shall be effective for a maximum of six months only, and shall revert to the rates in existence the day of this Order should Derby fail to comply with the directives enumerated hereafter. The limited period for higher rates with the reversion to existing rates is a necessary action by the regulator. The reason is a simple one: the present ownership and management have not properly exercised their discretion in the investment in and management of the Derby cable operation. Regrettably, it becomes necessary for the regulator to impose the following managerial-type directives:

1. Submit within thirty (30) days of the date of this order, Federal and State tax returns for 1978 through 1981 for California Industrial Products, Inc.;

2. Submit within sixty (60) days of the date of this order a documented house-by-house count of the number of potential subscribers (households) within Derby's service areas;

3. Submit within thirty (30) days documentation such as shown in Applicant's Attachments E-1, E-2, E-3, E-4, and E-5 for all areas within census tracts 402, 403, 404, 405 and all parts of 406 and 407 not having cable services and not being a part of Seven Twenty Limited Partnership's permit area;

4. Submit on or before June 30, 1983, satisfactory documentation of a loan commitment by an institutional and/or other lender(s) indicating that an amount certain (to be determined after the house-to-house count is completed) will be available to Derby, commencing August 1, 1983, to finance the construction necessary to completely build (1) the areas partially served at present, and (2) the specific areas not presently served that fall within the general area Derby does serve;

5. Employ construction personnel in addition to presently employed maintenance and installation personnel or contract for construction services;

6. Provide its proposed "new" service to all of its subscribers and notification thereof to the Director before the rates become effective; and

7. Provide copies of all contracts and agreements for services and equipment provided to Derby.

Derby shall prove compliance with the above-enumerated seven conditions by August 1, 1983 by filing no later than July 1, 1983 proof that each of the seven requirements have been met. The filing, due no later than July 1, 1983, shall be verified, and shall include an application to continue in effect the then-existing rates. If the filing does not comply with Order No. 95, Derby's rates will automatically revert to the rates in existence on the day of this order.

The foregoing enumerated managerial-type directives are imposed for the following reasons:

1. Derby files consolidated income tax returns with its parent company, California Industrial Products, Incorporated ("CIP"). CIP has been able to recoup some of its investments in Derby by utilizing Derby's operating loss as a tax benefit. The tax benefit is reflected in an inter-company "payable" to CIP. Management's refusal to provide copies of tax returns for years specified deprives the Department of necessary information relative to its financial condition.
2. The discrepancies mentioned in the section entitled, "Potential Number of Subscribers," create a need for Derby to undertake a documented house-by-house count of potential subscribers within its permit to determine the actual potential for its services; a potential which must be measured for effective construction, marketing and sales activities.
3. For the first time in years Derby is proposing to undertake a construction program which will modestly expand plant -- but Derby will do so only to the extent it will be able to finance such construction from internally generated funds. Internally generated funds are inadequate because of Derby's long-standing failures to build plant, increase its customer base, expand services, and experience growth. Derby now apparently sees the folly of its former ways, but is still unwilling to "prime the pump" to start a profitable process; thus, the requirement of injecting new capital into an enterprise that other investors see as possessing realistic promise of profit.
4. Derby's existing three construction employees have the primary responsibility for maintaining the existing underground cable facilities. Consequently, assigning responsibility for constructing the proposed cable facilities to these individuals and the single to-be-hired construction employee will mean that either existing system's

maintenance or construction will suffer as the result of increased activities in the other area. Requiring the employment of either a separate construction crew or an outside contractor appears to be the only feasible way of insuring both the maintenance of the existing system and construction of new facilities within the proposed time constraints.

5. Intercorporate contracts and other agreements made by Derby for equipment and services may have a significant and direct bearing on expenses and profits of Derby. Consequently, it is necessary that these agreements and contracts be reviewed by the Department in the rate approval process.

