

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: November 17, 2006

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Council File No. 06-0002-S68

Council District: All

To: Budget and Finance Committee
Information Technology and General Services Committee

From: William T Fujioka, City Administrative Officer



Reference: City Attorney Report to the Council, Dated November 14, 2006, Regarding Analysis of the Effect of California Assembly Bill 2987 on the City's Operations and Draft Ordinance in Response to the Legislation

Subject: **IMPACT OF ASSEMBLY BILL 2987, "DIGITAL INFRASTRUCTURE AND VIDEO COMPETITION ACT OF 2006," ON CITY'S CABLE TELEVISION REGULATORY AUTHORITY AND OPERATIONS**

SUMMARY

On August 30, 2006, the State Senate passed Assembly Bill 2987, the "Digital Infrastructure and Video Competition Act of 2006" co-authored by Assembly Members Fabian Nunez and Lloyd Levine. The City opposed this legislation because of the transfer of cable and video franchising authority from local governments to the State. However, the Governor approved the bill on September 29.

As a consequence of the passage of Assembly Bill 2987, the City Attorney has prepared a report and an accompanying draft Ordinance (attached), concurred in by the Information Technology Agency (ITA) as the cable television administration and enforcement agency for the City. This proposed Ordinance, if adopted, will help to secure the City's rights and clarify its responsibilities under the provisions of the new state franchising authority.

As indicated on page 14 of the City Attorney's report, the proposed Ordinance provisions, if adopted, will "ensure that the City will have the appropriate legal framework in place to interact with state video franchisees as they receive franchises in 2007, and begin to offer video services to City residents."

Having an appropriate legal framework in place on or before January 1, 2007 is vital to the City's interests for the following reasons:

- It allows the City to impose a fee, in addition to the standard five-percent of a franchisee's gross revenues ("franchise fee"), of one-percent of gross revenues from franchisees for the purpose of Public, Educational and Government (PEG) access. This PEG fee will allow the City to begin funding and operating studios and other PEG resources in the City or contracting with other entities such as non-profit organizations to fund and operate those services for use by the public for the creation of "community-based communications" in 2007 and 2008;

- It assists in preserving the City's rights and ability to obtain from current franchisees in-kind services such as public access studios and free cable and Internet access for City buildings, libraries, and schools, at least until January 1, 2009; and
- It helps to ensure that state video franchise holders provide PEG channel capacity on their networks equal in number to the greatest number of PEG channels that are active and provided by a current franchisee (e.g., Time Warner, Cox Communications, and Charter Communications) under the terms of a City franchise agreement in effect as of January 1, 2007. Additionally, state franchise holders are required to negotiate in good faith with current City franchisees to interconnect their separate networks to enable PEG channel delivery as long as the interconnection is technically feasible. If not technically feasible, the state franchise holder must pay for providing a direct interconnection to the originator of the channel.

The City Attorney's report explains in detail the various provisions of the "Digital Infrastructure and Video Competition Act of 2006" and the impact of those provisions on City operations. Briefly, as a consequence of implementing the bill's provisions, the City will retain, until January 2008, its customary franchise authority over incumbent cable television operators (unless or until they no longer maintain a City franchise), which involves the following:

- Enforcement of compliance with technical and safety and consumer service standards;
- Ensuring the availability of PEG access by cable subscribers;
- Timely collection of the City's five-percent gross revenue franchise fees;
- Verifying that cable providers' performance bonds and insurance are adequate and current; and
- Auditing of various compliance requirements under the terms of the existing agreements.

For fiscal years 2006-07 and 2007-08, the City expects to receive approximately the same cable franchise revenues as in the past few years: \$24 million. This estimate is based on (1) the current number of cable subscribers and (2) pricing tiers remaining the same.

According to the Information Technology Agency (ITA), sometime between 2007 and 2009, cable franchise revenues may increase with the imposition of one-percent PEG payments. As part of the original City franchise agreements, cable providers were required to pay PEG costs as part of their franchise obligations. When those City agreements expired in 2003, PEG payments concluded.

The proposed Ordinance addresses the legal structure that the City, at a minimum, must establish to preserve its rights and enumerate its responsibilities in response to the new legislation. In summary, the Ordinance accomplishes the following:

- Specifies that the City will continue to claim the five-percent franchise fee and impose an additional one-percent fee on video services for PEG purposes - Section 13.64.1 (a-c); Authorizes ITA to conduct financial audits of state franchise holders within the City similar to what is done for current City franchise holders - Section 13.64.2;
- Authorizes ITA to assess penalties against video service providers operating within the City for non-compliance with state and federal customer service standards - Section 13.64.3;

- Allows affected franchise holders operating within the City to appeal an assessed penalty to the Board of Information Technology Commissioners whose determination will be considered final - Section 13.64.3 (c);
- Specifies how the City must be notified by a state video franchise applicant when applying for or amending a state franchise - Section 13.64.4 (a);
- Authorizes ITA to file appropriate comments with the California Public Utilities Commission (state franchising authority) when notified of an application for or amendment of a state franchise - Section 13.64.4 (b); and
- Extends the City's current franchise agreements until January 2, 2008, on the same terms and conditions as currently in effect – Section 13.64.5.

Current City franchise holders (Time Warner, Cox Communications, and Charter Communications) have seen the November 14, 2006 City Attorney report and accompanying draft Ordinance and, to date, have not expressed opposition to either the report or the draft Ordinance.

The proposed Ordinance provisions are in compliance with City's Financial Policies in that they will ensure that ongoing revenue from cable franchise fees used to support such activities as L.A. CityView Channel 35, Los Angeles Cable Television Access Corporation (Channel 36), PEG access, and the Information Technology Agency's Cable Television Division will be maintained without interruption.

