Fiscal Note & Local Impact Statement

127 th General Assembly of Ohio

Ohio Legislative Service Commission
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BILL:	**Am. Sub. S.B. 117**	DATE:	**June 19, 2007**
STATUS:	**As Enacted – Effective September 24, 2007**	SPONSOR:	**Sen. Jacobson**

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Provides for the issuance of statewide video service authorizations by the Director of Commerce**

State Fiscal Highlights

STATE FUND	FY 2008	FY 2009	FUTURE YEARS
Video Service Authorization Fund (New Fund) – Department of Commerce			
Revenues	Potential minimal gain from application fees	Potential minimal gain from application fees	Potential minimal gain from application fees
Expenditures	Increase, up to available revenues	Increase, up to available revenues	Increase, up to available revenues
Video Service Enforcement Fund (New Fund) – Department of Commerce			
Revenues	Potential gain from civil penalties	Potential gain from civil penalties	Potential gain from civil penalties
Expenditures	Potential increase, up to available revenues	Potential increase, up to available revenues	Potential increase, up to available revenues
Division of Administration Fund (Fund 163) – Department of Commerce			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	Increase of several hundred thousand dollars in staffing and equipment costs	Increase of several hundred thousand dollars in staffing costs	Increase of several hundred thousand dollars in staffing costs

Note: The state fiscal year is July 1 through June 30. For example, FY 2008 is July 1, 2007 – June 30, 2008.

- ***State franchising system revenue.*** The bill designates the Director of Commerce as the state's sole franchising authority for Video Service Authorizations (VSAs). Applicants must pay a $2,000 application fee and a $100 fee to amend authorizations. Application fee revenue would be deposited in the Video Service Authorization Fund (New Fund). The amount of revenue generated each year will depend on the number of franchise agreements that expire, the number of cable operators that would opt to terminate their current franchise agreements and provide video service under a VSA in any given year (assuming competition from other video providers is present), and the size of each video service area, which may be as large as the entire state.

- ***Minimal application fee revenue.*** Depending on the number of franchise agreements that expire and the number of cable operators that opt to terminate their current franchise agreements and provide video service under a VSA in the first several years after the bill becomes effective, there is likely to be minimal application fee revenue to the Video Service Authorization Fund for developing and implementing the bill's various provisions, meaning that existing resources would likely need to be utilized.

- ***Enforcement Fund*.** The bill authorizes the Director of Commerce to determine and assess civil penalties for violations of the bill's provisions. Civil penalties are limited to $1,000 for each day of violation or noncompliance, up to a $10,000 maximum. Civil penalties collected are to be deposited into the Video Service Enforcement Fund (New Fund).

- ***Expenses*.** The staff resources needed to carry out the requirements of the bill may be significant, as the Department would have to examine VSA applications, issue and renew VSAs, and carry out the investigative activities in the bill. The Department will also incur various costs for computer equipment, supplies, and maintenance. Altogether, there would likely be increased costs of several hundred thousand dollars or more annually, the majority of which would likely be funded through the Division of Administration Fund (Fund 163), which receives revenue from assessments charged to the Department's operating divisions.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2007	FY 2008	FUTURE YEARS
Municipalities and Townships			
Revenues	Potential loss, depending on current franchise agreement	Potential loss, depending on current franchise agreement	Potential loss, depending on current franchise agreement
Expenditures	Potential increase, depending on current franchise agreement expiration date	Potential increase, depending on current franchise agreement expiration date	Potential increase, depending on current franchise agreement expiration date

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- ***Video Service Provider (VSP) fees – potential revenue loss*.** Some local governments may incur revenue losses because of the bill's narrower definition of permissible gross revenue. The new definition excludes items such as late payment charges, home shopping revenue, and fee-on-fee charges that are part of some current franchise agreements.

- ***Elimination of PEG programming and institutional network requirements*.** Under the bill, a municipality or township is prevented from requiring a Video Service Provider (VSP) to provide: (1) any funds, services, programming, facilities, or equipment related to public, educational, or governmental programming (PEG channels), (2) any institutional network on its video service network, or (3) anything of value for video service. Where current franchise agreements require cable operators to provide support for such PEG channels beyond what is provided for in the franchise fee and/or to provide cable or Internet service to schools and public buildings at no or reduced cost, in the future these local governments would have to find other ways of continuing these services. However, the bill provides a temporary funding mechanism allowing for these services, described below.

- ***Future PEG programming and institutional network costs*.** Current local franchising authorities may experience permissive increases in expenses in order to continue to operate PEG channels and/or receive cable programming or Internet services at the earlier of (1) a VSP's obligation expiring, (2) January 1, 2012, or (3) an earlier date that may be specified in a local ordinance or resolution. The extent of any increase is unknown, as it would depend on the particular provisions of each local franchising authority's current cable franchise contract.