BACKGROUND

On November 10, 1982, Derby Cablevision, Incorporated filed an application for approval of the following increases: TWO DOLLARS AND SEVENTY-FIVE CENTS ($2.75) in its monthly basic subscriber rate; FIFTY CENTS ($.50) in its monthly additional outlet rate; FIFTY CENTS ($.50) in its bulk accounts service rate; and TWO DOLLARS AND FIFTY CENTS ($2.50) for its reconnect charge.

Public hearings were held on December 15, 1982 in the Kapaa Library Auditorium, Kapaa, Kauai, and on December 16, 1982 in the State Office Building, Conference Rooms A, B, and C, Lihue, Kauai, at which times the public was afforded an opportunity to present its views and comments.

The departmental cable staff ("staff") on December 17, 1982 undertook an informal inquiry into the justifications submitted by Applicant in support of the proposed rate increases and other matters relating to the cable services provided by Derby.

The review and analysis of this application was held pursuant to Section 440G-11, H.RS. which requires that the Director "maintain surveillance over such filed rates and terms and conditions of service to insure that the rates and terms and conditions of service are fair both to the public and to the CATV company, taking into account the geographic, topographic, and economic characteristics of the service area and the economics of providing CATV services to subscribers in the service area."

POTENTIAL NUMBER OF SUBSCRIBERS

In its September, 1982 quarterly report to the Department, Derby reported the completion of 87 miles of plant passing 2,156 homes with a subscriber count of 2,162. In its response to staff's Initial Request for Information, Derby reported that it passes nearly all of the homes in its service area except for those areas which presently receive moderate-to-good over-the-air television reception.

Derby submitted a proposed construction schedule for eleven projects to be completed in a two-year time period; it also stated that it is considering expanding the areas provided cable service to include more of its present franchise area. However, no construction plans other than the eleven projects mentioned exist; indeed, no decision has even been made regarding future expansion to include more of its present franchise area.

Residents of Kauai clamor for service (refer, Transcript, Public Hearing, December 16, 1982) and the complaints by would-be customers mount. Yet Derby hires no installers; it refuses to add on customers whose property is passed by Derby facilities; and it has no sales personnel. Evidence in this proceeding would lead a reasonable person to conclude that it has scant knowledge of the number of potential customers that reside in the areas it currently "serves." Thus, an attempt is made herein to determine the extent to which Derby has provided service to its potential subscribers. The following provides the method used to determine the best estimate of homes not yet served by Derby:

1. Derby generally provides service to census tracts 405 (Lihue), 403 (Kapaa), 404 and 402 (areas around Kapaa and Lihue). The 1980 Census for Hawaii provides the following data for the indicated census tracts:

Census Tract	Households	Housing Units
402	1,829	1,965
403	1,425	1,824
404	1,181	1,302
405	1,389	1,597
TOTALS	5,824	6,688

2. The foregoing census reports 851 vacant housing units; after adjusting for these vacant units, the adjusted total housing is 5,837, an amount approximating the number of households, i.e. 5,824.

3. Exhibit 100, Kauai Electric Residential Meters Count, shows for the areas in question that there are 5,865 residential meters, approximately the adjusted housing unit count of 5,837.

4. An adjustment has been made to account for Wailua Homesteads, Anahola and Hawaiian Homes; areas not presently served by Derby. The estimated number of residential meters for these areas is about 1,400. The adjusted housing unit count becomes 4,437.

5. The adjusted housing unit count of 4,437 represents the number of potential subscribers in areas presently passed by Derby. Subtracting homes presently passed by Derby leaves a balance of about 2,280 homes not passed by existing cable plant.

6. Derby's construction plan indicates that it will serve an additional 440 homes in the above-mentioned areas in the next two years. This leaves approximately 1,840 homes not included in Derby's plans for cable services. These are 1,840 households in Derby's service area which Derby either disregards or intentionally ignores.