RECOMMENDATION

That the Council, subject to the approval of the Mayor, approve the draft Ordinance as submitted by the City Attorney and attached to this report.

FISCAL IMPACT STATEMENT

There is no General Fund impact at this time. The Information Technology Agency advises that approximately the same \$24 million in City cable franchise revenues that have been received in the past few years are anticipated in the near term. By ordinance, the existing five-percent cable franchise fees received by the City are divided between the General Fund (sixty-percent) and the Telecommunications Development Account (forty-percent). Over time, cable franchise revenues deposited in the Telecommunications Fund, Liquidated Damages and Lost Franchise Fees, Telecommunications Development Account are expected to increase as a result of the imposition of a one-percent PEG access fee.

The proposed Ordinance provisions are in compliance with City Financial Policies in that they will preserve ongoing revenue from cable franchise fees used to support such activities as L.A. CityView Channel 35, Los Angeles Cable Television Access Corporation (Channel 36), PEG access studios, and the Information Technology Agency's Cable Television Division. Since revenues may vary in future years, this Office will update revenue projections as information becomes available.

WTF:WDC:11070046c

Attachments



OFFICE OF THE CITY ATTORNEY
ROCKARD J. DELGADILLO
CITY ATTORNEY

REPORT NO. R 0 6 - 0 4 0 9
NOV 14 2006

REPORT RE:

**ANALYSIS OF THE EFFECT OF CALIFORNIA ASSEMBLY BILL 2987 (THE
DIGITAL INFRASTRUCTURE AND VIDEO COMPETITION ACT OF 2006) ON THE
CITY'S OPERATIONS AND DRAFT ORDINANCE IN RESPONSE**

The Honorable City Council
of the City of Los Angeles
Room 395, City Hall
200 North Spring Street
Los Angeles, CA 90012

Honorable Members:

On October 10, 2006, the Information Technology and General Services Committee of the City Council requested this office to prepare an analysis of the effect of California Assembly Bill 2987 (The Digital Infrastructure and Video Competition Act of 2006) (Act or AB2987) on the City's operations. This report provides an analysis of the Act along with a draft ordinance allowing the City to exercise its rights under this new law.

I. Overview of AB2987

In August of 2006, the California Legislature passed AB2987, which was signed by the Governor on September 29, 2006 and becomes effective on January 1, 2007. The Act provides a new mechanism for video franchising in California, which shifts franchising authority away from cities and counties to the state level. After January 1, 2008, the California Public Utilities Commission (PUC) will become the sole authority for granting new video franchises in the state. Nonetheless, the City will retain some of its prior authority over current and future franchisees.

Under the new law, the PUC will begin granting state video franchises no later than April 1, 2007. Geographically, the areas covered by state video franchises can be specified by the applicants, do not have to respect current City video franchise areas, and may cross city and county boundaries. A holder of a state franchise must pay five



percent of gross revenue to the City for all subscribers within City limits. In addition, if the City passes an appropriate ordinance, an additional one percent of gross revenue can be received by the City for Public, Educational and Government (PEG) purposes.

The City's current franchise authority will continue, without change, until January 1, 2008. Until that date, the City may grant, extend, renew or otherwise modify any of its existing franchise agreements, and it may grant new franchise agreements to new market entrants. After January 1, 2008, a new market participant wishing to provide video service must apply for a state franchise with the PUC. However, the City can continue to modify, renew or extend existing City video franchises after that date, whether they are expired or not.

Although the PUC will grant new franchises, the City will retain significant responsibility. The Act sets up a dual or parallel system under which the current City video franchise holders will continue under City authority (at least until January 2, 2008), while new entrants will be able to receive state franchises. Both City and state franchisees will be monitored by the City, but in different ways. For example, the City will continue to enforce the City's more stringent customer service standards against City video franchisees, but can only enforce less-demanding state and federal standards against state video franchisees. Similarly, the City will perform audits of the gross revenue of both City and state video franchise holders, but under a different framework for each. As the City is not the franchising authority for state video franchise holders, the City's ultimate ability to monitor and ensure the compliance of those franchise holders is less than with its own franchisees.

II. AB2987's Effect on Specific City Operations

A. Effect on Existing City Video Franchises

There are no immediate effects on the City's existing video franchises, which are held by Time Warner, Cox Communications (in the San Pedro area), and Charter Communications (in Pacific Palisades). Although our agreements with our franchisees are currently expired, they are akin to hold-over tenants, and thus are bound by all terms of the franchise agreements.¹

¹ See City Attorney Opinion 2006:2 ("Although Time Warner is operating under an expired franchise, all the obligations of the original agreement remain in full force and effect. The expiration of the franchise agreement does not have a detrimental effect on the City."); City Attorney Opinion 2002:11 ("hold-over franchisees are akin to 'hold-over tenants' and, therefore, continue to operate under the same terms and conditions of the franchise agreements"); *Charter Communs., Inc. v. County of Santa Cruz*, 133 F. Supp.2d 1184, 1188 (N.D. Cal. 2001) (an expired cable franchisee "continue[s] to operate as a holdover tenant"), *rev'd on other grounds*, *Charter Communs., Inc., v. County of Santa Cruz*, 304 F.3d 927 (9th Cir. 2002).

The Act does not cause any immediate changes to the City's franchises, but it gives our existing franchisees the ability to opt out of their City franchises upon the occurrence of any of the three following events: (a) the expiration of the local franchise agreement; (b) a mutually agreed-upon date set between the City and the franchisee; or (c) when notification is received by the City from a state video franchise holder that it intends to provide service in the City. Cal. Pub. Util. Code §5840(o).² As our current franchise agreements are expired, and as it is likely that new competitors will begin offering video service under state franchises sometime next year, the above triggers will shortly be met. However, even if a City franchise holder applies to the PUC for a state franchise, that franchise will not become operative before January 2, 2008. §5930(b). In addition, the new law gives the City the ability to unilaterally extend our existing franchises until January 2, 2008. *Id.*

Although our existing City franchise holders are not obligated under the new law to apply for a state franchise, the City can require them to apply for state franchises as soon as the City receives notice from a state franchise holder that it intends to provide service in the City. §5930(c). However, even if City franchisees are required by the City to apply for a state franchise, any state franchise issued to a City franchisee would not become operative until January 2, 2008.

