From ***"It's All Interconnected."***

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SPECIAL SECTION:
Time Warner and the Social Contract

13.0 The "Social Contract" was an Actual Agreement between the FCC and the Cable Companies.

In the 1990s, the cable companies informed the FCC that they needed rate increases to pay for upgrades of the cable plant for new services, as well as fixing quality-of-service issues. There were over 900 rate cases pending at the FCC by 1995.[1] The original cable franchises were only for one service, 'cable services,' but the companies wanted new revenues from broadband, Internet and even phone service.

In 1995, the FCC created the "Social Contract" — an Order to grant the cable companies financial assistance in the form of additional federally sponsored rate increases, where the cable companies, Time Warner[2] and Comcast[3], among others, could charge basic cable subscribers up to $5 a month extra on cable bills. The Social Contract was supposed to expire in the year 2000. After 2000, there was no oversight or investigations. The companies never lowered their rates to remove this extra federally-added charge on customers' bills.

We estimate that from 1996 through 2013, cable customers paid approximately $58 billion because of this Order. (Of this, $42 billion of this was charged since 2000.)

In the Social Contract, the companies also committed to bring the Internet to schools in their franchise areas. Schools were all to be given free cable modem service, a free cable modem — and would receive the inside wiring at cost. The Comcast Social Contract states:

> "Comcast will provide a free service connection to each public and private school located within 200 feet of Comcast's activated cable plant. Comcast will provide a service connection at cost to public and private schools beyond 200 feet of its activated cable plant. Comcast will also provide a free modem and free modem service to all such schools within a year after Comcast makes personal computer-based Internet access service via cable

[1] http://transition.fcc.gov/Bureaus/Cable/Orders/1995/fcc95478.txt ;
[2] http://www.newnetworks.com/Social%20Contract%20fcc95478.doc
[3] http://transition.fcc.gov/Bureaus/Cable/News_Releases/1997/nrcb7021.txt

> commercially available to residential customers. Free cable service, including basic and enhanced basic service, and service offered on migrated and new product tiers, will be provided to all connected public and private schools. ...Additional internal wiring to serve additional outlets in any school will be provided at cost. Such wiring will be provided at no charge if Comcast is able to coordinate installation with other comparable electrical wiring installation being done in new or rehabilitated schools." [4]

Moreover, the Time Warner "Social Contract" specifically states that the first modem, (the electronic box designed to let the customer use the Internet), is free, and all of the other modems in the school will be 'at cost.'

> "If requested, each school will receive one free modem to use this service with additional modems provided at cost."

13.1 The Charges Were Supposed to End in the Year 2000 — 14 Years Ago

There has been no formal investigation by the FCC or in the states. We know of no state or cable franchise where the price of basic service went down $5.00 a month to remove this extra fee, above and beyond basic service fees, or where an allowed rate increase took into account the end of the $5.00 charge.

The original agreement was for five years. Time Warner was supposed to spend $4 billion on their networks. According to the Order: [5]

> "The Social Contract is for a term of five years. From 1995 through 2000, Time Warner is required to invest $4 billion to rebuild and upgrade all of its domestic cable systems, including deployment of fiber optic technology, increased channel capacity and improved system reliability and signal quality."

13.2 Calculation on Customers and Charges

With a national average of 63 million customers annually from 1996-2013[6] the estimated Social Contract payments were $280 million dollars extra a month — $3.7 billion a year. By the end of 2013, this means has customers paid about $61 billion extra from 1996-2013. However, $49 billion of this was charged since 2000. Without audits, it is

[4] Ibid.
[5] http://transition.fcc.gov/Bureaus/Cable/Orders/1995/fcc95478.txt.
[6] http://www.ncta.com/Stats/BasicCableSubscribers.aspx.

impossible to tell the exact amount. On average, customers paid about $60 a year or about $771 extra since 2000.[7]

