

# **Actions Speak Louder Than Words:**

## **Recent Developments in Making ROW Users Comply With Franchise Agreements and With the Law**

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- Franchise Enforcement
  - Franchise fees and “gross revenue” issues
- Audits
  - Operator objections
- Preventative Action

# Franchise Fees: Getting What's Owed You

- Federal law specifically allows localities to administer franchises and collect a franchise fee, normally based on a percentage of the operator's gross revenue.
- “For any twelve-month period, the franchise fees paid by a cable operator with respect to any cable system shall not exceed 5 percent of such cable operator's gross revenues derived in such period from the operation of the cable system to provide cable services.”  
47 U.S.C. 542(b)

# “Gross Revenue”

- “[U]nless expressly limited by the terms of a statute, regulation or contract, gross revenues means all amounts received from operation of a business, without deduction. . . .Gross revenue normally includes all revenue collected from whatever source.”
  - *City of Dallas v. FCC*, 118 F.3d 393, 395, 398 (5<sup>th</sup> Cir. 1997)
- “...includes revenue from subscriptions and revenue from other sources – e.g., advertising and commissions from home shopping networks.”
  - *Texas Coalition of Cities v. FCC*, 324 F.3d 802, 806 (5<sup>th</sup> Cir. 2003).

## “Gross Revenue” (*cont.*)

- “LFAs and cable operators may expressly omit certain items, such as advertising revenue and home shopping commissions, from the gross revenue definition.”
  - *City of Pasadena, et al.*, Memorandum Opinion and Order, CSR 5441-R, FCC 01-289 (released October 4, 2001), at 16.

## “Gross Revenue” (*cont.*)

- BUT: Some operators insist certain types of non-subscriber revenue are not “revenue”, for franchise fee purposes:
  - Launch fees and marketing support
  - Advertising-related revenue, home-shopping commissions
  - Leased access charges, studio revenue, bad debt

# “Gross Revenue” (*cont.*)

- Disputes in:
  - Los Angeles
  - Springfield – Eugene - Lane County, Oregon
  - Tacoma, WA
  - Roanoke, VA
  - Milpitas, CA
  - Chandler, AZ
  - Indianapolis, IN
  - Sacramento, CA
  - undoubtedly others...

# “Gross Revenue” (*cont.*)

Operators’ explanations --  
NOT “REVENUE” BECAUSE:

- Not “from operation of cable system”
- Booked as an “offset” or “contraexpenditure”:
  - Historically required to offset launch fee revenue against programming costs, for FCC rate-regulation purposes
  - Historically, franchise fee calculation based on “gross subscriber revenues” (1972 FCC reg.). Broadened in 1977 and by Congress in 1984 to include non-subscriber revenues. *See City of Dallas.*
    - “Amounts paid for launch reimbursement and marketing support are used to offset the cost of making programming changes as well as the marketing of new channels.” (Charter)
    - “Launch reimbursement and marketing support are provided by networks to reimburse for out-of-pocket marketing and operational expenses...” (Charter)
    - Launch fees, advertising commissions etc. are “contra-expenditures”, not revenue under GAAP (Comcast)

# “Gross Revenue” (*cont.*)

BUT:

- Charter SEC filing:

“Launch Fees’ means any advance or lump sum payments received by . . . the system in connection with any programming agreement used in the operation of the system.”

- May 29, 2003 8-K, Charter Communications, Inc.

- “Gross revenue”: “receipts of a business before deductions for any purpose, except those items specifically exempted”

- *Blacks’ Law Dictionary*, 6<sup>th</sup> Ed. 1990.

- Franchise documents typically do not reference GAAP, in context of franchise fee calculation. FASB #51 is contrary authority; *see City of Dallas*.

- Historical FCC “offset” requirement generally doesn’t apply any more, even if rate-regulated

# “Gross Revenue” (cont.)

## Percent of Annual System Revenue From Various Sources

Revenue Source:	(373 systems responding) 7/1/99	7/1/00
Programming	86.8%	84.2%
Equipment	5.5%	5.4%
Non-Video	1.5%	3.5%
Advertising Services	5.6%	6.3%
Other Fees*	0.6%	0.6%

\*including “commissions, launch fees, and leased access”

-- Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992 Statistical Report on Average Rates for Basic Service, Cable Programming Services, and Equipment, Report on Cable Industry Prices, MM Docket No. 92-266, FCC 01-49 (released Feb. 14, 2001).