If a City video franchise holder applies for and receives a state franchise (whether on its own initiative or under a requirement from the City), it must serve the entire service area provided for under its City franchise agreement. §5840(o); §5930(c). This provides an initial safeguard that no areas of the City will be without cable service. However, nothing currently prohibits a state franchisee (that was once a City franchisee) from submitting an amendment to its state franchise service area that reduces the territory served.³ Although there is no clear method available to the City at this time to avoid this possibility, the City Attorney's Office will continue to assist the City in efforts to ensure complete coverage.⁴

² Hereinafter, all references to code sections will refer to new sections of the California Public Utilities Code added by AB2987, unless otherwise specified.

³ The relevant section of AB2987 is the following: "[T]he commission shall require a holder to notify the commission and any applicable local entity within 14 business days of ... (6) A change in one or more of the service areas of this division that would increase or decrease the territory within the service area." §5840(m) (emphasis added). The "local entity" referred to above is the City of Los Angeles. Although within the PUC's power, it has not yet promulgated proposed regulations regarding amendments. See §5840(f) ("The commission may establish procedures for a holder of a state-issued franchise to amend its franchise to reflect changes in its service area.").

⁴ Methods available to the City may include proposing amendments to AB2987, working with the PUC to promulgate protective regulations, or reaching voluntary agreements with video providers. Although AB2987 provides that a City video franchisee "opting into a state franchise ... shall continue to serve all areas as required by its local franchise agreement existing on January 1, 2007, until that local franchise otherwise would have expired" (§5840(p)), as our existing franchise agreements are expired, this clause does not immediately assist the City. One additional possibility is that the City representatives continue to negotiate with our video franchisees to extend our City franchises beyond January 2, 2008.

Currently, four PEG channels are being provided to the City by our video franchise holders in the majority of the City's franchise areas.⁵ The quantity and channel numbers of these channels cannot be reduced or changed by our incumbent video operators, except as provided for in our franchise agreements.⁶ In addition, our incumbent franchisees provide thirteen public access studios throughout the City where residents can create public access programming. The franchisees also provide free cable and internet access to City buildings, libraries and schools. These benefits cannot be reduced in the short term. The new law provides the following time parameters:

All obligations to provide and support PEG channel facilities and institutional networks and to provide cable services to community buildings contained in a locally issued franchise existing on December 31, 2006, shall continue until the local franchise expires, until the term of the franchise would have expired if it had not been terminated by the [local operator by seeking a state franchise], or until January 1, 2009, whichever is later. §5870(k).

Although our franchise agreements are expired, they will "exist" on December 31, 2006. Thus, following the logic of §5870(k), the City will receive the benefit of PEG studios and free cable access to City buildings until at least January 1, 2009. However, to strengthen any possible arguments about the status of these agreements, it is advisable for the City to extend our franchise agreements unilaterally as permitted under the new law on January 1, 2007.

As a final matter, in the areas of technical and safety audits, financial audits, and customer service, there will be no change in the City's current enforcement power over City video franchisees until at least January 2, 2008. After that point, if our City video franchisees receive state franchises, the City would be able to conduct enforcement and review in these areas only to the extent permitted by the new state rules. However, the City's rules are fully enforceable against an incumbent operator until it receives a state franchise, even if the receipt of the state franchise occurs after January 2, 2008.

B. The City to Receive Notification Upon Application for State Video Franchise

⁵ The PEG channels provided to the City in each franchise area include Channel 35 (L.A. Cityview); Channel 36 (programmed by the Los Angeles Cable Television Access Corporation, or "LACTAC"); and a local public access channel. In addition, in a majority of franchise areas a fourth PEG channel is also provided.

⁶ Our current franchise agreements do not allow our operators to reduce our current PEG channel usage, unless they are allowed to become "fallow" through lack of use. In fact, under our agreements, the City can demand up to six total channels, if appropriate levels of usage are shown. Even if our incumbent operators receive state franchises, they must provide the same quantity of channels and channel numbers as permitted and activated under our franchise agreements. See §5870(a), (b).

After January 1, 2008, a new entrant to the video service market must apply to the state PUC for a video franchise, which will have a ten-year term. "Video service," under the Act, is defined as "video programming services, cable service or [open video system] service provided through facilities at least in part of the public rights-of-way without regard to delivery technology, including Internet protocol or other technology." §5830(s). The PUC must notify an applicant within 30 days whether an application is complete, and once it is complete, must issue the franchise within 14 days. §5840(h). Thus, a procedure with a maximum length of 44 days is the net result under the law.

Simultaneously with the initial PUC filing, an applicant must deliver a copy of its filing to the City. The City will have 30 days in which to provide comments, if it wishes to do so, to the PUC on the application before a determination of completeness is made. Although neither AB2987 nor the PUC's proposed rules give the City's comments special weight, if there are particular concerns or deficiencies the City can signal these to the Commission. Given the 30-day timeframe, however, the City will have to move quickly to formulate a response.