CONSTRUCTION PLANS

Derby's construction plans (Attachment E-1) propose over a two-year period to construct a total of 15.77 miles of plant passing approximately 570 homes. Of the 570 homes to be passed, about 440 homes will be in areas where only Derby is licensed to provide cable services. The balance of Derby's estimate of 130 homes, as shown in Derby's construction plans, are in Lawai and Omao. (For details on this situation, refer to Order No. 94.)

Derby refuses to commit itself to providing cable services to all potential households within its franchised areas. Even excluding those areas granted to the Seven

Twenty Limited Partnership, Derby's construction plans omit or ignore approximately 1,800 households -- nearly equal to what it currently does serve !

Further, in its Attachment E-1, Derby proposes to construct approximately 3/4 of a mile of plant serving approximately 26 homes in the area known as Lawai. Yet, even in this small, defined area Derby understates the potential customers by upwards of 90 percent: maps filed with the Cable Television Division and on-site staff inspections indicate that in Lawai there are about 350 homes; Derby claims to provide service to about 150 homes; a balance of about 200 homes remains -- 200 homes not provided for in Derby's construction plans. Utilizing Derby's estimated cost of about $9,500 per mile of strand plant, the additional plant cost for Lawai will not exceed $50,000 -- construction costs seven times what Derby has included in its construction budget.

If it is assumed that the 1,840 homes are in areas that have moderate-to-good over-the-air television reception, then cable plant has not been built for these areas. (See answer to question 26 of Department's Informational Request.) If it is further assumed that for the purposes of estimation that there will be 40 homes passed per strand mile of plant, then Derby would need to construct 46 miles of plant for an estimated $437,000.

Derby will construct only what can be financed from internally generated funds, utilizing only its own personnel, i.e., two construction workers and a construction supervisor; as of September 30, 1982. Simply stated, Derby cannot or will not finance the construction required to complete the system.

In short, Derby's two-year construction plan is not worth waiting for. It is under capitalized; it fails to count 90 percent of the homes in some areas; and it is too much in accord with Derby's expressed policy over the past decade of refusal to expand service to address the real unmet needs of the community.

REVENUES

Derby's forecast of revenues for 1983 and 1984 erroneously projects minimal growth in residential subscribers. Four possibilities for Derby's error are:

1. Its failure to rely at all on the 1980 census housing count and Kauai Electric's meter count;

2. Its failure to appreciate the added value the satellite stations have for penetrating markets;

3. Its error in reporting to the Department the number of homes Derby actually passes at present; and

4. A combination of all or part of the above.

In summary there exists potential revenue producing subscribers not included in Derby's projections (refer Exhibit 101). Exhibit 102 demonstrates revenues that could be generated from existing subscribers, as well as from Derby's projections, plus 50 percent of the unaccounted households.

DEPRECIATION

Derby states that it had completed its initial construction phase of the cable system on March 31, 1976 and all net costs up to that date were capitalized. Depreciation started on April 1, 1976 was based on a seven-year service life using the declining-balance method and a 200 percent rate. In the March 31, 1982 financial statement filed with the Department, the following is part of Note 1, Summary of Significant Accounting Policies:

> "The Company's management has reviewed the Financial Accounting Standard Board's Statement of Financial Accounting Standards No. 51 - Financial Reporting by Cable Television Companies. It is Management's opinion that capitalization of all of the net costs incurred to March 31, 1976 is in compliance with the statement. The life of the system previously used for depreciation provision now appears unrealistically short. Accordingly, the depreciation has been restated for financial purposes using a life of 15-1/2 years, representing the remainder of the franchise life after March 31, 1976. The amount of $761,587.63 has been restored to accumulated earnings (deficit) of prior years."

In Order No. 70, the Director stated that:

> "The Division, in its computation, adjusts the depreciation expense by utilizing a remaining life principle with a 30-year life. It is well settled that depreciation methodologies used for tax purposes are not appropriate for regulatory purposes because they do not reflect the actual useful life of the asset in question. Accordingly, the Division's methodology appears more appropriate than the Company's."

