

CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

May 10, 2016

The Honorable City Council
Attention: Policy & Services Committee
Palo Alto, California

Cable Franchise and Public, Education, and Government (PEG) Fee Audit

In accordance with the Fiscal Year 2016 Annual Audit Work Plan, the Office of the City Auditor has completed the Cable Franchise and Public, Education, and Government (PEG) Fee Audit. The audit report presents three findings with a total of nine recommendations. The Office of the City Auditor recommends that the Policy and Services Committee review and recommend to the City Council acceptance of the Cable Franchise and PEG Fee Audit.

Respectfully submitted,

Harriet Richardson

Harriet Richardson City Auditor

ATTACHMENTS:

 Attachment A: Cable Franchise and Public, Education, and Government (PEG) Fee Audit (PDF)

Department Head: Harriet Richardson, City Auditor



CABLE FRANCHISE AND PUBLIC, EDUCATION, AND GOVERNMENT (PEG) FEE AUDIT

May 10, 2016



Office of the City Auditor

Harriet Richardson, City Auditor Houman Boussina, Senior Performance Auditor Lisa Wehara, Performance Auditor II Page intentionally left blank



OFFICE OF THE CITY AUDITOR

EXECUTIVE SUMMARY Cable Franchise and PEG Fee Audit May 10, 2016

PURPOSE OF THE AUDIT:

The audit objectives were to determine whether and to what degree, from July 1, 2010, through June 30, 2014:

- The City of Palo Alto accurately accounted for its receipt of franchise and public, education, and government (PEG) fees and met its oversight responsibilities regarding the Media Center's use of PEG access fees.
- Comcast and AT&T collected and promptly remitted the appropriate amount of franchise and PEG fees.
- The City established and sufficiently defined roles and responsibilities to administer its cable communications program and state franchises awarded to Comcast and AT&T.

REPORT HIGHLIGHTS

Finding 1: The Media
Center did not restrict its
use of \$340,000 of annual
PEG fees to capital
expenditures as required
by the federal Cable Act
(Page 8)

The Media Center inappropriately used an annual average of \$340,000 of public, education, and government (PEG) fees, or \$1.4 million during the audit period, paid by cable television subscribers in the Cable Joint Powers areas, for operating expenses. Neither the City nor the Media Center enforced the federal law that restricts the use of PEG fees to capital expenses associated with PEG access facilities.

Key Recommendations to the City Manager's Office:

- Assess the need for the City to continue collecting PEG fees, adjust the fee, or discontinue collecting the fee based on the need for future capital expenses related to PEG access facilities.
- Coordinate with the other JPA jurisdictions regarding potential amendments to their municipal codes based on adjustments made to the PEG fee requirement.
- If the PEG fee is retained, establish criteria for how PEG fees may be used and require
 documentation and review of expenditures to ensure compliance with the federal Cable
 Act.
- Determine whether to allocate a portion of the unrestricted franchise fees or other funds to subsidize the Media Center's operations.

Finding 2: Comcast and AT&T did not remit the full amount of franchise and PEG fees due. (Page 14)

Comcast and AT&T did not always calculate the fees due in accordance with DIVCA and the municipal code of each of the Cable Joint Powers. As a result, Comcast underpaid about \$141,000 in franchise and PEG fees from July 1, 2010, through June 30, 2014, and AT&T underpaid about \$76,000 from July 1, 2011, through September 30, 2014.

AT&T's underpayments are estimated because it did not provide sufficient records for us to verify the accuracy of franchise and PEG fee payments. In addition, AT&T's underpayments are for all of Santa Clara and San Mateo Counties because it remitted fees collected from subscribers in the unincorporated county areas directly to the counties and could not provide the information needed to calculate the amounts due only to the Cable Joint Powers (see scope limitations section on page 5).

Comcast and AT&T will owe interest, calculated at the highest prime lending rate during the delinquency period plus 1 percent, on underpaid fees, as required by DIVCA. DIVCA also

requires that AT&T pay the City for its portion of the audit costs because AT&T's underpayment exceeds 5 percent of the amount that it should have paid.

Key Recommendations to the City Manager's Office:

- Send letters to AT&T and Comcast demanding payment of the underpaid franchise and PEG fees, interest due, and for AT&T, its portion of the audit costs.
- Work with AT&T and Comcast to develop methods to ensure accuracy of their address
 databases and the basis for determining the revenues on which franchise and PEG fees
 should be calculated.
- Review franchise and PEG fee payments to ensure they were calculated based on the established criteria and promptly follow up on discrepancies.

Finding 3: Roles and responsibilities for managing the City's cable communications program are not clearly defined or assigned (Page 21)

The City has not clearly assigned or defined roles and responsibilities for its cable communications program or effectively managed the program to ensure that funds are used appropriately and that program outcomes are consistent with the City's and residents' cable communications needs.

Key Recommendations to the City Manager's Office:

- Assign responsibility for the City's cable communications program and require the assigned department to provide appropriate program oversight.
- Submit a draft ordinance to the Palo Alto City Council recommending revisions to the Palo Alto Municipal Code based on the revised assignment of roles and responsibilities.