Detailed Fiscal Analysis

Overview

This bill provides for a state franchising system for video service, which includes video programming over wires or cables regardless of the technology used to deliver that programming, including Internet protocol or any other technology. Currently, municipal corporations and townships have that authority pursuant to federal cable law that empowers governmental "franchise authorities" and state law that empowers municipal corporations and townships to authorize service within their jurisdictions.

Generally, the bill supersedes current local franchising authority in Ohio with a state franchising system for video service, under which the Director of Commerce is the franchising authority. However, the bill allows existing local franchise agreements and competitive video service agreements to continue until their scheduled expiration unless terminated under certain circumstances and prohibits the renewal or extension of those franchise agreements. In order for an incumbent cable operator to terminate an existing agreement, the bill generally requires video service competition to be present.

Traditionally, cable franchise contracts have lasted approximately 10 to 15 years, but in some cases, those time frames have been shortening. There are approximately 1,400 cable franchise agreements in the state. Implicitly, the bill excludes satellite service from the definition of "video service" because that service does not use wires or cables for transmission. Currently, cable's video service market share is approximately 67%, with Digital Broadcast Satellite (DBS) making up approximately 30% of the video services market.

State fiscal effects

Department of Commerce – Video Service Authorizations

The bill would prohibit any person from providing video service in Ohio unless it is provided under a Video Service Authorization (VSA) or through continuing local authority for existing local cable franchises or competitive service agreements until those franchises or agreements expire. While incumbent video providers are allowed to continue to offer video service under an existing cable franchise, the bill generally requires existing cable franchise agreements to remain in place until there is another provider of video service in that video service area. This ensures that competition is in place before a franchise agreement is terminated before its scheduled expiration. The VSA confers the authority to provide video service in its video service area as well as to construct and operate a video service network in, along, across, or on public rights of way for the provision of video service. Generally, video service areas must be coextensive with municipal, township unincorporated, or county boundaries and, for cable operators offering service under a franchise in effect on the bill's effective date, must be at a minimum the franchise area under that franchise. In effect, this means that while a cable operator would need to initially continue service in their current franchise area, video service areas could be established in more than one county or municipality as long as the political boundaries were adhered to. A VSA has a term of ten years and may be renewed for periods of ten years.

The Director of Commerce would issue and renew VSAs. For the purposes of federal cable law, a VSA constitutes a franchise and the Director is the sole franchising authority for VSAs in this state. Under the bill, neither the Director of Commerce nor the Public Utilities Commission has regulatory authority over a Video Service Provider (VSP), including the rates, terms, or conditions of the video service.

The bill does, however, give the Director of Commerce the authority to investigate various alleged violations, including: (1) providing video service without a VSA, (2) failure to submit an application to amend a VSA if certain information changes, (3) failure to work with local governments in addressing customer service complaints and meet specified customer service standards, and (4) discriminatory practices in providing video services.

Revenue

Applicants for VSAs must pay a $2,000 application fee and a $100 fee to amend an authorization. Application fee revenue would be deposited to the Video Service Authorization Fund (New Fund), which is to be used by the Department of Commerce to carry out its responsibilities in regard to VSAs. Revenue to the Department will depend on the number of franchise agreements that expire, the number of cable operators that opt to terminate their current franchise agreements and provide video service under a VSA in the first several years after the bill becomes effective, and the size of the video service areas applied for under the bill. Thus, there may be minimal application fee revenue to the Video Service Authorization Fund, perhaps only in the tens of thousands of dollars in the next several years, for developing and implementing the bill's various provisions. This would mean that existing resources would likely be used to finance the program's development and implementation. The Department may receive additional revenue to the Video Service Authorization Fund in future years as additional cable companies and VSPs apply for VSAs, intial VSAs are renewed after their ten-year terms expire and VSAs are amended as changes occur.

The bill authorizes the Director of Commerce to determine and assess civil penalties for violations of the bill's provisions. Civil penalties are limited to $1,000 for each day of violation or noncompliance, up to a $10,000 maximum. Civil penalties collected are to be deposited into the Video Service Enforcement Fund (New Fund).

