Attachment 1

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BILL ANALYSIS AB 2987

CONCURRENCE IN SENATE AMENDMENTS
AB 2987 (Nunez & Levine)
As Amended August 28, 2006
Majority vote

|ASSEMBLY: | 77-0 | (May 31, 2006) | SENATE: | 33-4 | (August 30,2006) |

Original Committee Reference: U. & C.

SUMMARY: Creates a mechanism for a state-issued franchise for the provision of cable and video service in California.

The Senate amendments:

1) Move the franchising authority from the Department of Consumer Affairs to the California Public Utilities Commission (PUC) and make other changes relating to the application for and renewal of state-issued franchises.

2) Allow incumbent cable operators to opt-in to a state franchise when a holder of a state franchise begins offering service in the incumbent's territory, but the incumbent provider must continue to offer specified services until the date the franchise would have otherwise terminated.

3) Increase the amount of information video service providers must provide to PUC concerning their video and broadband deployment.

4) Make changes to the definitions of gross revenue.

5) Make changes to the requirements to provide Public, Educational, and Government (PEG) programs to clarify the video service providers' obligation to provide and fund PEG.

6) Freeze rates for basic residential telephone service at current levels until 2009, with PUC authorized to raise those rates to reflect inflation increases.

7) Add specific requirements to prevent discrimination in the provision of video service.

This bill:

1) Provides that PUC is the sole franchising authority for the state-issued authorization to provide cable and video service (video service). Provides that PUC may fund its regulatory costs only through a charge on video subscribers that is imposed in an identical manner as the charge collected from other utilities for this purpose. PUC must begin accepting applications for state-issued franchises by April 1, 2007. As of January 1, 2008, all video service providers must seek a state franchise instead of a local franchise.

2) Provides that the application shall contain specified information and statements, signed under penalty of perjury.

3) Provides for a 44-day timeline in which PUC must complete an application for a state franchise.

4) Provides that a state franchise shall be valid for 10 years, at which point the holder must renew the franchise if it chooses to continue to offer video service in this state.

5) Provides that an incumbent cable operator may seek a state franchise to serve an area where it has a local franchise prior to the termination of the existing local franchise if a different company that holds a state franchise begins to offer video service in the same area. If the incumbent cable operator does opt-in to the state franchise, it must continue to provide video service to all areas it is required to serve under the local franchise until the date that franchise would have expired.

6) Requires the holder of a state franchise to pay rent to each local entity where it provides video service a franchise fee based on the gross revenue, as defined in the statute, for the use of the public right-of-way. If there is an incumbent cable operator in that jurisdiction the fee shall be 5% of the holder's gross revenue or the percentage applied to the incumbent's gross revenue, whichever is less. If there is no local franchises or after all local franchise have expired, the franchise fee will be 5% of gross revenue or a lower level set by the local government thru ordinance.

7) Provides that the holder shall designate a sufficient amount of capacity on its network to provide the same number of PEG channels that the incumbent cable operator currently provides within the local entity jurisdiction. If less than three PEG channels are currently provided within that local entity, a local entity may request the holder to provide up to three PEG channels. The local entity may request additional PEG channels if they produce more than 56 hours a week of original, locally produced programming on the current channels.

8) Requires all incumbent cable operators to continue to offer the same level of PEG support and I-net support as they do under their franchise agreements today thru January 1, 2009, or until their franchise expires, or would have expired had it not been terminated abrogated, whichever is later. Requires all holders of state franchises to contribute a pro rata share of the ongoing cash obligations of the incumbent cable operator for PEG and I-net support.

9) Provides that after the expiration of current franchise agreements, local entities can require all video providers pay a fee that is up to 1% of gross revenue to support PEG operations. If the franchise agreement that is in place today requires the incumbent cable operator to pay a fee greater than 1%, the local entity can set the fee at that higher level, never to exceed 3%.

10) Requires video service providers to offer PEG programming to all subscribers, and to provide the PEG programming at a similar quality and functionality as it offers for its basic tier of service.

11) Requires all video service providers to make one channel available for carriage of state public affairs programming administered by the state.

12) Provides that the local government shall control the time, place, and manner in which video service providers access the public right-of-way under the same terms and conditions as they

control the telephone companies' access to the right-of-way today and that existing laws regarding the permitting process and compliance with the California Environmental Quality Act (CEQA) shall remain unchanged, except that the local government shall be the lead agency for CEQA purposes.