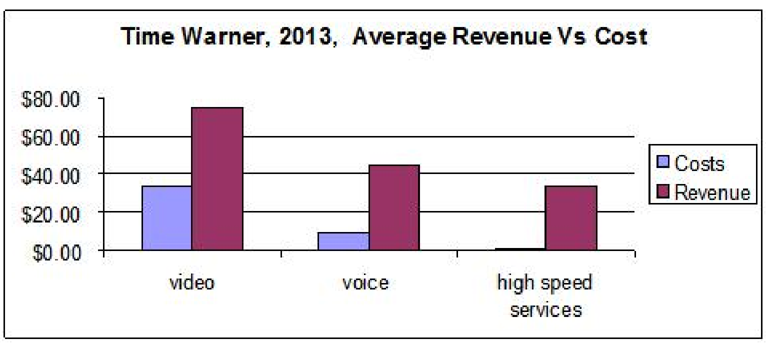
13.3 Schools Wired or “Universal Service” Payments

We could find no detailed analysis in any city of the fulfillment of the Social Contract and the wiring of schools. Moreover, notice the word "requested" in the quote on cable modems. Based on interviews with auditors of school districts' telecommunications bills, including E-Rate recipients, it is clear that most schools were never informed of this option as most schools did not get the free modem and service, much less the rest 'at cost.'[8]

14.4 Time Warner’s Financials: Affiliate Transactions Issues

In that context, we can examine a single cableco’s financials. Time Warner Cable Annual Report information for the year 2012 shows that the majority of expenses are placed in the basic cable and video service financial area, and other services, such as the high-speed Internet service, are paying a fraction of the overall expenses.[9]

Chart 9



13.5 Comparing the Revenues and Expenses

Time Warner’s 2012 Annual Report, shows that high-speed Internet services brought in over $5 billion in 2011, shown in Exhibit 46. Time Warner high-speed data expenses were $185 million annually, as shown in Exhibit 47.

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[7] We used the NCTA cable association information for annual subscribers and there was a ramp of charges from 1995-2000. To calculate any cable company, or specifically any franchise, the number of subscribers per year would be needed.

[8] David Schofield, Partner, NSA – Network Sourcing Advisors, Thomas Allibone, President LTC Consulting.

[9] http://www.sec.gov/Archives/edgar/data/1377013/000119312513062081/d483194d10k.htm.

Exhibit 46
Time Warner 2012 Annual Report: Residential Service Revenues
(In the Millions)

REVENUES	2012[a]	2011
Video	$10,917	$10,589
High-speed data	$5,090	$4,476
Voice	$2,104	$1,979
Other	$64	$49
Total residential services	$18,175	$17,093

Exhibit 47
Time Warner 2012 Annual Report: Residential Service Expenses
(In the Millions)

EXPENSES	2012[a]	2011
Video programming	$4,621	$4,342
Employee[a]	$2,865	$2,621
High-speed data	$185	$170
Voice	$614	$595
Video franchise and other fees[b]	$519	$500
Other direct operating costs[a]	$1,138	$910
Total	$9,942	$9,138

13.6 Revenues per Customer Vs Costs.

According to Time Warner's 2012 Annual Report's financials, customers were charged on average $44.07 for high-speed Internet and $34.06 for voice service.

Exhibit 48
Time Warner, Average Costs Charged to Customers, Per Month, 2012

Video	$74.90
High-speed data	$44.07
Voice	$34.06

However, as shown in Exhibit 49, since these costs are incremental, the costs to the company were $1.34 a month to offer the high-speed Internet service, and only $9.46 to offer the voice service, which includes long distance and calling features.

Exhibit 49
Time Warner, Average Costs to Offer Service per Month, 2012

Average monthly video programming costs	$33.60
Average monthly voice costs per voice subscriber	$9.46
Average cost for high-speed services	$1.34

There is another way of looking at this data. The next exhibit shows the profit margins for the services. It cost $33.60 to offer cable and the price to the customer is $74.90, making the profit margin 123% above the costs. The high-speed Internet profit margin is 2,442%, however, if the company charged only $2.68 a month for high-speed service, they would still have 100% profit margin.

Exhibit 50
Time Warner, Costs to Offer, Cost to the Customer Profit Margin, 2012

	Cost to Offer	Price to Customer	Profit Per Customer Item	Profit Margin
Video	$33.60	$74.90	$41.30	123%
Voice	$9.46	$44.07	$34.61	366%
High-speed data	$1.34	$34.06	$32.72	2442%

13.7 Time Warner's 'Triple Play' Charges to Customers

This next exhibit highlights the total charges as well as taxes, fees and surcharges that appear on a standard Time Warner Triple Play in New York City.[10] This includes basic high-speed Internet service, cable TV service and "Digital Home Phone" service.