The PUC application requires that the applicant provide only a moderate amount of information. The necessary information includes the applicant's legal name and any business names used; the principal place of business; names and addresses of any principal officers; a pledge to follow all applicable state and federal laws (including consumer protection laws); a statement of non-discrimination; a description of the "video service area footprint" to be served, including "the socioeconomic status of all residents within the service area footprint"; the expected date of deployment of services; assurance that the applicant possesses the "financial, legal, and technical qualifications" necessary to construct the system and promptly repair any damage to the public right-of-way; and, if the applicant is a telephone corporation, a description of the territory in which it provides phone service, including the "socioeconomic status" of all residents in that territory. §5840(e). In order to assure repair of any damage to the public right-of-way, a bond will also be required.⁷

An important point to note is that the video service area of an applicant is left entirely to the discretion of the applicant. Except for our incumbent City franchisees, who must initially serve their entire area footprint, the new market entrants can designate service areas without regard to city or county boundaries, existing service areas, community needs or any other factors.

Before providing video service within the City, a state franchisee shall give at least ten days' (but no more than 60 days') notice to the City before the date on which it

⁷ See §5840(e)(9). In the PUC's Order Instituting Rulemaking (October 5, 2006), the PUC proposed a bond amount of \$100,000. This amount is inadequate when compared with the bond requirements currently in place for City franchisees, which range from \$89,000 to \$1,000,000, depending upon the City's assessment of relevant risk factors. The City has delivered reply comments to the PUC requesting that the amount be increased.

plans to provide service. §5840(n). A state franchisee can terminate the franchise at any time upon providing 90 days' notice to its customers, the City, and the PUC. §5840(j). A state franchise can be transferred to a successor in interest, provided that the successor provide the same information to the PUC as was provided by the original franchisee. The City and the PUC are entitled to 14 days' notice of a transfer; however, the City has no right to object other than by way of comment. See §5840(l), (m).

In addition to providing the City with the mandated notices in AB2987 upon franchise application, franchise transfer and initiation of service as described above, in order to install the necessary hardware in the public rights-of-way a state franchisee must possess the appropriate City encroachment permits. For permits to operate in the rights-of-way, state video franchisees will go through the same process as applicants for encroachment permits for telecommunications. The new law specifies that the City can regulate the installation and maintenance of the network consistent with the City's authority over time, place and manner.⁸

The City's Above Ground Facilities (AGF) ordinance⁹ and other permitting processes will apply to the boxes, cabling, and other appurtenances to be installed by the state video franchisees, just as they apply to our current City video franchisees. One addition in AB2987 is that the City must approve or deny a permit application within 60 days of receiving a completed application. As our AGF requires permits to be processed within 30 days of receipt of a complete application, the City appears to be in compliance with this mandate. Another requirement of AB2987 is that a denial of an encroachment permit can be appealed "to the governing body" of the City. Currently, AGF permit denials can be appealed to the Board of Public Works.¹⁰ The City Attorney's Office will examine, on an ongoing basis, whether any additional changes in permitting procedures should be recommended to guarantee compliance with AB2987.

C. Receipt of State Video Franchise and PEG Fees

1. The City Will Receive a Five Percent Franchise Fee

A state video franchisee must pay five percent to the City of gross revenues received from video subscribers within City limits, or the percentage of gross revenue paid by City video franchisees, whichever is less. §5840(q)(1). As our City franchisees pay five percent, the City will receive five percent from the new entrants as well. Payments must be made on a quarterly basis, with the first payment not due until 180

⁸ AB2987 provides that "[t]he local entity shall allow the holder of a state franchise...to install, construct, and maintain a network within public rights-of-way under the same time, place, and manner as the provisions governing telephone corporations under applicable state and federal law, including, but not limited to, the provisions of Section 7901.1." §5885(a). In addition, the law states that the applicant's project must comply with California Environmental Quality Act (CEQA). §5885(b).

⁹ Los Angeles Municipal Code (LAMC) §62.03.2-4 (the AGF ordinance).

¹⁰ See LAMC §62.03.2 (Section VIII.E of the AGF).

days after service begins.¹¹ In order to receive payments, the City must provide documentation to the state franchisee regarding the percentage paid by City franchisees.¹²

For the purposes of determining gross revenue, AB2987 specifies that Generally Accepted Accounting Principles (GAAP) shall be used.¹³ The GAAP method is not as broad as the definition used in the City's current franchise agreements. AB2987 sets forth a list of specific items that are included in gross revenue, along with a list of items that are excluded.¹⁴ In the event a City franchisee were to receive a state franchise, it would be required to pay under the new accounting method as well.

For bundled services (for example, video service with internet and/or telephone service), the franchise fee will apply only to the video portion of the service. To determine the value of the video portion, an equal allocation will be made of the "package discount," if any, by comparing advertised rates for the separate services included in the bundle. See §5860(f). If any of the bundled services are not offered separately, the franchise holder must declare a separate retail value for each service for the purposes of determining the franchise fee. The declared retail value must be based on "comparable prices" in the marketplace. *Id.*

2. A Separate One Percent Fee for PEG May Be Imposed by the City

The Act gives the City the right to impose a one percent fee for PEG support, in addition to the five percent franchise fee discussed above.¹⁵ State franchise holders will

¹¹ See §5860(h) ("The state franchise fee shall be remitted to the applicable local entity quarterly, within 45 days after the end of the quarter for that calendar quarter."); §5860(a) ("[T]he remittance shall not be due until the time of the first quarterly payment required...that is at least 180 days after the provision of service began.").

¹² Although AB2987 does not specify the form of this documentation, copies of the City's franchise agreements setting forth the five percent franchise fee charged to our current City franchisees should be sufficient.

¹³ See §5860(g) ("For the purposes of determining gross revenue...a video service provider shall use the same method of determining revenues under generally accepted accounting principals [sic] as that which the video service provider uses in determining revenues for the purpose of reporting to national and state regulatory agencies.").