13) Provides that local government has 60 days from the date a completed application for an encroachment permit is received to either approve or deny that request. An application is not complete until the applicant has complied with all statutory requirements, including all requirements of CEQA.

14) Provides that video service providers may not discriminate in the provision of video service. A company has met this requirement if:

a) For a holder of a state franchise that has more than one million telephone customers in California within three years after a company begins providing video service, at least 25% of the households that have access to the company's service are low-income households and within five years after a company begins providing video service, at least 30% of the households that have access to the company's service are low-income households. These larger telephone corporations must also provide free service to one community center for each 10,000 video customers;

b) For holders with less than 1 million telephone customers they must offer video service to all customers within their telephone service area within a reasonable time, as determined by PUC. PUC shall not require holders to offer service in areas where cost of providing service is substantially above the average cost of providing service in the rest of the company's territory; and,

c) For a company that does not have a telephone service area a company that is offering service outside of its service area, or a company that is offering service in an area where there is no other providers of video services there is a rebuttable presumption that discrimination has not occurred.

15) Creates specific buildout requirements for companies with more than 1 million telephone customers as follows:

a) Companies that are predominantly deploying fiber optic facilities to the customers' premises must offer service to at least 25% of the households within its existing telephone service area within two years and 40% of those households within five years;

b) Companies that are not predominantly deploying fiber optic facilities must offer service to at least 35% of the households in its existing telephone service area within two years and 50% of those households within five years;

c) The five-year buildout provision can be extended if the company shows PUC that less than 30% of the households with access to its service have subscribed to the service; and,

d) Companies can only meet the buildout requirements through the use of technology that provides equivalent two-way broadband capability, and equivalent video programming, content and functionality. Satellite based technologies cannot be counted toward meeting the buildout requirement.

16) A company may apply for an extension of the buildout or redlining rules if extreme events that are out of the company's control keep it from meeting the standards. When evaluating a petition for a waiver, PUC can only grant a waiver if technical, operational, or regulatory issues beyond the company's control hindered its buildout.

17) Provides that all video service providers shall comply with all existing video consumer service and provisions standards in state and federal law. These rules will be enforced by the local entities. Increase by 250% the amount of fines from current levels the local entities can assess for violations of these consumer protection rules.

18) Requires that a background check be performed on all applicants for employment with the holder, for employees of independent contractors and vendors to the holder who would have access to the holder's network, central office, or customer premises.

19) Requires all holders employing more than 750 employees to annually report to PUC the number of California residents employed by the holder and the number of employees of independent contractors and vendors that provide service for the holder.

20) Provides that all holders of state-issued franchises shall annually report to PUC specified information regarding their broadband deployment and video deployment in California.

21) Provides that a court of competent jurisdiction shall have exclusive jurisdiction to enforce the provisions of this bill regarding payment of fees, provision of PEG channels and I-nets and that both PUC and the courts may enforce all redlining and building out requirements.

22) Provides that the telephone corporations providing video service under this bill shall not subsidize the cost of deploying a network that is used to provide video service and other costs necessary to offer video service with revenue derived from the offering of basic telephone service.

23) Provides that nothing in the bill creates a vested right in a state-issued franchise.

EXISTING LAW:

1) Authorizes local governments to grant additional cable television franchises in an area where a franchise has already been granted after a public hearing to discuss specified issues.

2) Provides that the additional franchises must serve the same geographic area as the original franchise. Such service shall be within a reasonable time and in a sequence which doesn't discriminate against lower income or minority residents.

3) Provides that the additional franchises must also contain the same PEG access requirements as the original franchise.

4) Requires all public utilities employing more than 750 total employees to annually report the number of California residents employed by the holder and the number of employees of independent contractors and vendors that provide service for the holder.

FISCAL EFFECT: Unknown

COMMENTS: The purpose of this bill is to promote competition for broadband and video service. Current law requires companies seeking a new video franchise to seek a separate franchise in each local government entity where it wants to provide video service. A company wishing to provide service across the state would need to seek over 400 franchise agreements. This bill would allow a company to seek a state-issued franchise from PUC.

Supporters believes this bill will lead to a rapid deployment of new video and broadband services across the state as new competitors, including the existing local telephone companies, make investments in existing and new networks needed to compete with the existing cable companies to provide video and internet services. This bill creates new investment opportunities in broadband internet networks because these networks are needed to provide competitive video services.