Comcast and AT&T Underpaid Franchise and PEG Fees by Revenue Category July 1, 2010, through June 30, 2014

		East Palo	Menlo		Santa	San	
Revenue Category	Atherton	Alto	Park	Palo Alto	Clara	Mateo	Total
Comcast - July 1, 2010, through June 30, 201	4						
Advertising Revenue	\$3,797	\$7,506	\$18,455	\$35,259	\$3,937	\$1,406	\$70,360
Flat fees	\$1,973	\$6,499	\$8,783	\$17,145	\$1,821	\$428	\$36,649
CPUC and FCC Fees	\$1,139	\$2,233	\$5,329	\$10,276	\$931	\$320	\$20,228
Unreturned Equipment	\$53	\$75	\$143	\$315	\$17		\$603
Underpaid Franchise Fees	\$6,962	\$16,313	\$32,710	\$62,995	\$6,706	\$2,154	\$127,840
Underpaid PEG Fees					\$8,548	\$4,197	\$12,745
Total Due from Comcast	\$6,962	\$16,313	\$32,710	\$62,995	\$15,254	\$6,351	\$140,585
AT&T - July 1, 2011, through September 30,	2014 ^{1, 2}						
Santa Clara County Revenue & Adjustments	\$542	\$2,261	\$2,837	\$6,215	\$4,455	\$4,006	\$20,316
Advertising	\$126	\$503	\$814	\$2,025	\$1,212	\$1,032	\$5,712
Unreturned Equipment	\$164	\$4,231	\$1,152	\$2,197	\$5,280	\$5,280	\$18,304
Other Revenues (Repair, Installation, etc.)	\$108	\$462	\$444	\$1,050	\$1,017	\$1,017	\$4,098
Underpaid Franchise Fees	\$940	\$7,457	\$5,247	\$11,487	\$11,964	\$11,335	\$48,430
Underpaid PEG Fees					\$2,126	\$25,091	\$27,217
Total Due from AT&T	\$940	\$7,457	\$5,247	\$11,487	\$14,090	\$36,426	\$75,647
Grand Total Due from Comcast and AT&T	\$7,902	\$23,770	\$37,957	\$74,482	\$29,344	\$42,777	\$216,232

¹ The figures shown for Santa Clara and San Mateo Counties include AT&T underpayments for all county areas because AT&T did not provide sufficient information to calculate underpayments specific only to the Cable Joint Powers.

Source: Comcast and AT&T financial records

² Some AT&T underpayments are estimates because AT&T did not provide all requested records.

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ABBREVIATIONS	
ASD	Administrative Services Department
DIVCA	Digital Infrastructure and Video Competition Act
FCC	Federal Communications Commission
FY	Fiscal Year
I-Net	Institutional Network
IT	Information Technology
JPA	Joint Powers Authority
PEG	Public, Education, and Government

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INTRODUCTION

Audit Objectives

The audit objectives were to determine whether and to what degree, from July 1, 2010, through June 30, 2014:

- The City of Palo Alto accurately accounted for its receipt of franchise and public, education, and government (PEG) fees and met its oversight responsibilities regarding the Media Center's use of public, education, and government PEG access fees.
- Comcast and AT&T collected and promptly remitted the appropriate amount of franchise and PEG fees.
- The City established and sufficiently defined roles and responsibilities to administer its cable communications program and state franchises awarded to Comcast and AT&T.

Background
Legal framework: franchise and
PEG fees

The California Digital Infrastructure and Video Competition Act (DIVCA) of 2006 gives the California Public Utilities Commission sole authority to issue video and cable franchises to companies that provide such services within the state. DIVCA requires a franchise holder to pay a franchise fee of 5 percent of its gross revenues to each jurisdiction served, unless the jurisdiction adopts an ordinance that sets a lower fee, as rent or toll for using the public rights-ofway. DIVCA requires franchise holders to provide PEG access channels within each jurisdiction served, and jurisdictions may adopt an ordinance that establishes a fee to support PEG channel facilities. DIVCA limits the PEG fee to 1 percent of the franchise holder's gross revenues for entities that did not assess a PEG fee prior to December 31, 2006. The federal Cable Communications Policy Act of 1984 (Cable Act), 47 U.S.C. § 542, restricts the use of PEG fees to capital expenses associated with PEG access facilities when the fee is assessed in addition to a franchise fee, but allows paid advertising, underwriting, or sponsorships to fund PEG-related activities. Franchise holders may pass both the franchise and PEG fees on to their cable subscribers. DIVCA requires franchise holders to maintain records so the local entities can assess the accuracy of franchise and PEG fee payments.

Joint Exercise of Powers Agreement The cities of Palo Alto, Menlo Park, and East Palo Alto; the Town of Atherton; and unincorporated portions of San Mateo and Santa Clara Counties created a Joint Powers Authority (JPA) in 1983 to obtain cable television service within these jurisdictions. The JPA members are known as the Cable Joint Powers. Two cable franchise holders, Comcast and AT&T, currently serve the Cable Joint Powers.

Palo Alto administers and enforces the state franchises on behalf of the Cable Joint Powers through an agreement among the members. A working group comprised of Cable Joint Powers members considers cable and video service-related issues related to state franchises.