¹⁴ Gross revenues include, for example, all video charges to subscribers, including subscription charges, equipment rentals, late fees, and insufficient fund fees, as well as franchise fees that are passed through and paid by the subscribers. §5860(d). Gross revenues do not include revenues not actually received by the state franchisee, even if billed; revenues from non-cable services; revenues paid by subscribers to home shopping networks (although if the home shopping network pays a commission to the franchise holder, the commission is counted in gross revenue); and amounts collected from subscribers to recover any taxes or fees other than franchise fees. §5860(e).

¹⁵ See §5870(n) ("A local entity may, by ordinance, establish a fee to support PEG channel facilities consistent with federal law...."). The new law allows a city or county that is imposing a separate fee for PEG in excess of one percent on December 31, 2006, to impose a greater fee (up to three percent) for PEG. However, since the City is not imposing a fee at this time, the City may only impose up to the one percent fee. *Id.*

have no obligation to provide in-kind support for PEG facilities, so as a practical matter this fee is the primary manner in which the new market entrants will provide PEG support.¹⁶ If our City franchise holders were to obtain state franchises, they would also be subject to this fee. In addition, if a City franchisee chooses to obtain a state franchise between January 2, 2008 and January 1, 2009, it would be obligated to continue supporting its existing PEG studio facilities and simultaneously pay the one percent PEG fee for this time period.

Because it is not known at this time when the state franchisees will begin offering service, it is recommended that this PEG fee be imposed as soon as possible. If a state franchisee were to begin service before the fee's imposition, it would arguably not be obligated to pay the one percent for the time period before the fee's enactment.

PEG fees received by the City, per AB2987, can only be used in a manner consistent with federal restrictions on PEG funds. This restriction on PEG funds results from the fact that federal law only allows an unrestricted "franchise fee" of up to five percent.¹⁷ Despite this limitation, additional fees for PEG beyond the five percent can be imposed, and do not count towards the five percent, as long as they are used for "capital costs ... for public, educational, or government access facilities...."¹⁸ The City Attorney's Office will assist the City in developing guidelines for the use of this money in order to comply with federal rules.

3. The City's Audit Authority

The City may, not more than once annually, audit the business records of state franchise holders to ensure that the proper percentages of gross revenue are paid to the City.¹⁹ Each state franchise holder must keep records of gross revenue for at least four years. §5860(i). In addition, each payment to the City must be accompanied by an explanation by the state franchise holder of the basis for the franchise fee. Any claim by the City of underpayment of fees must be made within three years and 45 days after the end of the quarter in which the fee was paid, or three years from the date of payment, whichever is later. *Id.*

If the audit discloses that fees have been underpaid by more than five percent over the audit period, the costs of the audit will be paid by the franchisee. If the audit finds that the franchisee has not underpaid, the City will bear the costs of the audit. In all other cases, both parties bear their own costs. §5860(i). The only method of

¹⁶ State franchise holders will also have to activate and provide channels on their networks for PEG, as well as any necessary interconnections. These obligations are discussed in Part II.D, below.

¹⁷ See 47 U.S.C. §542(b).

¹⁸ See 47 U.S.C. §542(g); see also Cal. Pub. Util. Code §5870(n) (stating that the PEG fee must be used "to support PEG channel facilities consistent with federal law").

¹⁹ See §5860(i).

resolving disputes over fee payments is by an action in court, which can be filed by either the City or the franchisee.²⁰

D. PEG Responsibilities of State Video Franchisees

As discussed above, state video franchise holders will have no obligation to provide in-kind PEG facilities. They will, however, be charged a fee equal to one percent of gross revenue for PEG purposes consistent with federal law, provided the City enacts an ordinance imposing this fee. In addition to the one percent, state video franchise holders must provide PEG channel capacity on their networks, and will have to interconnect their systems with our existing franchisees. These obligations are described below.

1. PEG Channels

State video franchise holders must provide a number of PEG channels equal to the greatest number of PEG channels that are activated and provided by an incumbent City franchisee under the terms of a franchise in effect as of January 1, 2007. §5870(a).²¹ In addition, AB2987 also requires that a minimum of three channels be provided by state franchisees even if the number provided by City franchisees is less. PEG channels shall be carried on the basic service tier and will have the same channel numbers as the channels used by the incumbent City franchisees.²² After the initial channel number designations, the channel assignments cannot be changed by the state franchisees unless requested by the City or required by federal law. §5870(b).

Although our current franchises will be "in effect" on January 1, 2007, to resolve any possible ambiguity it is advisable to exercise the City's right to unilaterally extend those franchises until January 2, 2008. Because our existing agreements provide up to six channels (and the majority of our incumbent operators are currently providing four channels) preserving the PEG "baseline" of our existing agreements may allow us to demand more than the three-channel PEG minimum required of the state franchise holders. Extension of the City's franchise agreements until January 2, 2008, does not preclude the City from further negotiation with our cable operators to extend their City franchise agreements beyond that date, or to negotiate additional favorable terms in other areas of the agreements.

²⁰ See §5860(i) ("Either the local entity or the holder may, in the event of a dispute concerning compensation under this section, bring an action in a court of competent jurisdiction."); see also §5870(p) (stating that with regard to PEG fees and other PEG issues "[a] court of competent jurisdiction shall have exclusive jurisdiction to enforce any requirement under this section").

²¹ PEG channels of existing City franchisees are deemed "activated" under the new law if they are being programmed for PEG programming at least eight hour per day. §5870(a).

²² AB2987 also provides that PEG signals shall be receivable by all subscribers, whether they receive digital or analog service, without any additional equipment beyond that necessary to receive the lowest-cost tier of service. §5870(g)(3).

The City must send a request to an incoming state franchise holder specifying the number of PEG channels that will be required. The state franchisee will have three months from receipt of the request to designate the appropriate PEG capacity on its network.²³ If usage on any particular PEG channel carried by a state franchisee exceeds 56 hours per week (as measured on a quarterly basis), the City may request an additional PEG channel.

