FRANCHISING COMMUNICATIONS PROVIDERS

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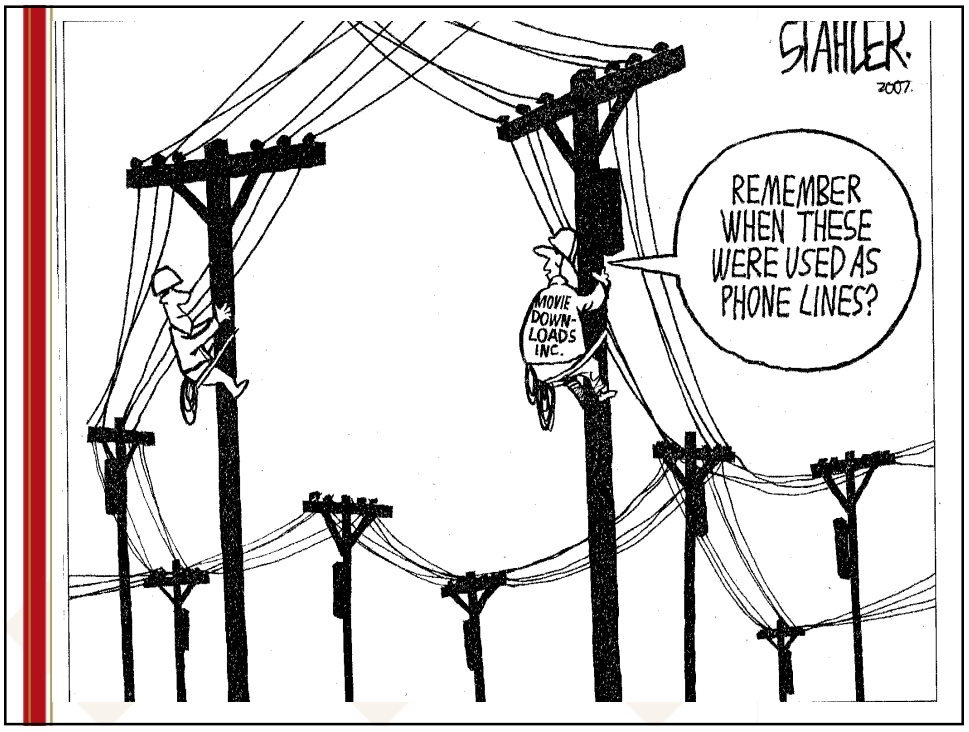

Introduction

- **Define types of communications services**
- **Review industry financial statistics**
- **Is your City collecting fees from providers**
- **Bundled revenues – determine fees owed**
- **Renewal of franchises**
- **Process to be followed**
- **Key provisions in franchise negotiations**

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Types of Communications Services

- **Information services**
  - Cities have no legal authority to regulate
- **Telecommunication services**
  - Some states permit local franchising/fees
- **Cable services**
  - 50% of states permit local franchising

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Information Services

Information services means:

the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control or operation of a telecommunications system or the management of the telecommunications service.

47 U.S.C. § 153(20)

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Telecommunications Service

Telecommunications Service means:

the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used.

47 U.S.C. § 153(46)

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Cable Service

Cable Service means:

(A) the one-way transmission to subscribers of
(i) video programming, or
(ii) other programming service and
(B) subscriber interaction, if any, which is required for the selection or use of such video programming or other programming service.

47 U.S.C. § 522(6)

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Top 15 Cable Operators

		2010 Subs	2012 Subs
1.	Comcast Corporation	23,212,000	22,118,000
2.	Direct TV	18,760,000	19,914,000
3.	Dish Network Corporation	14,318,000	14,061,000
4.	Time Warner Cable, Inc.	12,706,000	12,484,000
5.	Cox Communications, Inc.	5,038,000	4,661,000
6.	Charter Communications, Inc.	4,716,000	4,269,000
7.	Verizon Communications, Inc.	3,203,000	4,473,000
8.	Cablevision Sys. Corp.	3,067,000	3,257,000
9.	AT&T, Inc.	2,504,000	4,146,000
10.	Bright House Networks, LLC	2,222,000	2,059,000
11.	Suddenlink Communications	1,225,000	1,230,000
12.	Mediacom	1,216,000	1,037,000
13.	Insight Communications	710,000	Sold to TW
14.	CableOne, Inc.	654,000	613,000
15.	WideOpenWest Networks, LLC	393,000	456,000

Source: NCTA website

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Cable Industry Revenue (in billions)

Year	Res Video	Other Rev	Total Rev
1996	$24,136	$2,984	$27,120
1997	$26,270	$3,532	$29,802
1998	$27,626	$6,152	$33,778
1999	$30,050	$7,341	$37,391
2000	$32,541	$9,575	$42,116
2001	$35,734	$9,743	$45,477
2002	$36,738	$11,160	$47,898
2003	$39,338	$15,056	$54,394
2004	$41,813	$18,212	$60,025
2005	$43,832	$21,846	$65,678
2006	$46,518	$25,354	$71,872
2007	$49,105	$29,719	$78,824
2008	$51,467	$34,470	$86,281
2009	$53,040	$36,861	$89,901
2010	**$55,470**	**$38,310**	**$93,780**
2011	**$56,938**	**$40,660**	**$97,598**