[10] http://newnetworks.com/timewarnertripleplaybill.htm

Exhibit 51
Time Warner Triple Play, New York City, 2012-2014
(From Actual Bills)

	June 2012	April 2014	Increase
Equipment			
Package Allocation	$ 0.01		
Remote	$ 0.25		
Converter	$ 9.99		
Total:	$10.25	$ 11.25	9.8%
Internet Modem Lease	$ 2.50	$ 5.99	140%
Advertised Price	$99.00		
All The Best Triple Play			
Digital Home Phone Svc	$23.67	$ 25.15	6%
Basic Service	$12.10	$ 12.63	4%
Standard Service	$26.09	$ 28.47	9%
DTV – (renamed Variety Pass)	$ 6.26	$ 7.22	15%
Package Allocation	$ 0.01	$ 0.01	0%
Standard Internet	$30.77	$ 36.51	19%
Taxes, Fees Surcharges			
Franchise Fee	$3.58	$ 4.34	21%
FCC Regulatory Fee - Cable	$0.09		
Federal Universal Service Fund	$0.90	$ 1.14	27%
State And Local Sales Tax	$1.96	$ 2.30	32%
State And Local Telecom Excise Tax	$1.11	$ 1.17	5%
Regulatory Recovery Fee - State	$0.30	$ 0.59	97%
E-911 Fee	$1.00	$ 1.00	0%
Mctd 186e	$0.15	$ 0.16	7%
Public Access Fee	$0.90	$ 1.23	37%
Regulatory Recovery Fee-federal	$0.21		
state USF – Added 2014		$ 0.02	
Total	**$121.95**	**$156.18**	
Late Fee		$ 8.50	

- The advertised price to customers in 2012 was $99.00, yet the total bill came to $121.95 — an additional 22 percent.

- After one year the total bill went to $156.18, an overall increase of 28%. This includes the ending of the 1-year promotion as well as increases in many of the charges. Some charges, such as the 'Internet modem lease' had a 140% increase.
- We note that the 'late fee' is $8.50 in 2014.

The difference in the advertised price in 2012 to the actual price in 2014 was 56%. The company also notes that buying the Triple Play saved money in 2014. The bill states:

> "Enjoy the $28.20 you saved over retail rates this month."

Other charges added to the $99.00 Triple Play are:

- **Cable Set-Top Box —** The Triple Play at $99.00 does not come with the 'set-top box', which is the device that allows you to receive cable service; this adds an additional $9.99 fee.[11]
- **Internet Modem —** The Triple Play at $99.00 does not include cable modem that is required to access on the Internet.
- **Cable Franchise Fee—** "State regulations do not require that there be a franchise fee for cable television service." [12] Most of the cable companies claim that they pay franchise fees when in fact, it is passed through so customers pay additional charges.
- **Regulatory Recovery Fee —** "These charges are not mandated by state or federal authorities and are therefore not charged separately by all telephone companies." [13]
- **Universal Service—** "This line item appears when a company chooses to recover its USF contributions directly from its customers by billing them this charge. The FCC does not require this charge to be passed on to customers." [14]
- **Telecom Excise Tax —** "Unlike the sales tax, the excise tax is imposed on the telecommunications provider, but it may be passed through to the consumers of the service and appear on their monthly bill." [15]

[11] http://newnetworks.com/timewarnertripleplaybill.htm
[12] http://www.tax.ny.gov/pdf/stats/policy_special/telecommunications/2009/taxation_of_the_telecommunications_industry_in_ny_state_october_2009.pdf
[13] http://www3.dps.ny.gov/W/PSCWeb.nsf/All/72BA9EC4CC879AFA85257687006F3AB8?OpenDocument
[14] http://www.fcc.gov/guides/universal-service-program-schools-and-libraries
[15] http://www.tax.ny.gov/pdf/stats/policy_special/telecommunications/2009/taxation_of_the_telecommunications_industry_in_ny_state_october_2009.pdf

13.8 Implications

Time Warner and Comcast have announced they plan to merge and there will be hearings nationwide to review the current franchise agreements and approve the mergers.