Expenses

The staff resources needed to carry out the requirements of the bill may be significant, as the Department would have to examine VSA applications, issue and renew VSAs, and perform the investigative activities in the bill. Each VSA application, including applications to amend video service authorizations to reflect any change of information, would need to be reviewed for completeness within 30 days. Depending on the pay class and step of the new staff positions required, payroll costs could be several hundred thousand dollars or more annually. The Department will also incur various costs for computer equipment, supplies, and maintenance. The new staff members would likely be funded through a combination of VSA application fee revenue deposited in the Video Service Authorization Fund (New Fund) and revenue from administrative assessments of the Department's operating divisions, which are deposited into the

Division of Administration Fund (Fund 163). The Department noted that the cash balance in Fund 163 is sufficient to defray these costs without an increase in the assessment to the operating divisions.

Local fiscal effects

As noted above, the bill generally supersedes current local franchising authority in Ohio with the bill's state franchising system for video service. As a result, the bill contains a number of provisions that could have an impact on current local franchising authorities across the state. For instance, the bill prohibits a political subdivision from requiring a VSP to obtain from it any authority to provide video service within its boundaries. Furthermore, except under certain circumstances, the bill prohibits political subdivisions from requesting anything of value from a VSP for providing video service, imposing any fee, license, or gross receipt tax (separate from the fee provided for in the bill) on the provision of video service by a VSP, or imposing any franchise or other requirement on the provision of video service by a VSP. The sections below highlight some of the fiscally significant provisions in the bill and their potential impacts.

VSP fees – potential revenue loss

The bill requires a VSP to pay a quarterly VSP fee to each municipal corporation and each township in which it offers video service, which would replace the franchise fees that each local franchising authority currently receives through individual negotiations with cable operators. The current franchise fees are generally imposed as remuneration for the use of the streets or rights of way, for the purpose of providing revenue with which to defray the cost of regulation arising out of the granting of the franchise, and for the promotion, assistance, and financing of public, educational, and governmental access programming. Under the bill, payment of the VSP fee must be made between 45 and 60 days after the calendar quarter ends, which is generally consistent with the current franchise agreements that LSC surveyed. The VSP must calculate its gross revenue for the quarter and multiply that amount by the applicable percentages in the bill.

The bill generally caps the gross revenue percentage payable to municipal corporations or townships at 5%, which is consistent with the cap under federal cable law. A VSP that pays a VSP fee can identify and collect the amount of that fee in the regular bill of each of its video service subscribers that has a service address within any portion of the municipal corporation or the unincorporated area of the township. According to the Ohio Cable Telecommunications Association (OCTA), the majority of local franchising authorities impose a franchise fee of 5%, with the vast majority imposing a fee between 3% and 5%. Locally, the amount of revenue derived from franchise fees varies. For instance, the city of Columbus received between $6.1 million and $6.5 million annually from CY 2003 to CY 2005 in franchise fee revenue.[1] In that same period, the city of Cincinnati received between $2.3 million and $2.6 million.[2] The city of Dayton receives approximately $1.2 million per year, according to a March 25, 2007 article in the *Dayton Daily News*.[3]

[1] City of Columbus, Consolidated Annual Financial Reports, CY 2003 – CY 2005.
[2] City of Cincinnati, Consolidated Annual Financial Reports, CY 2003 – CY 2005.
[3] DeBrosse, Jim, "Bill 117 Would Have Drastic Effects on Cable Competition, Public Access," Dayton Daily News 25 Mar. 2007:A10.

Under the bill, gross revenue consists of all of the following revenue for the calendar quarter collected by the VSP for video service from all of its subscribers having a service address within any portion of the municipal corporation, or the unincorporated area of the township: (1) recurring monthly charges for video service, (2) event-based charges for video service such as those for pay-per-view or video-on-demand services, (3) charges for rental of set top boxes and other video service equipment, (4) service charges related to the provision of video service such as those for activation, installation, and repair, and (5) administrative charges related to the provision of video service such as those for service orders or service termination charges. The bill would also include advertising revenue in the gross revenue calculations, but only if a municipal corporation or board of township trustees adopts an ordinance or resolution that uniformly applies to all VSPs.

Under the bill, gross revenue would not include: (1) taxes, fees, or assessments collected by the VSP from video service subscribers for pass-through to any federal, state, or local government agency, (2) uncollectible charges, except for those that are subsequently collected, (3) late payment charges, (4) maintenance charges, (5) charges for services other than video service, (6) reimbursement by programmers of marketing costs actually incurred by the VSP, and (7) any revenue not expressly enumerated in the bill as making up gross revenue.

Given the large number of cable franchise agreements across the state, many of which differ in what is included as "gross revenue," the particular impact of this bill will differ from jurisdiction to jurisdiction. Ultimately, the impact on each current local franchising authority will depend on what currently qualifies as gross revenue in each authority's current franchise agreement and how it compares to the terms that would be allowed under the bill.