Today only a few areas of the state have multiple video operators. Instead, competition for video service comes primarily from satellite services, such as DirecTV and the DISH network, which are not required to obtain a local franchise or pay a franchise fee to the locals. Today satellite service accounts for approximately 27% of the video market. A few companies are obtaining local franchise agreements to provide competing video services, but due to the current franchising process, this is occurring on a limited and slow basis across the state.

The companies that wish to provide competing services claim that part of the reason why competition is slow in coming is the time it takes to negotiate individual franchise agreements across the state. They also point to another provision in current state law that requires new entrants into a video market to provide video service to the entirety of the incumbent's service territory. This law was is intended to prevent new entrants from discriminating in where they decide to offer service. Some of the potential new entrants argue that this law forces them to build their infrastructure in a manner that is uneconomical for them and, as a consequence, they simply opt to not compete in certain franchise territories..

This bill addresses these problems by allowing video service providers to go to a single entity, PUC, to get a franchise to provide video service across the state. PUC will be required to review and either deny or issue a franchise within a 44-day time period. PUC will also enforce certain standards of the bill, including buildout and redlining requirements, but the courts will be the final arbitrators on disputes over other provisions such as franchise fee and PEG support obligations.

Franchise Fees: This bill requires all holders of state-issued franchises to pay the local government a rent or toll in the form of a "franchise fee" for the use of the public right-of-way. The rent or toll cannot exceed the franchise fee that is paid by the incumbent cable provider today. After the current franchises expire, the "fee" will be set at 5% of gross revenue, or the local entity can set the "fee" at a lower level. Federal and state law already cap franchise fees at 5%.

Redlining: One concern when new entrants begin providing video services is that they will choose to provide the service only to higher income neighborhoods and thus provide these areas of the state with the advantages of new technologies and competition but deny the same benefits to lower income neighborhoods, a process known as "redlining." Federal and state law prohibit redlining by requiring the local franchise authorities to assure that access to video service is not denied to any group of potential residential video subscribers based on income.

To prevent redlining, the bill sets out specific targets which different types of video service providers must meet. The requirements differ between companies because that companies that already have telephone customers have already built some of the needed network and will have very different costs in making the jump to video service and acquiring new customers than companies that must build new networks and/or have no customers today.

The specific redlining and buildout requirements are spelled out in numbers 14 and 15 above.

PEG Channels: In many instances, local franchise agreements require the video operator to offer a set number of channels to provide PEG and to either provide monetary or in-kind support needed to produce these shows. This bill maintains current PEG obligations by:

1) Grandfathering-in the number of PEG channels that are offered in each franchise today. All video providers must provide the capacity for the same number of PEG channels as the incumbent cable operator. If less than three PEG channels are currently provided within that local entity, a local entity may request the holder to provide up to three PEG channels. The local entity may request additional PEG channels if they produce more than 56 hours a week of original, locally produced programming on the current channels.

2) Grandfathering-in all obligations for financial support of PEG that are in place today. All incumbent cable providers must continue to offer the same level of PEG support and I-net support as they do today under their current franchise agreements until January 1, 2009, or until their franchise expires or would have expired had it not been terminated under terms of this bill, whichever is later. All holders of state franchises must contribute a pro rata share of the ongoing cash obligations of the incumbent cable operator for PEG and I-net support.

After the expiration of the existing franchises all the obligation to carry the same number of PEG channels that exist today continues forever, unless the local entity fails to provide at least eight hours of programming a day for that channel measured quarterly. All video service providers will be required to continue to provide monetary support for PEG of up to 1% of gross revenue to support PEG operations, but if the franchise agreement that is in place today requires the incumbent cable operator to pay a fee greater than 1%, the local entity can set the fee at that higher level, but never to exceed 3%.

The bill also requires video service providers to offer PEG programming to all subscribers, and to provide the PEG program at a similar quality and functionality as it offers for its basic tier of service. The intent of this provision is to prohibit a holder of a state franchise from dramatically lowering the quality of the PEG programming or removing certain functionality such as stereo sound from the PEG programming while leaving it in place for other channel offerings. Some video providers are concerned that technology constraints could make it financially difficult for them to meet the same standards as their commercial channels. By requiring them to offer similar quality and functionality, these providers are given a minimum amount of flexibility while are expected to provide these channels at a quality level and with functionality that is nearly identical to their commercial channels.