JPA franchise and PEG fees

The Palo Alto Municipal Code (Municipal Code) requires each franchise holder to activate seven PEG access channels on its network. It sets the cable franchise fee at 5 percent of the franchise holder's gross revenues and the PEG support fee at 88 cents per month per subscriber. The other Cable Joint Powers members have similar requirements, except Santa Clara County requires a PEG support fee that is the higher of 1 percent of gross revenues or 88 cents per subscriber, limited to 3 percent of gross revenues, and San Mateo County requires a PEG support fee that is the higher of 1 percent of gross revenues or 88 cents per subscriber.

Roles and responsibilities

The Municipal Code defines roles and responsibilities for managing the City's cable communications program:

- The Office of the City Clerk is responsible for managing the City's cable communications program.
- The City Manager designates a cable coordinator to administer and provide oversight of state franchises in the City.
- The City may designate one or more entities, including itself, to control and manage the use of PEG access channels and any PEG facilities and equipment.

The City, through its Information Technology (IT) Department, contracts with an individual who serves as the City's cable coordinator to oversee and manage the cable communications program. This position was formerly managed in the Administrative Services Department (ASD) but was moved under the oversight of IT when IT became a separate department from ASD.

Use of funds and financial reporting

Palo Alto distributes the franchise fees to each of the Cable Joint Powers based on the percentage of fees derived from Comcast's and AT&T's subscribers within each jurisdiction, after:

- Reimbursing Palo Alto for its costs to administer the state franchises, including the fees paid to the cable coordinator.
- Paying the costs of regulatory and oversight functions.
- Paying for other cable- or video-related activities that benefit the area in which the revenue was generated.

In 2001, the Palo Alto City Council designated the Midpeninsula Community Media Center, Inc., (Media Center) as the community access organization to meet the Cable Joint Powers' existing and future PEG access needs. The City's 2011 contract with the Media Center requires Palo Alto to remit all of the PEG fees it receives from Comcast and AT&T on behalf of the Cable Joint Powers to the Media Center. The City separately contracts with the Media Center for cablecasting services, including broadcasting Palo Alto City council and committee meetings via cable television.

Palo Alto currently receives about 50 percent of the allocated franchise fee revenues. Exhibit 1 shows the distribution of franchise fees to the Cable Joint Powers, and Exhibit 2 shows the total PEG fees received and remitted to the Media Center from July 1, 2010, through June 30, 2014.

Exhibit 1: Franchise Fee Payments to Each Jurisdiction

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	FY 20)11	FY 2012		FY 2013		FY 2014	
Jurisdiction	Comcast	AT&T*	Comcast	AT&T*	Comcast	AT&T*	Comcast	AT&T*
Palo Alto	\$688,735	\$96,631	\$678,092	\$131,907	\$716,504	\$137,738	\$735,326	\$135,902
Menlo Park	\$384,301	\$34,815	\$380,990	\$49,218	\$399,290	\$55,996	\$412,231	\$64,065
East Palo Alto	\$130,772	\$21,645	\$130,560	\$28,915	\$135,299	\$34,505	\$137,082	\$39,495
Atherton	\$105,734	\$5,981	\$105,191	\$8,955	\$111,060	\$10,524	\$116,765	\$10,735
Santa Clara County	\$82,831	-	\$84,322	-	\$92,266	-	\$100,399	-
San Mateo County	\$32,917	-	\$33,084	-	\$33,869	-	\$34,019	-
Total	\$1,425,289	\$159,072	\$1,412,239	\$218,995	\$1,488,289	\$238,763	\$1,535,822	\$250,198

^{*}No revenue is shown from AT&T for Santa Clara and San Mateo Counties because AT&T remitted all of its franchise fee payments for Santa Clara and San Mateo Counties directly to the counties.

Source: City of Palo Alto financial records

Exhibit 2: PEG Fees Remitted to the Media Center

	FY 20	011	FY 2012		FY 2013		FY 2014	
Jurisdiction	Comcast	AT&T ²	Comcast ¹	AT&T ²	Comcast ¹	AT&T ²	Comcast ¹	AT&T ²
Palo Alto	\$156,306	\$19,573	\$251,013	\$25,440	\$297,289	\$26,978	\$294,613	\$28,062
Menlo Park	\$79,199	\$6,693	\$25,811	\$8,990	-	\$10,620	-	\$12,305
East Palo Alto	\$33,495	\$4,117	\$10,849	\$5,279	-	\$6,643	-	\$7,958
Atherton	\$15,736	\$1,072	\$5,157	\$1,479	-	\$1,774	-	\$1,918
Santa Clara County	\$15,368	-	\$5,120	-	-	-	-	-
San Mateo County	\$5,944	-	\$1,975	-	-	-	-	-
Total	\$306,047	\$31,455	\$299,925	\$41,188	\$297,289	\$46,016	\$294,613	\$50,243

Starting in November 2011, Comcast stopped providing a detailed breakdown by jurisdiction; total PEG fees are shown under Palo Alto.

Source: City of Palo Alto financial records

² No revenue is shown from AT&T for Santa Clara and San Mateo Counties because AT&T remitted all of its PEG fee payments for Santa Clara and San Mateo Counties directly to the counties.