Institutional networks – permissive costs

Depending on the local franchise agreement, it may be that cable operators are required to provide at no or reduced cost, cable television or Internet services to community facilities, such as schools and city or public buildings through institutional networks. The bill states that no municipal corporation or township can require a VSP to provide any institutional network on its video service network. However, a VSP that was an incumbent cable operator required to provide any institutional network on January 1, 2007 must continue to provide the institutional network until the earlier of (1) the date the obligation would have expired if not terminated under the provisions of the bill, (2) January 1, 2012, or (3) an earlier date that may be specified in a local ordinance or resolution. If the obligation included terms regarding the infrastructure of the institutional network upon the expiration of the obligation, the VSP must also honor those terms. Under the bill, nothing precludes a VSP and a municipality or township from entering into other arrangements for institutional networks.

In the near term, it appears as if municipalities and townships would continue to receive any institutional network services agreed upon in a municipality's or township's current franchise agreement. However, once any one of the above three triggers occurs, current local franchising authorities may experience an increase in expenses in order to continue receiving institutional network services at no or reduced cost. The extent and timing of any increase is unknown, as these impacts would depend on the particular provisions and expiration date of each municipality or township's current cable franchise contract.

PEG channels – permissive costs

A "PEG channel" is a channel for public, educational, and governmental programming made available by a VSP or cable operator for noncommercial use. While the bill specifies the conditions under which a municipal corporation or township in a video service area can require the VSP to provide PEG channels, the VSP only bears the responsibility for transmitting PEG channel programming to subscribers once the programming is delivered to the VSP. Specifically, the bill stipulates that the production and operation of the PEG channel is the sole responsibility of the municipal corporation or township. Furthermore, except as provided below, the municipal corporation or township cannot require a VSP to provide any funds, services, programming, facilities, or equipment related to the PEG channel.

According to the Ohio Municipal League, cable companies currently support PEG channels through franchise fees and other provisions of the franchise contracts. However, OCTA noted that the vast majority of cable franchise agreements do not require the cable operator to fund PEG channels above and beyond the franchise fee. In such circumstances where there are unfulfilled monetary or other obligations for PEG channel facilities, the bill provides for that support to continue until the earlier of (1) the expiration of an incumbent cable operator's franchise, (2) January 12, 2012, or (3) an earlier date that may be specified in a local ordinance or resolution.

Specifically, each VSP within a municipality or township must have a pro rata share of the same unfulfilled obligation to support PEG channel facilities during the same time period as the incumbent through the incumbent form of support whether it is a percentage of gross revenues, a pro rata share of a lump sum payment, or a pro rata share of the fair market value of in-kind support. Similarly, an obligation to provide connectivity for PEG channel programming must be fulfilled until the earlier of (1) January 1, 2012, (2) an earlier date that may be specified in a local ordinance or resolution, or (3) the date that connectivity obligation would have expired.

In the near term, it appears that revenue derived from municipality and township franchise agreements for operating PEG channels would be maintained. However, once any one of the above three triggers occurs, local franchising authorities may incur new permissive increases in expenses in order to continue to produce and operate the channels if VSPs were to cease or decrease current levels of support for PEG channels. The extent and timing of any increase is unknown, as these impacts would depend on the particular provisions and expiration date of each municipality or township's current cable franchise contract.

Audits

The bill authorizes a municipal corporation or township, at its sole expense and not more often than once per calendar year, to conduct an audit for the purpose of verifying the accuracy of a VSP's calculation of the VSP fees it paid to the municipal corporation or township in the audit period. The bill adds that a VSP must pay any amounts found to have been underpaid in the audit within 30 days after notice and must include statutory interest, unless the VSP is disputing the amount due through a civil action. For calendar year 2007, the annual statutory interest rate is 8.0% on the underpayments. Whether the interest will have an impact on local government revenues will depend on the terms of current cable franchise agreements. If a current franchise agreement does not contain such a provision, the bill may yield more revenue than might be generated currently.

However, a municipal corporation or township cannot employ, appoint, or retain any person for compensation that is dependent in any manner upon the dollar amount of the audit findings. Municipalities and townships can hire legal counsel on a contingency fee basis to enforce the findings of an audit, however. An action by a municipal corporation or township or by the VSP to dispute the amount of the VSP fee due based on the audit results must be brought in a court of competent jurisdiction not later than two years following the end of the quarter to which the disputed amount relates.

LSC surveyed various local franchise agreements contained within the municipal code of several large cities in this state. It appears that many franchise agreements contain similar provisions allowing local governments to audit and inspect the books and records of the cable operator or its equipment. Therefore, it appears that the above audit provisions in the bill are generally consistent with current practice. The Ohio Municipal League noted that such audits are currently conducted commensurate with the resources of the local franchising authority.

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