In order for programming to count towards the 56-hour trigger for a new PEG channel under AB2987, the programming must be non-duplicated and locally produced. §5870(d)(1). "Locally produced" is defined as programming produced or provided by the City or any local resident; any local private or public agency that provides service to residents of the franchise area; or any transmission of a meeting or proceeding of any local, state, or federal governmental agency. §5870(d)(2).

2. Interconnection

State franchisees must negotiate in good faith with City franchisees to interconnect their networks for the purpose of PEG channel delivery, provided that an interconnection is technically feasible. §5870(h). If a state franchisee cannot reach a mutually acceptable agreement with a City franchisee, the City may require that the City franchisee allow the state franchisee to interconnect the City and state franchisee networks at a point identified by the state franchisee. If no technically feasible point for interconnection can be identified, the state franchisee shall bear the cost of providing a direct interconnection to the channel originator.

The costs of interconnection will be borne by the state video franchisee, unless otherwise agreed to by the parties. AB2987 does not give any authority to the PUC in interconnection matters, so in the event of a dispute, the only recourse would be a court action.²⁴

E. Customer Service Standards For State Video Franchisees

The City will enforce state and federal customer service standards with respect to state video franchisees, but will not be able to enforce the City's more stringent customer service standards against state franchisees.²⁵ The City may continue to

²³ The three-month period may be tolled if "the designation of provision is technically infeasible" for any period, or if a delay is caused by the "failure or delay of the incumbent cable operator to make adequate interconnection available." See §5870(a).

²⁴ See §5870(p) ("A court of competent jurisdiction shall have exclusive jurisdiction to enforce any requirement under this section or resolve any dispute regarding the requirements set forth in this section.")

²⁵ The Act specifies the customer service standards with which state franchisees must comply: "The holder of a state franchise shall comply with the provisions of Sections 53055, 53055.1, 53055.2, and 53088.2 of the Government Code, and any other customer service standards pertaining to the provision of video service established by federal law or regulation or adopted by subsequent enactment of the

enforce its current customer service standards against City franchisees until they no longer hold a City franchise. Thus, it is likely that the City, for at least some period of time, will be enforcing two somewhat different customer service standards simultaneously.

AB2987 requires the City to adopt, by ordinance or resolution, a schedule of penalties for violations of customer service. §5900(d). These penalties may be enforced for “material breaches” of customer service standards. The new law sets forth a specific schedule of maximum penalties: 1) \$500 a day, not to exceed \$1500 for each occurrence of a material breach; 2) \$1,000 per day, not to exceed \$3,000 for each occurrence of an additional material breach of the same nature within 12 months; and 3) \$1,500 per day, not to exceed \$7,500 per occurrence for a third or further material breach of the same nature within 12 months. *Id.* The City is required to provide a state franchisee of 30 days’ notice of a material breach, and an opportunity to cure before a penalty is imposed. §5900(e). A “material breach” is defined as a “substantial and repeated” failure of the state franchisee to comply with an applicable customer service standard.²⁶

Any penalty imposed by the City can be contested by the franchisee in a court of appropriate jurisdiction, which can conduct a *de novo* review of any issues presented. §5900(h). One-half of any penalty actually received by the City must be remitted to the California Digital Divide Account (a state account administered by the state of California).²⁷ A failure to pay a court-ordered penalty (or to comply with any other court order related to the franchise) can provide sufficient grounds for the PUC to withhold renewal of a state franchise.²⁸

F. Non-Discrimination and Build-out Provisions in AB2987

State video franchise holders are given discretion as to the initial boundaries of the service area in their state franchise applications. The franchise areas do not have to follow City boundaries, existing service areas, or take into account any other external factors. However, once the boundaries are set, AB2987 places certain non-

Legislature.” §5900(a). The holder of a state franchise must also comply with the privacy provisions of Penal Code §637.5. §5900(b). The Act states that the City cannot “adopt or seek to enforce any additional or different customer service standards under...any other authority or provision of law.” §5900(c). One additional customer protection measure in the Act is that personnel who visit customer premises must have passed a background check. §5910(a), (e).

²⁶ See §5900(j). The Act also seems to suggest that only one material breach can be assessed even if multiple customers are affected. See §5900 (f) (“A material breach for the purposes of assessing penalties shall be deemed to have occurred for each day [after the notice period has expired] ... that any material breach has not been remedied...irrespective of the number of customers affected.”).

²⁷ “Any penalty shall be provided to the [city or county] who shall submit one-half of the penalty to the Digital Divide Account established in [California Public Utilities Code] Section 280.5” §5900(g).

²⁸ See §5850(d) (“The commission shall not review the franchise if the video service provider is in violation of any final nonappealable court order issued pursuant to this division.”).

discrimination restrictions and build-out obligations on state franchise holders. These restrictions and obligations are discussed below.

1. Non-Discrimination Obligations of State Video Franchisees

The Act imposes a requirement concerning non-discrimination based on income:

A cable operator or video service provider that has been granted a state franchise under this division may not discriminate or deny access to service to any group of potential residential subscribers because of the income of the residents in the local area in which the group resides. §5890(a).

A state franchisee can prove that it is not in violation of the above non-discrimination provision in the following ways. If it is a company with more than one million telephone customers in California, it must show that: (1) within three years after providing video service, at least 25 percent of households with access to its service are low-income households;²⁹ (2) within five years after providing video service, at least 30 percent of households with access are low-income households; and (3) that the state franchisee is providing free service to community centers at a ratio of one community center for every 10,000 video customers.