Program Revenues Collected from Comcast and AT&T

Palo Alto established the Cable Fund as a restricted-use fund for nonrecurring cable-related revenue, such as settlements and grants. The fund is used to carry out specific actions required by the policy. The fund's balance was \$759,000, including about \$4,000 in interest receivable, as of June 30, 2014. In FY 2015, the City began using the Cable Fund to record franchise and PEG fee remittances from the cable companies and to allocate the fees to the Cable Joint Powers and the Media Center, respectively.

Exhibit 3 summarizes the main components of the cable communications program, which generates \$2.1 million in revenues and incurs \$436,000 in expenditures annually for the Cable Joint Powers.

Exhibit 3: Summary of Estimated Annual Cable Communications Program FY 2014 Revenues and Expenditures

Program Revenues Con	ected from Comcast and AT&T
Franchise fees	\$1.8 million - distributed to the Cable Joint Powers, after deducting the City's expenses, based on the percentage of fees generated within each area
PEG fees	\$345,000 - all remitted to the Media Center (see program expenditures below)
Total	\$2.1 million
Program Expenditures	
Management and oversight	\$48,000 - consultant (cable coordinator) costs, allocated to the Cable Joint Powers \$14,000 - other costs (cable program oversight, accounting, procurement, financial statement preparation, legal, audit, etc.), allocated to the Cable Joint Powers
Media Center*	\$345,000 in pass-through PEG fees to the Media Center
Institutional Network (I-Net) operation and management	\$29,000 - Comcast contract costs for use of I-Net fiber, allocated to the Cable Joint Powers through the Cable Fund
Total	\$436,000*
Estimated Net Annual Program Revenues*	\$1.7 million - net unrestricted Cable Joint Powers revenues
* An additional \$125,000 for	cablecasting services (i.e., broadcasting via cable television), including Palo Alto City Council and committee

meetings, is associated with the City's contract with the Media Center and is not allocated to the Cable Joint Powers or included in the estimated net annual program revenues shown above.

Source: Estimates based on City of Palo Alto financial records, staff reports, and contracts

Audit Scope

We assessed the City's oversight of its cable communications program and the use of franchise and PEG fee payments that Comcast and AT&T collected from cable subscribers in the Cable Joint Powers areas and remitted to Palo Alto from July 1, 2010, through June 30, 2014. We also reviewed Cable Fund activity from its inception in 2000. We did not review changes that the City made after the audit period for how it accounts for franchise and PEG fees and use of the Cable Fund.

Scope Limitations

Despite repeated requests, AT&T did not provide all information needed to perform a complete review of the accuracy and completeness of the franchise and PEG fees it remitted to Palo Alto. As a result, The Buske Group sometimes estimated AT&T's underpayment of franchise and PEG fees based on common industry practices.

We intended our audit to cover four years, based on DIVCA's data retention provision, but AT&T only provided three years of data based on the DIVCA provision that requires claims for refunds or other corrections to be made within three years and 45 days of the end of the quarter for which compensation was remitted, or three years from the date of remittance, whichever is later. However, AT&T provided information for July through September 2014, which was not originally included in the audit period.

AT&T remitted fees collected from subscribers in unincorporated Santa Clara and San Mateo Counties directly to the counties and could not provide the information needed to calculate the amounts due for the unincorporated areas specific to the Cable Joint Powers. As a result, the audit report includes estimates of AT&T's franchise and PEG fee underpayments for all of Santa Clara and San Mateo Counties, including areas that are not in the Cable Joint Powers.

Audit Methodology

To conduct this audit, we:

- Reviewed federal, state, and local regulations regarding collection and use of franchise and PEG fees.
- Assessed the City's process to calculate and remit franchise and PEG fees to the Cable Joint Powers and the Media Center, respectively.
- Reviewed the City's and the Media Center's financial records to determine whether franchise and PEG fees were used appropriately.
- Interviewed the cable coordinator and staff in the Office of the City Clerk, ASD, IT Department, and Media Center to assess operation and oversight of the state franchises and the City's cable communications program.

- Consulted with the City Attorney for legal advice regarding the federal Cable Act and DIVCA.
- Contracted with The Buske Group, a subject-matter expert, to obtain and review Comcast and AT&T records on our behalf to determine if they collected and promptly remitted the appropriate amount of franchise and PEG fees to the City.

Data Reliability

Compliance with government auditing standards and independence impairment We assessed the reliability of the Comcast and AT&T data by interviewing our hired subject matter expert, who was knowledgeable about the data, and by comparing Comcast and AT&T address and fee allocation data with Cable Joint Powers members' address data to identify any miscoding that could result in payment misallocation. Except as noted in the Scope Limitations section above, we determined that the data were sufficiently reliable for the purposes of this report.