It is noted that Derby's decision to change its depreciation practices was made when Derby's net cable plant was approaching zero value for tax purposes.

From Derby's Plant-In-Service and Depreciation Reserves schedules, the following are noted:

1. The annual depreciation for existing plant is listed by Derby as $98,985. This represents an average service life of about 15.5 years on a plant balance of $1,537,409. The annual depreciation expenses for automotive, office furniture and fixtures, and office leasehold appears to be based on an average service life of about 15 years. Yet, the schedule shows these items as having five-year service lives. Also, Derby's projected annual depreciation for 1983, 1984, 1985 and 1986 appear to be related neither to the annual depreciation shown in Derby's exhibits nor to a depreciation value based on five-year service life applied from 1976.
2. The annual depreciation for a new plant is shown as being based on the number of months remaining in the cable permit. Therefore, the annual depreciation expense shown by Dérby is higher than what those expenses would be were the service lives not based on a continuing shortening depreciation period.

Exhibit 103 reflects adjusted depreciation expense and accrued depreciation reserves.

EXPENSES

Due to significant differences in pay program expenses and depreciation projections which affect expenses, Derby's projected expenses had to be adjusted. The adjusted expenses are $501,195 for 1983 and $564,243 for 1984 as compared to Derby's projections of $394,000 for 1983 and $424,000 for 1984 (see Exhibit 104). Also, Derby includes a provision of $18,000 per year in rent for an earth station. Derby alleges that the earth station is being acquired by utilizing a lease-for-purchase agreement. While no adjustment was made to Derby's projected expense in this regard, Derby must submit for verification a copy of this contract to the Cable Television Division.

PLANT

Exhibit 105 shows adjustments to Derby's plant as of December 31, 1982 with projections for additional plant for 1983 and 1984. The accumulated plant as projected by Derby would include additional capital expenditures of $104,075 for 1983 and $65,740 for 1984 -- suggesting minimal expansion in plant construction which is insufficient and no longer acceptable. Consequently, Derby shall provide the Director with an expanded construction program in accordance with Exhibit 108.

CABLE SERVICES

Derby proposes for the immediate future to provide its cable services within the standard VHF frequencies (channels 2 through 13). It contemplates in the future to provide cable services, utilizing the mid-band frequencies.

Derby presently provides the five local broadcast television stations programming from Honolulu plus seven FM radio broadcasts. The Company proposes to expand its services to include Fuji (Japanese pay TV service), HBO and Showtime (pay services), CNN (Cable News Network), USA Network (sports channel), and WTBS (super satellite television station).

In Order No. 70, dated April 30, 1978, the Director stated that "Derby offers basic antenna CATV service only. Unlike other CATV companies operating in the State of Hawaii, it offers no distant signals from the mainland, no public access facilities, and no pay or subscription service." The Director further stated that "The Division's investigation further reveals that Derby is losing an opportunity to generate revenues and profits by its failure to provide pay or subscription service."

Only now -- nearly five years after Order No. 70 was signed by the Director in 1978 -- does Derby propose to provide the pay services which all other Hawaii-based companies have been providing for years with considerable success and profit. It is noteworthy that even now Derby has not committed to providing these new services . . . unless granted all of the rates and charges it proposes.

Notwithstanding the recent effects of Hurricane Iwa, the lack of growth in the visitor industry, and the problems in agriculture, there exists a great need for entertainment on the Garden Island. This need manifests itself in the uninterrupted growth beyond projections of the Seven Twenty Limited Partnership in such areas such as Koloa-Poipu and Kalaheo, areas most affected by the recent natural disaster and the lack of growth in the economy of Kauai. Derby's phenomenal success with Japanese pay television (over 40 percent subscription by subscribers with Japanese surnames) is another bright manifestation of this need for entertainment services which Derby traditionally and stubbornly has resisted providing.

