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SUBJECT: Effects of AB 2987 on Cable Television Regulation and Audits

Introduction and Recommendations

AB 2987, the Digital Infrastructure and Video Competition Act of 2006, ("the Act" or "AB 2987") went into effect on January 1, 2007. The Act brings about dramatic changes in how many cable television franchises are granted and enforced in California. This memorandum focuses on the potential impacts of AB 2987 on cable franchise renewal negotiations and on future audits that a City or County may wish to consider.

This letter represents a general summary of certain changes in the law resulting from AB 2987. This letter is not intended to provide legal advice. Should your City or County need specific legal advice regarding AB 2987, please consult your legal counsel.

Our general recommendations as to what action may be required by your City or County are noted on page 4 of this letter.

AB 2987 Analysis

The California Public Utilities Commission ("the CPUC" or "the Commission") is the state agency charged with administering state-granted video/cable franchises. The CPUC began accepting applications for state-granted video franchises on January 1, 2007. The Act requires the CPUC to process these applications no later than April 1, 2007. In some cases, these state video franchises replace local cable television franchises.

The Act provides for a streamlined franchise application and review process. Thus far, AT&T and Verizon have been granted state franchises covering several large metropolitan areas across the state. Cox Communications has also been approved for a state franchise to serve portions of San Diego County. The CPUC approved franchise applications submitted by Verizon, AT&T, and Cox within a few weeks and in Verizon's case, within days of being submitted.

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AB 2987 Analysis (Continued)

The Act also allows incumbent cable operators to replace their locally granted franchises under the following circumstances:

- (1) When a franchise granted by a City or County expires. However, AB 2987 also states: "When an incumbent cable operator is providing service under an expired franchise or a franchise that expires before January 2, 2008, the local entity may extend that franchise on the same terms and conditions through January 2, 2008. A state franchise issued to any incumbent cable operator shall not become operative prior to January 2, 2008."
- (2) When a new video service provider (such as AT&T or Verizon) obtains a state video franchise and then provides notice to the City or County (under Section 5840 of the Public Utilities Code) that it intends to initiate providing video service in all or part of the City or County.

In light of the above, and some of the considerations discussed below, CSG and DE&Co anticipate that your cable company may allow the current franchise to terminate upon expiration and may seek a state franchise at the earliest opportunity.

What Regulatory Changes Can Be Expected?

AB 2987 generally weakens and/or eliminates the ability of a Local Franchising Authority (LFA) to monitor or control its video franchise in the following areas:

- (1) Definition for Gross Revenues;
- (2) Security instruments (such as letters of credit and performance bonds) protecting LFAs and their residents;
- (3) The creation and enforcement of consumer service standards which exceed state standards;
- (4) An LFA's control over the transfer, renewal, and termination of franchises;
- (5) An LFA's authority to require that cable/other franchised video providers allow LFAs to access these providers' systems for the transmission of emergency announcements;
- (6) An LFA's authority to negotiate for Institutional Networks ("I-Nets") in cable franchises; and
- (7) Several aspects of public, educational and government access ("PEG Access") programming and funding;

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Proposed Gross Revenue Definition Under AB 2987

During the drafting of AB 2987, a great deal of debate ensued regarding the definition of Gross Revenues. Under the final version of AB 2987, the Act requires the use of Generally Accepted Accounting Principals (GAAP) for the calculation of franchise fees. This may cause a change in the amount of franchise fees reported to your City or County if your franchise agreement or municipal code has required that Gross Revenues be reported on a cash basis of accounting.

Public, Educational, And Governmental Access (PEG) Implications

Regarding Public, Educational, and Governmental (PEG) access, AB 2987 may benefit certain LFAs. AB 2987 reads in part:

“A local entity may, by ordinance, establish a fee to support PEG channel facilities consistent with federal law that would become effective subsequent to the expiration of any fee imposed pursuant to paragraph (2) of subdivision (l). If no such fee exists, the local entity may establish the fee at any time. [T]he fee shall not exceed 1 percent of the holder’s gross revenues, as defined in Section 5860 [a new section to be added to the Public Utilities Code]. Notwithstanding this limitation, if, on December 31, 2006, a local entity is imposing a separate fee to support PEG channel facilities that is in excess of 1 percent, that entity may, by ordinance, establish a fee no greater than that separate fee, and in no event greater than 3 percent, to support PEG activities. The ordinance shall expire, and may be reauthorized, upon the expiration of the state franchise.”

Currently, your cable operator may or may not impose a PEG fee on cable subscribers. Regardless of whether a PEG fee is being itemized on subscriber bills, your cable operator, may however, provide support for PEG Access in the form of in-kind support (labor, facilities, playback, duplication services, etc.) as well as institutional networks. Under AB2987, support for PEG channel facilities and institutional network (I-Nets) are grandfathered only until January 1, 2009¹. We recommend that you evaluate the value of PEG support you are receiving from your incumbent cable operator and compare that to the amount of support that might arise under a 1% of gross revenues scenario. If you are interested in establishing a PEG fee by ordinance, we are available to assist you in this regard.

¹ 5870 (k) states, “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 pursuant to subdivision (o) of Section 5840, or until January 1, 2009, whichever is later.”

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Customer Service and Enforcement

As holders of state franchises begin constructing systems and marketing services to new customers, customer service performance becomes ever more important. Please keep in mind that local governments also have the authority under the Act to enforce customer service standards with respect to state-granted video franchises. However, before assessing monetary penalties, local governments must adopt by resolution or ordinance a schedule of monetary penalties set forth in AB 2987. We are available to assist you in this regard.

Our Recommendation: Stay Ahead Of The Curve



AB 2987 will affect greatly the City's cable television/video franchising authority. The City should prepare accordingly.



First, we recommend that the City investigate whether your incumbent cable operator intends to apply in 2007 for a state franchise and prepare for the changes that might occur given the expiration of an existing local franchise. .

Second, we recommend that the City consider performing franchise fee audits now and during calendar year 2007, before any potential state franchises are granted. It may be more difficult to conduct audits and access accounting records of the cable operator, once a state franchise becomes operable. (If you would like a schedule of our hourly rates and estimated fees for performing cable franchise fee audit services, these will be provided upon request.)

Third, we recommend that the City revisit the historic PEG contributions and the City's ongoing PEG capital and operating support needs. As discussed herein, AB 2987 authorizes the City to establish a PEG fee pursuant to the limitations of AB 2987. Policy considerations should be addressed regarding the line-itemization aspects of the PEG fee, as any fee established by a City resolution would be eligible to be passed through by a state franchisee directly to City subscribers.

Fourth, we recommend that the City study the matter of adopting penalties for violation of customer service standards. Since the City may already have a method for enforcing franchise breaches under its Municipal Code (Liquidated Damages), a simple amendment may be needed to codify the requirements for penalties and notices consistent with violations of customer service standards established by AB 2987.

Fifth, we recommend that you carefully manage encroachment permits submitted by telephone corporations for video distribution facilities in your City or County.

Lastly, we recommend that the City become an active participant in any subsequent review of AB2987 by the California legislature.

If you have any questions concerning these recommendations or any elements of this memorandum, please do not hesitate to contact us for clarification. Please contact John Risk at (714) 444-4900 or Bill Morgan at (949) 399-0600.