We conducted this performance audit of cable franchise and PEG fees in accordance with our FY 2014 and FY 2015 Annual Audit Work Plans and generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Except as noted in the Scope Limitations section above, we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The government auditing standards require auditors to be free from external interference or influence that could compromise an auditor's professional judgment or create the appearance that the auditor's professional judgment may be compromised. Subsequent to our providing the Media Center with a copy of the draft audit report and discussing our finding regarding the Media Center's use of PEG fees, the Media Center commissioned Sue Buske, president of The Buske Group, to write a paper supporting the appropriateness of the Media Center's use of PEG fees for what we identified as operating expenses. When Ms. Buske wrote the opinion, which conflicts with our conclusions, she was under contract with our office to perform work for a separate audit objective unrelated to the use of PEG fees, although we had informed her of the nature of our work regarding the use of PEG fees. Prior to beginning her work for the Office of the City Auditor, Ms. Buske had signed an "independence statement" to confirm that she was not biased (i.e., political, ideological, social, or other

convictions that might impair her independence related to the subject matter of the audit) and that she would immediately notify the City Auditor regarding any new threats to independence that occurred during the course of the audit or after the report is issued.

Ms. Buske did not notify the City Auditor as required by the independence statement. When we became aware of this situation and asked Ms. Buske about the opinion document, she referred us back to the Media Center. The Media Center indicated that they would rely on Ms. Buske's opinion when responding to our audit finding. Although Ms. Buske's work on the audit was limited to determining whether Comcast and AT&T had collected and promptly remitted the appropriate amount of franchise and PEG fees, we believe that Ms. Buske's opinion document and lack of notification to the City Auditor creates the appearance that the auditor's professional judgment may be compromised. To avoid an independence impairment, we relied on the research and legal advice that we had obtained during the audit and not on Ms. Buske's opinion document.

Finding 1

The Media Center did not restrict its use of \$340,000 of annual PEG fees to capital expenditures as required by the federal Cable Act

The Media Center inappropriately used an annual average of \$340,000 of public, education, and government (PEG) fees, or \$1.4 million during the audit period, paid by cable television subscribers in the Cable Joint Powers areas, for operating expenses. Neither the City nor the Media Center enforced the federal law that restricts the use of PEG fees to capital expenses associated with PEG access facilities. 2

\$1.4 million of PEG fees used for operating expenses did not comply with federal law

From July 1, 2010, through June 30, 2014, Comcast and AT&T collected \$1.4 million in PEG fees from cable television subscribers in the Cable Joint Powers areas. They remitted the fees to the City of Palo Alto, which gave them to the Media Center, as required by the written agreement with the Media Center. To the extent that the Media Center used the fees for operating expenses, the expenditures did not comply with the federal law that restricts the use of PEG fees to capital expenditures for PEG access facilities. Federal law does not restrict the use of franchise fees, but does restrict the use of PEG fees to capital expenses for PEG access facilities. Because the Cable Joint Powers impose a PEG support fee, the PEG fee must be used only for capital expenses associated with PEG access facilities.

Media Center's records support that PEG fees were allocated to operating expenses

Media Center staff provided detailed financial records showing that it allocated PEG fees to operating expenses, including salaries and benefits, professional services, janitorial services, maintenance, outreach, and insurance:

• In calendar year 2013, \$340,000 in PEG funds comprised more than 40 percent of the Media Center's operating revenue.

¹ Because the Media Center's fiscal years run from January 1 through December 31, we were able to review its financial records only through December 31, 2013, although our audit period ran through June 30, 2014. The differences in timing do not affect the issues cited in our findings, although the dollar amounts may differ.

² The Media Center's accounting policies in use during the audit period say that it capitalizes the aggregate cost of assets over \$1,500 and expenses maintenance and repair costs as incurred. A 2008 federal appellate court decision ruled that Congress intended "capital costs associated with the construction of PEG access facilities" to refer to channel capacity designated for PEG use, as well as for facilities and equipment, including vans, studios, cameras, or other equipment, related to the use of PEG channel capacity.

• From calendar year 2010 through 2013, the Media Center had only \$161,563 in capital expenditures associated with its PEG program, including website redesign, a cablecasting system, computers, software, and camcorders. Although the Media Center received \$1.4 million in PEG fees during this period and had only \$161,563 in capital expenditures, it requested, and the City paid, an additional \$52,708 from the Cable Fund for a portion of the cost of a cablecasting system that the Media Center purchased.

Media Center's capital plan does not show capital needs related to PEG access facilities The Media Center's August 2014 capital plan did not show planned capital expenditures through 2018 or plans to construct or expand PEG access facilities, but Media Center staff said that the Media Center Board had recently approved spending \$579,000 from the Media Center's "investment account" to provide high-definition broadcasting in its studios. The studio update is a potentially qualifying capital expense for use of PEG fees, but the Media Center did not identify it as such. Media Center staff provided financial records in April 2015 showing that it had over \$427,000 in capital expenditures in calendar year 2014 and an equal amount budgeted for calendar year 2015 for its studio upgrade project. Although these may have qualified as an appropriate use of PEG fees under the federal Cable Act, the Media Center used its investment fund for these expenditures and used the PEG fees for operating expenses.

Agreement with the Media Center requires compliance with DIVCA and the federal Cable Act The agreement between the City of Palo Alto and the Media Center requires the Media Center to use PEG funds in a manner consistent with DIVCA and federal law. It specifically states that PEG fees shall not be construed to be a franchise fee within the meaning of the Cable Act, which allows the PEG fees to be used only for capital costs associated with PEG access facilities. The agreement requires the Media Center to provide the City with an annual plan and budget that lists the activities and programs for which it plans to use funds received from the City during the following fiscal year. Although the Media Center provided its annual plan and budget as required, the City's cable coordinator reviewed the plan based on the Media Center's incorrect definition of capital expenditures, which did not ensure that the Media Center used the PEG fees in compliance with the Cable Act.