If the state franchisee is a company with less than one million telephone customers in California, it can show non-discrimination by "offer[ing] video service to all customers within their telephone service area within a reasonable time," as determined by the PUC. §5890(c). However, the PUC shall not require the state franchisee to offer video service when the cost to provide video service is "substantially above the average cost of providing video service in that telephone area." *Id.*

A rebuttable presumption of non-discrimination is given to a state franchisee when it: (1) provides video service outside of its telephone service area; (2) is not a telephone corporation; or (3) offers video service in an area where no other video service is being offered, other than satellite service. §5890(d).

In addition to the above framework, AB2987 empowers the PUC to "review the [state franchisee's] proposed video service area to ensure that the area is not drawn in a discriminatory manner." §5890(d).³⁰ The City, per the new law, may bring complaints

²⁹ For the purposes of AB2987, a "low-income household" is defined as a residential household "located within the state franchise holder's existing telephone service area" where the average annual household income is less than \$35,000 based on U.S. Census Bureau estimates. §5890(j)(2).

³⁰ The Act is silent as to the criteria to be used for this evaluation. However, the Act does state that no non-discrimination provision "shall be construed to require a [state franchise] holder to provide video service outside of its wireline footprint or to match the existing cable franchise territory of any cable provider." §5890(k).

to the PUC regarding non-compliance with the non-discrimination provisions of AB2987, or the PUC may open an investigation upon its own motion. §5890(g). Before issuing a decision, the PUC shall hold public hearings. The PUC may suspend or revoke the franchise if it finds non-compliance on the part of the state franchisee, or it may impose a fine not to exceed one percent of the state franchisee's monthly revenue for each month of non-compliance. *Id.*

2. Additional Build-Out Obligations of Certain State Video Franchisees

The Act places additional build-out requirements on state video franchisees that are telephone corporations with more than one million customers. These requirements vary depending upon the type of technology that the company plans to use. If the state franchisee is predominantly deploying fiber optic cables to individual homes, the state franchisee must, within two years, provide access to its video service to a number of households equal to at least 25 percent of the customer households in franchisee's telephone service area. Within five years, it must provide access to video service to a number of households equal to at least 40 percent of its telephone service households.

If the franchisee is not predominantly deploying fiber optic cables to individual homes, the state franchisee must, within two years, provide access to video service to a number of households equal to at least 35 percent of its telephone service households. Within five years, the number of households offered access to video service must be 50 percent of the number of telephone service households served by the franchisee.

The City may bring complaints regarding these build-out requirements to the PUC, or the PUC may investigate on its own motion. In reviewing any failure to meet the build-out requirements, the PUC must hold public hearings, and can grant the franchisee an extension in order to satisfy the requirements. Some of the factors to be considered include the ability of the state franchisee to receive access to the rights of way; the degree to which developments or buildings are inaccessible using reasonable technical solutions; and whether the franchisee has used "substantial and continuous effort" to meet the build-out requirements. See §5890(f). These factors can also be considered by the PUC to determine whether state franchisees have met non-discrimination obligations as well.

III. Conclusion

AB2987 will present the City with a number of challenges as it manages the transition from City video franchise authority to state franchise authority. The proposed ordinance included with this Report allows the City to exercise its rights under the new law and allows the City to fulfill its new responsibilities, particularly in the area of customer service. Time is of the essence because the City may be at a disadvantage with respect to PEG monies and PEG in-kind services if the City does not act by

January 1, 2007. It should be additionally noted that because this ordinance adopts a fee, it is subject to the notice requirements set forth in Government Code §6062a.

The ordinance would have the following effects: 1) specifying that the City will claim a five percent franchise fee and a one percent fee for PEG purposes; 2) granting authority to ITA to conduct financial audits of state franchise holders; 3) authorizing ITA to assess penalties for non-compliance with state and federal customer service rules, and allowing affected companies to appeal an assessed penalty to the Board of Information Technology Commissioners (BITC); 4) specifying how notice must be given to the City by a state video franchise applicant when applying for or amending a state franchise, and authorizing ITA to file any appropriate comments with the PUC; and 5) extending our current franchises until January 2, 2008, on the same terms and conditions.

The above provisions ensure that the City will have the appropriate legal framework in place to interact with state video franchisees as they receive franchises in 2007 and begin to offer video service to City residents. As the City gains experience interacting with and regulating these new franchisees, the City Attorney's Office will work closely with City staff to determine whether any additional changes in City policy should be recommended.

Pursuant to Council Rule 38, copies of this Report and the draft ordinance have been sent to ITA, the Board of Public Works, and BITC. They have been asked to deliver their comments directly to the City Council as it considers this matter.

If you have any questions, please contact Deputy City Attorney Lonnie Eldridge at (213) 978-8136. Either he or another member of this office will be available to answer any questions you have.

Sincerely,

ROCKARD J. DELGADILLO, City Attorney

By *Claudia Culling*
CLAUDIA CULLING
Special Counsel – Municipal

CC:LJE
Attachment



OFFICE OF THE CITY ATTORNEY
ROCKARD J. DELGADILLO
CITY ATTORNEY

REPORT NO. R06-0413
NOV 16 2006

REPORT RE:

**AMENDED DRAFT ORDINANCE IN RESPONSE TO CALIFORNIA ASSEMBLY BILL
2987 (THE DIGITAL INFRASTRUCTURE AND VIDEO COMPETITION ACT OF 2006)**

The Honorable City Council
of the City of Los Angeles
Room 395, City Hall
200 North Spring Street
Los Angeles, CA 90012

Honorable Members:

This office has prepared and now transmits for your action the attached amended draft ordinance, approved as to form and legality. This draft ordinance amends the draft ordinance transmitted to the Council on November 14, 2006, regarding the City's response to California Assembly Bill 2987. This new draft ordinance adds a new section, which specifies that the operative date of the ordinance will be December 31, 2006, and also makes one technical correction to the ordinance. All other provisions remain the same. This change helps ensure that the ordinance will, on January 1, 2007, extend our existing cable franchises to January 2, 2008, in the event that the 31-day publication period for the ordinance has not yet terminated.