Source: SNL Kagan – NCTA website

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Subscribers v. Revenue

Basic Video Subscribers		Total Revenue
2005	65.4 million	$65.7 billion ($ 83.69/sub/mo)
2007	64.9 million	$78.8 billion ($101.21/sub/mo)
2009	62.1 million	$89.9 billion ($120.64/sub/mo)
2011	58.0 million	$97.6 billion $140.23/sub/mo)

Subscribers down but per subscriber revenue up

Source: NCTA website

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Three Questions to Ask

1. **Who is working in your ROW?**
   - Franchised/licensed
   - Subcontractor
2. **Are they complying with the local code/franchise?**
   - Permitting – fees
   - Restoration
   - Bonding
3. **Is the City being compensated?**
   - Franchise/license fees - % of revenue
   - Linier foot charges
   - Utility taxes, occupation tax

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Follow-up Questions

- **Does code/franchise maximize compensation options?**
  - Consistent with state and federal law
- **Has the City verified required payments?**
  - Review of fees remitted by ROW users
- **Has the City verified the classification of services?**
  - VOIP (IP voice) – Is it telecom or broadband?
- **Audit v. review**
  - Rarely is an audit performed
  - Agreed upon procedures = review

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Why Impose Fees?

- **Municipalities impose fees on ROW users**:
  - To recover fair rental rate for ROW occupation
  - To reimburse for the disruption of the ROW
- **ROW disruption imposes a financial burden**
  - Should not be borne by municipality
    - But by ROW user

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ROW Occupation = Financial Burdens

1. **Disruption caused by system construction**
2. **Reduced value (integrity/life span) of ROW**
   Following multiple street cuts
3. **Difficulty accessing existing facilities**
   In an already crowded ROW
4. **Ongoing maintenance and oversight of ROW**
5. **Added cost of ROW replacement**
   Given added facilities that must be relocated

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Example - Cable Provider

- **Cities have right to review accuracy of payments**
  - Regardless of state issued franchise, or
  - Locally issued franchise
- **Issues to consider:**
  - Gross revenue definition
    - Permitted exclusions
  - GAAP issues
  - Bundling of services
  - Interest due on late/underpaid fees
  - Statute of limitations
  - Reimbursement of audit fees

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Bundled Revenues

- **Cable operator charges $99 for triple play**
  - Voice, video and data (broadband)
  - Only required to remit 5% fee on video/cable
- **How is the $99 allocated by operator?**
  - 33% to video?
  - Is video offered at steeper discount
    - to reduce franchise fee burden?
- **Review can verify how revenue is booked**
  - Determine allocation of $99 among bundled services

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Fee on Fee

- **Still most common source of underpayment**
- **Accounts for additional .25% on 5% fee**
- **Franchise fee is assessed <u>on operator</u>**
  - <u>Not subscriber</u>
- **If cable bill = $20.00**
  - If fee is built into the $20 rate, 5% fee = $1.00
    - $19 to operator, $1 to City
  - If fee is added as line item, 5% fee = $1.05
  - $1.00 franchise fee is revenue to operator
  - $20 to operator, $1.05 to City

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Fee on Fee

- **Typical cable bill = $70.00 /mo**
- **Assume City with 20,000 cable subscribers**
  - $840,000/year for 5% franchise fee
  - Failure to include fee on fee
  - Results in loss of $42,000/year
- **Over 5 years (statute of limitations)**
  - $250,000 (including interest)

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Do you know who is in your ROW?

- Most cities have nearly a dozen telecommunications providers occupying portions of ROW
  - What services are they providing?
  - What regulations apply to their services
- Use to have one company – narrow line of service
  - Today every communications company competes
- Allowing fee use of the ROW costs all residents.

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Why is Renewal More Difficult Now Than 15 Years Ago?

1. **Industry consolidation over the last decade**
2. **Increased competition from Direct TV**
3. **AT&T and Verizon franchising efforts**
4. **State franchising - impacting over 20 states**
5. **Online competition**
   a. YouTube and over-the-top competition (Hulu)
   b. Wireless devices – "cable anywhere" (iPad, iPhone, laptops)
6. **Poor economy**
   a. Fewer subscribers
   b. Reduced cash flow for operator – less staff
   c. Less capital expenditures
   d. Tight restrictions on franchise commitments

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Why Does One Contract Require So Much Effort?