³ We did not assess whether these capital expenditures were actually for items that were specific to PEG access facilities.

The agreement also states that equipment or facilities purchased with PEG fees or City funds belong to the City upon termination of the agreement or dissolution of the Media Center. To the extent that the Media Center used the PEG fees for operating expenses instead of tangible capital expenses, there is less equipment or facilities in the Media Center's possession for potential transfer to the City upon termination of the agreement.

Some thought the Media Center was "grandfathered in" to use PEG fees for operating expenses A 2011 Congressional Research Service report said that more than 100 PEG access centers nationwide have closed due to restrictions on the use of PEG fees and the lack of other funding to support operating expenses. Despite the Media Center's acknowledgment of those closings, its executive director and the City's cable coordinator said they believed that the Media Center was "grandfathered in" under DIVCA to use the funds as they had under the City's prior local franchise agreements. However, neither DIVCA nor the City's agreement with the Media Center allow the PEG fees to be used in a manner other than as prescribed in the federal Cable Act, and DIVCA specifically requires that PEG fees only be used "as authorized under federal law."

Franchise fees, Cable Fund, or Media Center's investment account could have paid for **Media Center operations**

Instead of providing all of the PEG fees collected to the Media Center without knowing if there was a specific capital-expense need for the fees, the Cable Joint Powers could have used some of the franchise fees collected to support the Media Center's ongoing operations. It was not within the scope of our audit to review how the Cable Joint Powers members used their allocation of franchise fees, but the Media Center's financial statements do not show that it received franchise fees from any Cable Joint Power members.

The Cable Fund was another option for supporting the Media Center's operating costs related to PEG channels. The JPA's Cable Fund policy prioritizes support to the Media Center to operate the PEG channels, but the Cable Joint Powers did not allocate Cable Fund revenues to the Media Center for operating expenses. Doing so would have allowed the Media Center to reserve the PEG fees received for capital expenses associated with PEG access facilities and be compliant with the federal Cable Act.

A third option would have been for the Media Center to use its investment account for its operating expenses. The Media Center already uses this account to offset the portion of its annual operating expenses that exceed its revenues from PEG fees and other sources. The investment account, established through a

charitable contribution received when the former Cable Co-op sold its principal assets to AT&T, had a balance of \$6.4 million as of December 31, 2014.

Customer usage and satisfaction data for PEG channels not tracked

Neither the City nor the Media Center collect customer usage and satisfaction data, such as frequency and duration of resident access to Media Center PEG channels, ease of access to PEG channels, and users' overall satisfaction with PEG channel programming and transmission quality. The Media Center provided us with a 2004 telephone survey, which showed that about one-third of all subscriber respondents had watched at least one Media Center channel and 70 percent of those viewers, or 23 percent of those surveyed, had watched a City Council or other public meeting - a lower than anticipated viewership. Consistent with these results, Palo Alto's National Citizen Survey™ show a declining trend in PEG channel viewership. In 2006, 31% of respondents reported that they had watched a meeting of local elected officials or other public meeting on cable television, the internet, or other media during the previous year compared to 16% in 2014.

Concerns about ongoing usefulness of PEG channels The above issues may raise questions about the ongoing need for PEG access channels, particularly because there have been significant changes in technology since the Cable Act and DIVCA were enacted, and other options are now available for residents to obtain local information and programming. A November 2008 Mackinac Center Policy Brief provided insights on the evolving state of PEG channels:4

- Only a small portion of cable subscribers actually watch the programming on PEG channels.
- PEG channels do offer some benefits today, including broadcasts of local government meetings, school concerts, sporting events, graduation ceremonies, and training opportunities for aspiring filmmakers.
- The idea that PEG channels offer unique choices to viewers is outdated. Much of the programming and local information is available on the internet through websites such as YouTube and through e-mail groups, rendering PEG channels increasingly redundant.

⁴ Theodore Bolema, Ph.D., J.D., An Evaluation of Legislative Proposals for Higher Cable Fees to Finance Public, Education and Government Access Channels (Mackinac Center Policy Brief, November 10, 2008), available at https://www.mackinac.org/archives/2008/2008-11REGfeesWEB.pdf.

There is no real evidence that cable subscribers want more PEG channels or that PEG cable channel viewing will significantly increase following the proposed increase in funding.⁵

Recommendations

We recommend that the City Manager's Office:

- 1.1 Consult with ASD, IT, the City Attorney's Office, and Cable Joint Powers members to assess the need to continue collecting PEG fees and adjust the fee based on a demonstrated need for future capital expenses related to PEG access facilities or discontinue collecting the fee.
 - a. If it is determined that the PEG fee should be adjusted or discontinued, submit a staff report to the City Council with a recommendation to amend the Municipal Code to reflect the revised fee or to eliminate the requirement and recommend to the other Cable Joint Powers members that they do the same.
 - b. If it is determined that the PEG fee should continue to be collected:
 - Amend the agreement with the Media Center to remove the requirement for the City to remit all PEG fees collected to the Media Center.
 - Coordinate with ASD, the City Attorney's Office, and the Cable Joint Powers to develop and implement criteria for the use of PEG fees to ensure compliance with the federal Cable Act, and that the fees are set at a level appropriate for anticipated and necessary capital expenses.
 - Place the PEG fees in a restricted account and distribute them based on City-approved capital expenditures that meet federal Cable Act requirements.
 - Require that semi-annual documentation of expenditures be provided and adopt procedures to review the documentation to ensure that PEG fees are spent only as allowed by the federal Cable Act and take immediate corrective action as necessary.

