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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