- Because it's not just the cable franchise that is impacted
- **During renewal cities must also consider:**
  - Cable regulatory ordinance
  - Right-of-way ordinance or code provisions
  - Customer service provisions
  - General code provisions
  - Competing operators' franchises
  - Gas, electric, telephone franchises
- Some of the City Code may require redrafting
- Certain agreements with operator may be in "side letter"

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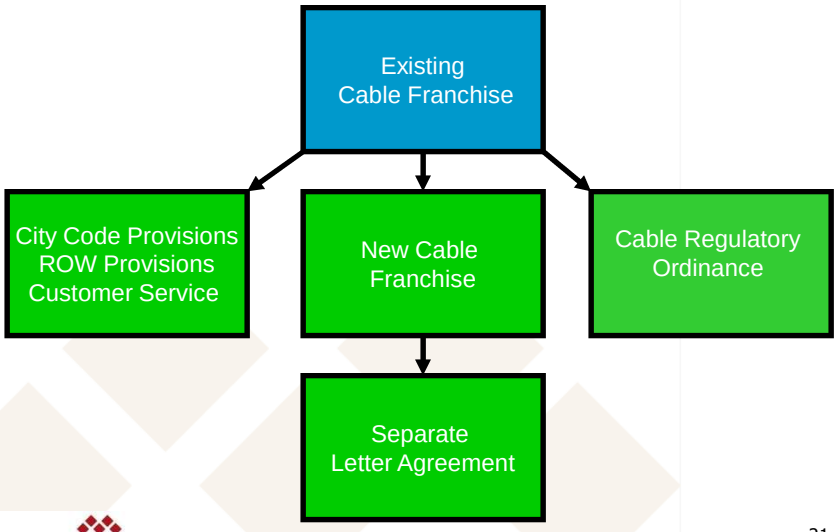
Renewal Documents



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Why Can't We Put the Cable Franchise Up For Competitive Bid?

- Cable Act prohibits a City from denying a cable operator's request for franchise renewal
  - Just because another operator may be willing to agree to more favorable franchise terms
- Under the Cable Act an operator can only be denied franchise renewal for one of the following four reasons:
  1. Operator's failure to comply with existing franchise
  2. Quality of operator's service
  3. Operator's legal, technical and financial qualifications
  4. **Reasonableness of operator's proposal to meet the City's assessment of needs and interests**
     - Taking into consideration associated costs

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Should We Conduct Informal or Formal Renewal Process?

- **Short answer – prepare for both**
- **Operator must request renewal 3 years prior to franchise expiration**
  - Request triggers the formal protections
  - Failure to request renewal
    - Loss of Cable Act formal protections
  - Request will also ask for informal negotiations
  - City has 6 months to "initiate" renewal
- **If you chose to proceed informally** -
  - Be careful not to "paint yourself in a corner"

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Informal Process

1. **Most franchises are negotiated informally**
2. **Still need to know local needs/interests**
   – Needs Assessment remains crucial
3. **Be careful not to get backed into a corner**
   a. Nowhere to go – must accept poor proposal
   b. What if operator changes deal at 11th hour
      - What is City's recourse?
4. **<u>Renewal is like buying a new car</u>**
   a. Make certain you have a plan B
   b. Be prepared to walk if price is too high
5. **Preparation for formal**
   a. Provides City with options
   b. Allows for successful negotiations

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What is a Needs Assessment?

1. **Franchise fee and PEG fee review/audit**
2. **Technical/engineering review of the cable system**
   - Condition of current cable plant
   - How well the system has been maintained
   - Compliance with electric safety code
3. **Telephone survey of cable subscribers**
4. **Nonprofit/civic organizations/departmental surveys**
5. **Review of current PEG Access facilities and operations**
   - Evaluate condition of equipment and facilities
   - Evaluate services offered and channels utilized
   - Evaluate operational procedures and connectivity
6. **Public hearings**

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Can Operators' Itemize Fees on Subscriber Bills?

- **Yes**
- **<u>Subscriber bill itemization</u>** - *Cable Act §622(c) [542(c)]*
  - Each cable operator may identify as a separate line item on each regular bill of each subscriber:
    1. The amount of the total bill assessed as a franchise fee
       - And the identity of the LFA (City) to which the fee is paid
    2. Franchise imposed support for PEG channels or the use of such channels
    3. The amount of any other fee, tax, assessment
       - Imposed by any governmental authority
       - On transaction between the operator and subscriber

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Can City Obtain PEG Support Beyond the 5% Fee?

- Yes
- **The term "franchise fee" does <u>not</u> include:**
  - *<u>Capital costs</u> which are required by the franchise to be incurred by the cable operator for public, educational, or governmental access facilities*.
    - 47 U.S.C. § 542
- **Operators oppose PEG fees – Operators argue:**
  - Makes them less competitive than Direct TV / Dish
  - Use your franchise fees, that's what they're for
  - Why do you want raise taxes; Mayor won't like that?
  - Nobody watches PEG anyway
  - No other cities ask for PEG fees
  - We never pay PEG fees – corporate policy

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