The Social Contract, the charges on the current Triple Play bills (as well as the advertising), and the revenues and profit from these services are all tied together and bring up a series of issues:

- **Did Time Warner and Comcast Stop Billing the Extra $5.00 per Month after 2000?**

The Time Warner Contract expired in 2000. Did the companies continue to collect the extra $5.00 a month — and if so, why? Shouldn't the charges have stopped if the contract was over?

- **Did Time Warner and Comcast Wire All the Schools and Libraries in Their Regions?**

Comcast's contract:

> "Comcast will provide a free service connection to each public and private school located within 200 feet of Comcast's activated cable plant… Comcast will offer 250 public libraries a free cable modem and free unlimited cable modem service through each modem."[16]

If the companies continued to collect the extra charges, did they continue to supply free services to the schools and libraries, and were those service 'upgraded' if the monies were still being collected?

- **Profits on High-speed Services vs the Social Contract**

The Social Contract was also for upgrades of the cable networks. With a profit margin of 2442% for high speed Internet, if the monies were still being collected post 2000, are customers being overcharged to fund massive profits?

- **High-speed Profits Vs What Competitors Would Pay.**

Time Warner's internal costs for offering high-speed Internet is $1.24 a month. No independent Internet Service Provider (ISP) would be charged only $1.24 a month to offer competitive Internet or high-speed services. These profits clearly indicate that Time Warner is giving its own ISP major financial subsidies and advantages that harm any other competitors.

[16] http://transition.fcc.gov/Bureaus/Cable/News_Releases/1997/nrcb7021.txt

In the case of Netflix and its ISP, Cogent, or the other competitors whose business requires access and use of the cable networks at ‘competitive prices’, this suggests there is no level playing field for competitors, something that has made the news recently with the deal between Netflix and Comcast.

Wired Magazine’s headline summarizes the issue:

“Why the Comcast-Netflix Pact Threatens Our Internet Future”[17]

Simply put, Comcast wants to charge content providers extra to use their networks and they can do this by using their own ISP and broadband services vs competitors offering services.

If customers paid for these upgrades to the cable networks via the Social Contract as an extra ‘hidden fee on basic cable service’, and NetFlix gets charged more for service, this means that they may raise customers’ rates to use Netflix. (As of May 9th, 2014, Netflix has sent out a notice of a $1.00 a month increase.)

- **The Cost of Basic Cable Service vs the Profits of the Cable Triple Play Affiliates.**

With a profit margin of 2243% for high-speed Internet, it may be that, like Verizon, Time Warner has been using changes for the basic cable service to fund most of the expenses for network improvements, while the affiliate services are paying only small incremental costs. This raises the rate of basic cable services, but also doesn’t address the fact that the cablecos do not include mandatory, required other parts of the business such as the ‘cable-set-top box’, (which is now about $10.00 and used to be included in the cost of basic cable service).

This directly harms customers who may just want ‘cable service’ at a reasonable price.

Recommendations: Every Municipality with a Time Warner or Comcast Franchise Should:

- Require an audit to determine if the Social Contract, at $5.00 a month is still being collected and if so it should be removed and the company should refund excess charges.
- Require a full audit to examine whether all school and libraries were wired and if so what was deployed and if so were they upgraded over the last 14 years.
- If the schools were required to ‘request’ the service, did the companies’ provide adequate notification that these programs are available by the cable companies?

[17] http://www.wired.com/2014/02/comcast-netflix/

- Audits should also be done of whether the schools and libraries paid extra to other providers for services that could have been supplied for free or at cost.
- All charges that are not 'mandated' should be removed or included in the advertised price for service.
- The profits of the various services, like and high-speed Internet should be examined to see if the services have contributed revenues at 'market prices' or if they are not, is the failure of contributing to the cost of the cable line anti-competitive that harms customers and competition. Also, this audit should include whether the costs to 'basic rate' customers have been inflated because the other areas have not contributed their fair share.