## Regulatory Fee Issues

- How treat revenue collected from subscribers as part of “regulatory fee” line item?
- Time Warner Cable: ongoing attempts to include reg. fees within franchise fee cap – a subtraction of \$ owed the locality
- NATOA action: requested FCC confirmation that regulatory fees cannot affect or be deducted from the LFA’s franchise fees
- “Regulatory recovery fees” proliferate –

# Franchise Fee Audits

- Industry upheaval = audits are increasingly important:
  - Wireline decline
  - Triple play providers
  - Tricky issues (VoIP, VidIP, Video-over-DSL, cable modem etc.)
  - Structural changes, system purchases, bankruptcies, etc.
  - Massive residential development / annexation in some places
- Eugene, OR: 27% drop in franchise fees from Qwest, during 2002-2003 (while population was booming)

# Audit Objections

- Privacy objections: Cable Act §551
- Competitiveness objections
- Reluctance to share certain non-subscriber, business-related info (e.g., launch fees, ad revenue)
- “We’re really busy” – using delay as a tool

## Audit Objections (*cont.*)

- Cable Act subscriber privacy statute (47 U.S.C. 551):

“(c) Disclosure of personally identifiable information

(1) Except as provided in paragraph (2), a cable operator **shall not disclose personally identifiable information** concerning any subscriber without the prior written or electronic consent of the subscriber concerned and shall take such actions as are necessary to prevent unauthorized access. . . .

(2) A cable operator **may disclose such information if the disclosure is—**

(A) **necessary to render, or conduct a legitimate business activity related to, a cable service or other service provided by the cable operator to the subscriber”**

## Audit Objections (*cont.*)

- Operators' section 551 arguments:
  - “Information required for audit = ‘personally identifiable information’”
  - “Disclosure does not fall within ‘legitimate business activity’ exception of s551(c)(2)(A).”
  - Confidentiality agreements w/LFA may not help; the issue is the disclosure itself.
  - 1992 FCC Order (re: disclosure of subscriber complaints)

*Cable Television Technical and Operational Requirements; Review of the Technical and*  
No. 91-168, FCC 92-508 (released

*Operational Requirements of Part 76, MM Dkt.*  
November 24, 1992), at para. 39.

# Audit Objections (*cont.*)

## COUNTERARGUMENTS – s.551 Objections:

- “Necessary to render, or conduct legitimate business activity related to...” exception
  - operator true-up, determining \$ due or owed, certainly seems like a legitimate business activity...
- 1992 Order:
  - involved viewing habits
  - involved sharing info with city-as-a-regulator, not a contract-based franchise-fee determination
- Operator’s privacy policy
- Address-only is arguably not “personally identifiable information”

# Audit Objections (*cont.*)

## COUNTERARGUMENTS – s.551 Objections, *cont.*

- s.551's "marketing exception" allows disclosure of "names and addresses" if subscribers are provided "opportunity to prohibit or limit" disclosure.
- s.551 was intended to protect viewing habits and subscriber transactions. A franchise fee audit typically does not involve such information.

# Preventative Maintenance

- “Gross Revenue” issues:
  - Be precise about what is included
  - Spell it out in franchise agreement, not just franchise ordinance
- Audit issues:
  - See Spring 2004 NATOA Journal
  - Demand periodic audits upfront, with specified timetable for completion
  - Put one person in charge

# Preventative Maintenance, (*cont.*)

- Audit issues, (*cont.*):
  - Privacy/competitive info issues:
    - Consider statement that street addresses, without more, do not amount to “personally identifiable information”
    - Confidentiality agreements aren’t the entire answer
    - Consider plan where LFA would receive audit report, but not raw data.

## Preventative Maintenance, (*cont.*)

- Audit costs, penalties and pass-throughs
  - Specify in franchise agreement that operator pays all reasonable costs of audit, if audit reveals underpayment of [n]%.
    - Prohibit pass-through of interest and penalties
    - Arrange for administrative penalties to exceed amount improperly withheld
    - These are all sticks... any carrots?

# DBS “Tax Parity” Issue

- Local pressure from cable operators on local officials to enact some sort of tax on DBS, because after all, cable operators pay franchise fees (and DBS providers do not)
- DBS providers are specifically protected under federal law from local taxation of any sort.
- States are specifically allowed to impose taxes on DBS, and distribute among localities if they wish. (DBS industry is vigorously fighting in several states).