Failure of Derby to provide the entertainment services (pay and others) desired by Kauai's residents has resulted in significant losses in revenues which may have provided on a consolidated basis (basic and pay), a reasonable return to Derby on its cable investments. The Department conservatively estimates, assuming a 50 percent pay subscription rate of basic subscribers that Derby has since 1978 deprived itself of approximately $50,000 annually in net revenues.

RESULTS OF OPERATIONS

With the approved rates, it is anticipated that Derby will incur annual operating losses of approximately $100,000 in 1983 and 1984. However, Derby will have available cash flow of $189,000 and $195,000 for 1983 and 1984, respectively (see Exhibit 106).

Assuming Derby were to build plant for only 50 percent of the "unaccounted-for-households" which are passed by cable (refer, supra), and assuming 50 percent of these households become cable subscribers, annual losses would be reduced to $35,151 and $2,346 for 1983 and 1984 (see Exhibit 107).

The message from the regulator to the regulated company, in this instance, is clear and simple: "build or else."

CONCLUSION

The proposed rates do result in a loss. But Derby is being granted all of the rate relief it has requested. The impacts on Kauai resulting from the recent hurricane and Kauai's economic situation with her visitor and agricultural industries were considered, but the proposed rates are granted with reluctance. Derby needs rate relief in order to be viable. Given the nature of the conditioned approval of the requested rate relief, it is now up to Derby to maintain the rates. If Derby is not in strict compliance with the conditions and the directives of this order on August 1, 1983, the then-existing rates will be reduced and the permit will be placed in serious jeopardy.

DATED: Honolulu, Hawaii, 26 January 1983

STATE OF HAWAII

Mary G. F. Bitterman

MARY G. F. BITTERMAN
Director

DIRECTIVES AND CONDITIONS ACCEPTED:

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For Derby Cablevision, Incorporated

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing **Decision and Order** were mailed, postage prepaid, to the following on this 26th day of January, 1983:

Derby Cablevision, Inc.
Box 278
Kapaa, Hawaii 96746

The Seven Twenty Limited Partnership
Box 720
Eleele, Hawaii 96705

Donald Wong
The Seven Twenty Corporation
Puhi Station
Lihue, Hawaii 96766

David L. Fairbanks, Esq.
Goodsill, Anderson & Quinn
Box 3196
Honolulu, Hawaii 96801

Rosemarie Takamoto
Secretary

EXHIBIT 100

TABLE 1

KAUAI ELECTRIC RESIDENTIAL METER COUNT

Area	Unit	Residential Meters
Puhi/Huleia	42	244
Pua Loke/Ahukini	44	288
Kupolo/Niumalu Nawiliwili	46	254
Lihue Town Estates	47	95
Lihue/Rice Camp Industrial Area	48	223
Lihue/Korean Camp Town Lots/Kilipaka	50	298
Kapaia/Isenberg	52	309
Hanamaulu	54	378
Hanamaulu	56	411
Waipouli/Wailua Houselots	59	199
Waipouli/Wailua Houselots	60	223
Waipouli/Wailua Houselots	61	376
Waipouli/Wailua Houselots	63	219
Wailua Homesteads	65	266
Wailua Homesteads	67	248
Wailua Homesteads	69	198
Wailua Homesteads	71	202
Wailua Homesteads	72	215
Kapaa	74	426
Kapaa	75	224
Kapaa Town	77	206
Kealia	79	91
Anahola/Hawaii Homes	81	272
		5,865

EXHIBIT 102

DERBY CABLEVISION, INCORPORATED

ADJUSTED REVENUES

	1983	1984
Basic Services:		
Monthly	$338,956	$397,337
Installation	29,600	9,700
Additional Outlets:		
Monthly	10,128	12,033
Installation	0	0
Pay Services:		
Monthly	78,203	165,623
Installation	27,020	1,980
Bulk and Business:		
Monthly	120,000	120,000
Installation	0	0
Other	2,000	2,000
TOTALS	$605,907	$708,673