Consumer Protection: State law currently contains a thorough set of consumer service and performance standards. The local franchising authority enforces the standards. Some franchise agreements also adopt additional or more stringent standards. This means the consumer protection rules for video service varies from jurisdiction to jurisdiction and can even vary within a jurisdiction if there are multiple franchises. This bill leaves the authority to enforce

consumer protection rules with the local governments but creates a uniform set of state rules based on the existing state and federal consumer protection rules. The bill also increases the amount of penalties that the local governments can issue by 250% over existing law.

Cross-subsidy Protection: Competition is unfair if one competitor can use the profits of a relatively uncompetitive business to subsidize its entry into a relatively competitive business. This anti-competitive behavior hurts customers because it creates an unlevel playing field, making it more likely that competition will be neither robust nor durable. Most telecommunications markets are competitive; competition keeps a lid on rate increases and so provides a check against anti-competitive cross subsidy. But the market for basic residential telephone service is not competitive. While there is some substitution of cellular service for basic residential service, and there are a few competitors such as Cox Cable, by and large there is little competition.

This bill deals with the potential for cross-subsidization by freezing rates for basic residential telephone service at current levels until 2009, with PUC authorized to raise those rates to reflect inflation increases. Additionally, this bill prohibits all telephone companies from raising the price of basic telephone service to finance the cost of providing cable service.

Privacy: The major telecommunications companies have been accused by whistle-blowers of sharing customer information with federal authorities without a warrant, raising privacy concerns. Federal lawsuits have resulted. Heightening those concerns are very recent press reports that AT&T keeps track of their video customers' viewing habits and that those customer records are business records owned by AT&T.

This bill subjects new cable competitors to the same state and federal privacy standards as are imposed on the existing cable operators.

Transition: Over time this bill will result in a major change in how video service is permitted in California. Eventually all video providers will operate under a state-issued franchise instead of a locally issued franchise. While new entrants into the market can easily go to PUC for a state-issued franchise once PUC is ready to accept applications, all incumbent cable operators will still be operating under local franchise. In some cases, these franchise agreements last another 20 years, in others they have already expired and the providers are operating under short-term extensions. To help meet the goals of the Legislature in creating a level playing field for all video service providers while avoiding a chaos causing rapid shift from local to state franchises, the bill creates a specific transition process. This transition process is also intended to allow time for the PUC to establish the necessary resources and processes to issue state franchises to new entrants and incumbent cable operators.

No incumbent cable operators will be allowed to operate under a state-issued franchise prior to January 2, 2008. If the incumbent cable operator's franchise expires before that date, it can request a state franchise that begins on January 2, 2008, and it's current local franchise will be extended until that date. All parties wishing to provide video service can continue to negotiate a local franchise until January 1, 2008.

If a video service provider with a state franchise provides notice that they are about to begin providing video service in a territory served by an incumbent provider, the incumbent provider can then seek a state franchise to replace the local franchise. Allowing the incumbent provider to operate under a state franchise creates a level playing field for all providers by allowing them to compete under the same regulatory rules and with the same financial obligations.

If the incumbent provider's local franchise expires after January 1, 2008, and the incumbent does not opt-in to the state franchise before the franchise expires, the incumbent provider must seek a state franchise at the expiration of the existing local franchise.

In all of the above circumstances, the incumbent cable operator will be obligated to continue to meet all PEG, I-net, and emergency broadcast requirements under the franchise until the franchise would have expired without the provision of this bill, or January 1, 2009, whichever is later. New entrants will be required to meet the same emergency broadcast requirements of the local franchise and pay a pro rated share of any cash PEG and I-net obligation.

While the transition period leaves local franchises in place for a period of time, the transition period should not allow local government to diminish the rights an incumbent cable operator has to occupy the public rights-of-way, any protections or rights provided under federal law, or to frustrate the Legislature's intention in enacting this division.

No Vested Right: This bill preserves the right to amend the statute and therefore the terms of the state-issued franchise.

Arguments in opposition: Opponents argue the bill:

1) makes customer cherry-picking legal (they fear this will increase the digital divide);

2) provides a one-size-fits-all approach to the PEG/I-net issue (will cause many communities to lose their right to activate PEG access channels that are in current franchise;

3) will make customer standards difficult to enforce (the bill includes several provisions that undermine enforcement efforts);

4) is a public safety risk with the expiration of local emergency service notifications; and, 5) creates a new state bureaucracy to perform a local function (they argue the franchise should be issued at the local level.)

For more detailed information on the current franchising process and the provision of video service generally, please refer to the April 24, 2006, Assembly Utilities and Commerce Committee analysis.

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