Fiscal Note & Local Impact Statement

127 th General Assembly of Ohio

Ohio Legislative Service Commission
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BILL: **Sub. S.B. 117**

DATE: **May 9, 2007**

STATUS: **As Reported by Senate Energy and Public Utilities**

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
General Revenue Fund – Department of Commerce			
Revenues	Gain from application fees, potentially in the hundreds of thousands of dollars or more	Gain from application fees, potentially in the hundreds of thousands of dollars or more	Gain from application fees, potentially in the hundreds of thousands of dollars or more
Expenditures	Increase, dependent on staffing needs	Increase, dependent on staffing needs	Increase, dependent on staffing needs

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.*** 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 applications. Application fee revenue would be deposited in the GRF, as no fund is specifically named to receive the revenue, and may be in the hundreds of thousands of dollars or more annually, depending on the number of franchise agreements that expire and 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.

- ***Staffing.*** While the Department of Commerce is unsure of the staff resources needed to issue and renew VSAs and carry out the investigative activities in the bill, LSC assumes that staffing needs may be significant, as there would likely be at least hundreds of video service authorization applications that would need to be examined by the Department. The bill does not create a new fund or designate an existing fund from which related expenditures would be paid.

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 current local franchise authorities may experience a loss in revenue due to the bill's gross revenue cost basis if its current franchise agreement with a cable operator includes sources of revenue, such as late payment charges, home shopping revenue, and fee on fee changes, that are not included in the bill's gross revenue components.

- ***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 (1) provide any funds, services, facilities, or equipment related for public, educational or governmental programming (PEG channels), (2) request anything of value from a VSP for providing video service, and (3) provide any institutional network on its video service network. It may be that current franchise agreements require cable operators to provide support for such PEG channels above and 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. The bill provides a temporary funding mechanism allowing for these services, described below.

- ***Future PEG programming and institutional network costs.*** The bill ensures (1) that any unsatisfied obligations by a cable operator under a current franchise agreement to a municipal corporation or township for the ongoing costs of PEG channel facilities are paid by requiring municipalities and townships to charge VSPs a pro rata per subscriber share of the total payment required and (2) that any current institutional network continues until the incumbent cable operator's franchise expires or January 1, 2012, whichever is earlier. Once this occurs, 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. The extent of any increase is unknown, as it would depend on the particular provisions of each local franchising authority's 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 at the option of the service provider and prohibits the renewal or extension of those franchises and agreements.

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 DBS (digital broadcast satellite) 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. The VSA confers the authority to provide video service in its video service area (which 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). 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), which is a person that has been granted a VSA under the bill, in its offering of video service including the rates, terms, or conditions of the video service.

Applicants for VSAs must pay a $2,000 application fee and a $100 fee to amend applications. Application fee revenue to the GRF (as no fund is specifically named to receive the revenue) may be in the hundreds of thousands of dollars or more annually, depending on the number of franchise agreements that expire and 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.

The Department is unsure of the staff needed to carry out the VSA issuance and renewal and investigative activities in the bill. However, the number of additional staff may be significant, as there would likely be at least hundreds of video service authorization applications that would need to be examined. Each of these would need to be reviewed for completeness since each video service authorization covers a video service area that must be coextensive with municipal, township, or county boundaries. There is no fund referenced or created from which related expenditures would be paid.

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 not sooner than 45 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 include a portion 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 has received approximately $1.2 million, according to a March 2007 article in the *Dayton Daily News.*

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, (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, current local franchising authorities may differ in what is included as "gross revenue" and thus, the particular impact of this bill will differ based on the sources of revenue each local franchising authority includes in its current franchise agreement. It may be that other sources of revenue, such as late payment charges, home shopping revenue, and fees paid on subscriber fees (so called "fee on fee" revenue where cable operators must include their franchise fee charge revenue in gross revenue calculations), are not included in the cost basis under the bill, but are included currently in the definition of gross revenue in a local franchise authority's individual franchise agreement. Ultimately, the impact on each current local franchising authority will depend on each authority's franchise agreement and how it compares to the cost basis under the bill. Due to the large number of franchise agreements across the state, the total impact across the state cannot be easily quantified.

Service to community facilities – 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. The bill states that no municipal corporation or township can require a VSP to provide any institutional network on its video service network. Also, the bill generally prevents political subdivisions from requesting anything of value from a VSP for providing video service.

[1] City of Columbus, Consolidated Annual Financial Reports, CY 2003 – CY 2005.
[2] City of Cincinnati, Consolidated Annual Financial Reports, CY 2003 – CY 2005.

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 franchise would have expired if not terminated under the provisions of the bill or until January 1, 2012, whichever is earlier. VSPs must also honor any terms of a franchise agreement regarding an institutional network's infrastructure. 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 the current franchise agreements expire or after January 1, 2012, whichever is earlier, current local franchising authorities may experience an increase in expenses in order to continue receiving cable programming or Internet services at no or reduced cost. The extent of any increase is unknown, as it would depend on the particular provisions of each municipality or township's 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 in the appropriate format. Specifically, the bill stipulates that the production and operation of the PEG channel is the sole responsibility of the municipal corporation or township. Furthermore, the municipal corporation or township cannot require a VSP to provide any funds, services, programming, facilities, or equipment related for 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, the 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 additional payments for PEG channels, the bill provides that, after January 1, 2007 and until the expiration of an incumbent cable operator's franchise or January 12, 2012, whichever is earlier, if the incumbent cable operator has existing unsatisfied obligations under a franchise to remit to a municipality or township cash payments for the ongoing costs of PEG channel facilities, the municipality or township is required to charge the VSPs providing service a pro rata per subscriber share[3] of the total payment required. Additionally, all VSPs are subject to any recurring payment requirements whether expressed as a percentage of gross revenue or as an amount per subscriber per month or otherwise.

In the near term, it appears that revenue derived from municipality and township franchise agreements for the purpose of operating PEG channels would be maintained. However, once the current franchise agreements expire or after January 1, 2012, whichever is earlier, 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

[3] The pro rata per subscriber share of the total payment is calculated by determining the ratio of the reported subscribers for each VSP within the municipality or township to the total number of subscribers served within the municipality or township and multiplying the ratio by the unsatisfied cash payments.

of any increase is unknown, as it would depend on the particular provisions of each municipality or township's cable franchise contract.

Audits – likely no new costs

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. However, a municipal corporation or township cannot employ, appoint, or retain any person for compensation that is dependent in any manner upon the outcome of the audit. 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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