⁵ This was in reference to proposed amendments to Michigan state law that would have removed several legal limitations on the amount of PEG fees that local governments could charge cable companies to finance local PEG channels.

1.2 Consult with ASD, IT, the City Attorney's Office, and the Cable Joint Powers on whether to allocate a portion of the unrestricted franchise fees or other funds, instead of restricted-use PEG fees, to subsidize the Media Center's operations or to discontinue subsidizing the Media Center's operations. Based on the resulting recommendation, the City Manager's Office should make recommendations to the Council regarding appropriate future funding, if any, for the Media Center.

Finding 2

Comcast and AT&T did not remit the full amount of franchise and PEG fees due

Comcast and AT&T did not always calculate the fees due in accordance with DIVCA and the municipal code of each of the Cable Joint Powers. As a result, Comcast underpaid about \$141,000 in franchise and PEG fees from July 1, 2010, through June 30, 2014, and AT&T underpaid about \$76,000 from July 1, 2011, through September 30, 2014.

AT&T's underpayments are estimated because it did not provide sufficient records for us to verify the accuracy of franchise and PEG fee payments. In addition, AT&T's underpayments are for all of Santa Clara and San Mateo Counties because it remitted fees collected from subscribers in the unincorporated county areas directly to the counties and could not provide the information needed to calculate the amounts due only to the Cable Joint Powers (see scope limitations section on page 5).

Comcast and AT&T will owe interest, calculated at the highest prime lending rate during the delinquency period plus 1 percent, on underpaid fees, as required by DIVCA. DIVCA also requires that AT&T pay the City for its portion of the audit costs because AT&T's underpayment exceeds 5 percent of the amount that it should have paid.

Comcast and AT&T underpaid \$216,000 in franchise and PEG fees

Comcast underpaid the Cable Joint Powers about \$128,000 in franchise fees and \$13,000 in PEG fees, and AT&T underpaid about \$48,000 in franchise fees and \$27,000 in PEG fees.⁷

Comcast and AT&T underpaid franchise and PEG fees because they did not always comply with provisions of DIVCA and the Cable Joint Powers' municipal codes that require:

 Payment of a 5 percent franchise fee based on gross revenues for all charges billed to subscribers for cable or video service provided by the franchise holders and their affiliates, including

⁶ AT&T provided data for July 1, 2011, through September 30, 2014, based on the DIVCA requirement for local entities to make claims for underpayments within three years and 45 days of the end of the quarter for which compensation was remitted or three years from the remittance date, whichever is later.

⁷ AT&T's estimated underpayments shown in this report include all of Santa Clara and San Mateo Counties because AT&T does not maintain its records in a manner that would allow us to calculate underpayments only for the unincorporated county areas that are within the Cable Joint Powers geographical area.

- revenue related to programming provided to the subscriber, equipment rentals, late fees, and insufficient fund fees.
- Payment of an \$0.88 PEG fee per subscriber, except for Santa Clara and San Mateo Counties, which require the fee to be the higher of \$0.88 per subscriber or 1 percent of gross revenue.

Exhibit 4 summarizes the amount of underpaid franchise and PEG fees for each of the Cable Joint Powers members.

Exhibit 4: Comcast and AT&T Underpaid Franchise and PEG Fees by Revenue Category

		East Palo	Menlo	Palo	Santa	San	
Revenue Category	Atherton	Alto	Park	Alto	Clara	Mateo	Total
Comcast - July 1, 2010, through June 30, 20							
Advertising Revenue	\$3,797	\$7,506	\$18,455	\$35,259	\$3,937	\$1,406	\$70,360
Flat fees	\$1,973	\$6,499	\$8,783	\$17,145	\$1,821	\$428	\$36,649
CPUC and FCC Fees	\$1,139	\$2,233	\$5,329	\$10,276	\$931	\$320	\$20,228
Unreturned Equipment	\$53	\$75	\$143	\$315	\$17	-	\$603
Underpaid Franchise Fees	\$6,962	\$16,313	\$32,710	\$62,995	\$6,706	\$2,154	\$127,840
Underpaid PEG Fees	-	-	-	-	\$8,548	\$4,197	\$12,745
Total Due from Comcast	\$6,962	\$16,313	\$32,710	\$62,995	\$15,254	\$6,351	\$140,585
AT&T - July 1, 2011, through September 30), 2014 ^{1, 2}						
Revenue Adjustments	\$542	\$2,261	\$2,837	\$6,215	\$4,455	\$4,006	\$20,316
Advertising	\$126	\$503	\$814	\$2,025	\$1,212	\$1,032	\$5,712
Unreturned Equipment	\$164	\$4,231	\$1,152	\$2,197	\$5,280	\$5,280	\$18,304
Other Revenues (Repair, Installation, etc.)	\$108	\$462	\$444	\$1,050	\$1,017	\$1,017	\$4,098
Underpaid Franchise Fees	\$940	\$7,457	\$5,247	\$11,487	\$11,964	\$11,335	\$48,430
Underpaid PEG Fees	-	-	-	-	\$2,126	\$25,091	\$27,217
Total Due from AT&T	\$940	\$7,457	\$5,247	\$11,487	\$14,090	\$36,426	\$75,647
Grand Total Due from Comcast and AT&T	\$7,902	\$23,770	\$37,957	\$74,482	\$29,344	\$42,777	\$216,232