EXHIBIT 103

DERBY CABLEVISION, INCORPORATED

PROJECTED DEPRECIATION

	Accumulated Depreciation Dec. 31, 1982	Annual Depreciation For 1983	Accumulated Depreciation Dec. 31, 1983	Annual Depreciation For 1984	Accumulated Depreciation Dec. 31, 1984
Headend	$ 0	$ 100	$ 100	$ 100	$ 200
Construction Equipment	0	1,538	1,538	1,538	3,076
Furniture & Fixtures	1,431	292	1,723	292	2,015
Auto	12,087	2,133	14,220	2,133	16,353
Leasehold	385	68	453	68	521
Distribution System:					
Overhead	0	4,671	4,671	8,323	12,994
Underground	286,978	50,383	337,361	50,383	387,744
TOTALS	$300,881	$59,185	$360,066	$62,837	$422,903

EXHIBIT 104

DERBY CABLEVISION, INCORPORATED

EXPENSES

	1983	1984
Derby's Expenses as shown in Attachment B for Total Expenses	$569,000	$655,000
Less Derby's Projections for:		
Depreciation	105,000	118,000
Pay Programming	70,000	113,000
	$394,000	$424,000
Add Department's Projections for:		
Depreciation	59,185	62,837
Pay Programming	48,010	77,406
ADJUSTED TOTALS	$501,195	$564,243

EXHIBIT 105

DERBY CABLEVISION, INCORPORATED

PROJECTED PLANT

	Plant Balance Dec 1983	Plant Additions 1983	Plant Balance Dec. 1983	Plant Additions 1984	Plant Balance Dec. 1984
Headend	$ 15,000	$ 0	$ 15,000	$ 0	$ 15,000
Construction Equipment	0	20,000	20,000	0	20,000
Furniture & Fixtures	3,791	0	3,791	0	3,791
Auto	19,197	0	19,197	0	19,197
Leasehold	1,014	0	1,014	0	1,014
Distribution System:					
Overhead	0	84,075	84,075	65,740	149,815
Underground	1,511,481	0	1,511,481	0	1,511,481
Land	58,256	0	58,256	0	58,256
TOTALS	$1,608,739	$104,075	$1,712,814	$65,740	$1,778,554
Less Accumulated Depreciation	300,881		360,066		442,903
NET PLANT	$1,307,858		$1,352,748		$1,355,651

EXHIBIT 106

DERBY CABLEVISION, INCORPORATED

RESULTS OF OPERATIONS

	DERBY		DEPARTMENT	
	1983	1984	1983	1984
Revenues	$ 583,000	$ 678,000	$ 532,237	$ 615,334
Expenses	569,000	655,000	501,195	564,243
	$ 14,000	$ 23,000	$ 31,042	$ 51,091
Intercompany Interest Expense*	130,000	132,000	130,000	132,000
Net Profit (Loss) Before Taxes	$(116,000)	$(109,000)	$ (98,958)	$ (80,909)

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* Interest expense has been recorded in Derby's March 31, 1981 financial statement showing an amount equal to the rate of 7% per annum for amounts advanced from California Industrial Products, Inc. for the five years ended March 31, 1981. Interest recorded for fiscal year 1981 was $532,133.

EXHIBIT 107

DERBY CABLEVISION, INCORPORATED

ADJUSTED RESULTS OF OPERATIONS

	1983	1984
Revenues	$ 605,907	$ 708,673
Expenses	511,058	579,019
	$ 94,849	$ 129,654
Intercompany Interest	130,000	132,000
Net Profit (Loss) Before Taxes	$ (35,151)	$ (2,346)

EXHIBIT 108

CONSTRUCTION SCHEDULE

Project No.	Location	Miles of Plant	Number of Households	Estimated Cost	1983 By Quarter *				1984 By Quarter *				1985 By Quarter *			
					1st	2nd	3rd	4th	1st	2nd	3rd	4th	1st	2nd	3rd	4th
	TOTALS															

* Use a line drawn from the quarter when construction will begin to the quarter showing the completion date of the project.