If you have any questions, please contact Deputy City Attorney Lonnie Eldridge at (213) 978-8136. Either he or another member of this office will be available to answer any questions you have.

Sincerely,

ROCKARD J. DELGADILLO, City Attorney

By *Claudia Culling*
CLAUDIA CULLING
Special Counsel – Municipal

CC:LJE
Attachment

ORDINANCE NO. _____

An ordinance amending the Los Angeles Administrative Code to add provisions regarding new video service fees, penalties and other related matters.

**THE PEOPLE OF THE CITY OF LOS ANGELES
DO ORDAIN AS FOLLOWS:**

Section 1. A new Article 3 is added to Chapter 2 of Division 13 of the Los Angeles Administrative Code to read:

Article 3. Video Franchise Fees, Customer Service and Other Video-Related Matters

Sec. 13.64. Regulation of State Video Franchises and City Video Franchises

Under State law to be effective January 1, 2007, the California Public Utilities Commission (PUC) will have the authority to grant state video franchises. The City of Los Angeles will acquire certain rights and responsibilities with respect to state video franchise holders. These include the receipt of a franchise fee and a fee for Public, Educational and Government (PEG) purposes, both based on a percentage of the gross revenues of state franchise holders, as well as the establishment and enforcement of penalties for violations of customer service rules. The City will retain authority, without change, over all City video franchisees until such time as they no longer hold a City franchise, or are no longer operating under a current or expired City franchise. The City may continue to grant, modify, renew, extend or terminate City video franchises for video service until January 1, 2008. After January 1, 2008, the City may modify, renew, extend or terminate existing City video franchises, whether current or expired. For purposes of this article, the terms "City video franchise" and "City video franchisee" shall have the same meaning as the terms "City cable franchise" and "City cable franchisee" as they are used in this Division 13.

Sec. 13.64.1. State Video Franchise Fees

(a) For any state video franchise holder operating within the boundaries of the City of Los Angeles, there shall be a fee paid to the City equal to five percent of the gross revenue of that state video franchise holder.

(b) For any state video franchise holder operating within the boundaries of the City of Los Angeles, there shall be an additional fee paid to the City equal to one percent of the gross revenue of that state video franchise holder, which fee shall be used by the City for PEG purposes consistent with state and federal law.

(c) Gross revenue, for the purposes of (a) and (b) above, shall have the definition set forth in California Public Utilities Code §5860.

Sec. 13.64.2. Audit Authority

Not more than once annually, the City's Information Technology Agency (ITA) may examine and perform an audit of the business records of a holder of a state video franchise to ensure compliance with Section 13.64.1.

Sec. 13.64.3. Customer Service Penalties Under State Video Franchises

(a) The holder of a state video franchise shall comply with all applicable state and federal customer service and protection standards pertaining to the provision of video service.

(b) ITA shall monitor the compliance of state video franchise holders with respect to state and federal customer service and protection standards. ITA will provide the state video franchise holder written notice of any material breaches of applicable customer and service standards, and will allow the state video franchise holder 30 days from the receipt of the notice to remedy the specified material breach. Material breaches not remedied within the 30-day time period will be subject to the following penalties to be imposed by ITA:

(1) For the first occurrence of a violation, a fine of \$500.00 shall be imposed for each day the violation remains in effect, not to exceed \$1500.00 for each violation.

(2) For a second violation of the same nature within 12 months, a fine of \$1000.00 shall be imposed for each day the violation remains in effect, not to exceed \$3000.00 for each violation.

(3) For a third or further violation of the same nature within 12 months, a fine of \$2500.00 shall be imposed for each day the violation remains in effect, not to exceed \$7,500.00 for each violation.

(c) A state video franchise holder may appeal a penalty assessed by ITA to the Board of Information Technology Commissioners (BITC) within 60 days. After relevant speakers are heard, and any necessary staff reports are submitted, BITC will vote to either uphold or vacate the penalty. BITC's decision on the imposition of a penalty shall be final.

Sec. 13.64.4. City Response to State Video Franchise Applications

(a) Applicants for state video franchises within the boundaries of the City of Los Angeles must concurrently provide complete copies to the City of any application or amendments to applications filed with the PUC. One complete copy must be provided to the City Clerk, and one complete copy to the General Manager of ITA.

(b) ITA will provide any appropriate comments to the PUC regarding an application or an amendment to an application for a state video franchise.

Sec. 13.64.5. Extension of Existing City Video Franchises

Any entity providing video service under an expired City video franchise on January 1, 2007, shall hereby have the terms of its City video franchise extended on the same terms and conditions until January 2, 2008. The extension of a City video franchise does not preclude the City from further modifications, renewals, extensions or termination of that City video franchise.

Sec. 2. The operative date of this ordinance shall be December 31, 2006.

Sec. 3. The City Clerk shall certify to the passage of this ordinance and have it published in accordance with Council policy, either in a daily newspaper circulated in the City of Los Angeles or by posting for ten days in three public places in the City of Los Angeles: one copy on the bulletin board located at the Main Street entrance to the Los Angeles City Hall; one copy on the bulletin board located at the Main Street entrance to the Los Angeles City Hall East; and one copy on the bulletin board located at the Temple Street entrance to the Los Angeles County Hall of Records.

I hereby certify that this ordinance was passed by the Council of the City of Los Angeles, at its meeting of _____.

FRANK T. MARTINEZ, City Clerk

By _____ Deputy

Approved _____

Mayor

Approved as to Form and Legality

ROCKARD J. DELGADILLO, City Attorney

By Lonnie Eldridge
LONNIE ELDRIDGE
Deputy City Attorney

File No. CF _____

Date: 11/16/06