Only portions of unincorporated county areas are included in the Cable Joint Powers geographical area. However, the figures shown for Santa Clara and San Mateo Counties include AT&T underpayments for all county areas because AT&T did not provide sufficient information to calculate underpayments specific only to the Cable Joint Powers.

Source: Comcast and AT&T financial records

Comcast and AT&T did not pay franchise fees on all advertising revenue

Comcast underpaid about \$70,000 in franchise fees because it excluded from its gross revenue the commissions paid by its advertising affiliate, Spotlight, to third-party advertising agencies and their representatives and because it did not include revenue that Spotlight earned from assisting other cable operators in the Cable Joint Powers areas. DIVCA requires an affiliate's revenue to be treated as the franchise holder's revenue, and specifically states

Some AT&T underpayments are estimates because AT&T did not provide all requested records.

that not doing so has the effect of evading the payment of fees that would otherwise be paid to the local entity.

AT&T underpaid franchise fees by about \$6,000, based on a standard 15 percent commission charged by advertising agencies to assist in selling advertising time to businesses. The Buske Group estimated this amount because AT&T did not provide sufficient information to verify advertising revenue.

Comcast did not pay franchise fees on all flat fees charged to subscribers

Comcast underpaid about \$37,000 in franchise fees because it did not include in its gross revenues all flat fees collected from its subscribers. Flat fees include late, nonsufficient fund, convenience, wire maintenance, early termination, and collection fees. Instead, Comcast allocated to its gross revenues only the flat fee charges that represented subscribers' video revenue as a percentage of its total revenue, which could include other services, such as internet and telephone. Because flat fees are not based on a subscriber's service level, the only amounts that should be excluded from gross revenues are those for subscribers who did not have video service. Comcast also excluded from its revenues its expenses for collecting past-due payments. The Buske Group estimated this underpayment because Comcast only provided records of net collection fees.

AT&T remitted fees collected from subscribers in unincorporated Santa Clara and San Mateo County areas directly to the counties

The Cable Joint Powers agreement requires Palo Alto to remit to the JPA members the franchise and PEG fees that Comcast and AT&T collect from subscribers, based on the percentage of total fees collected in each member's jurisdiction and after deducting the City's administrative costs. The JPA area includes unincorporated areas of Santa Clara and San Mateo Counties that border the Cable Joint Powers cities. However, AT&T remitted the franchise and PEG fees collected from subscribers in all of Santa Clara and San Mateo Counties directly to the counties and could not provide information needed to calculate the amounts due only to the Cable Joint Powers. An AT&T representative told us that the City would have to provide the addresses for the county areas in the JPA for AT&T to appropriately allocate fees to the Cable Joint Powers. Because Palo Alto was unaware of these direct payments, the cable coordinator did not allocate to the counties the City's administrative costs for this portion of the revenues. This caused the counties to underpay and the other Cable Joint Powers members to overpay their respective shares of administrative costs.

The counties did not remit the PEG fees paid directly to them for the unincorporated areas to the Media Center, as required by the contract with the Media Center, and it was beyond the scope of this audit to determine if the counties used the PEG fees only for capital expenditures related to PEG access facilities, as required under the federal Cable Act (see related discussion in Finding 1). However, regardless of whether the counties used the PEG fees in accordance with the Cable Act, AT&T's payments directly to the counties resulted in subscribers other than those who paid the fees to receive the benefit of those payments.

AT&T excluded customer refunds and credits from gross revenues

AT&T excluded adjustments, such as customer refunds and credits that it made for noncable service revenues that are subject to franchise fees, from its revenues. This caused AT&T to underpay Santa Clara County about \$20,000 in franchise fees.

Comcast excluded FCC and CPUC fees from gross revenues

Comcast underpaid about \$20,000 in franchise fees because it did not include fees assessed by the California Public Utilities
Commission (CPUC) and the Federal Communications Commission
(FCC) in gross revenues. Although DIVCA clearly defines franchise fees as those paid to the local entity, Comcast excludes the CPUC and FCC fees because it claims that these are franchise fees and that including them would cause it to pay more than DIVCA's 5 percent cap on franchise fees. Comcast includes these fees in subscribers' monthly service charges and should have included them in gross revenues.

Comcast and AT&T did not pay franchise fees on unreturned equipment charges

Comcast underpaid about \$600 and AT&T underpaid about \$18,000 in franchise fees because they excluded unreturned equipment revenue from their calculation of gross revenue that is subject to franchise fees. Comcast's underpayment may be understated because it changed the mapping for unreturned equipment revenue, which made it difficult to determine if it fully reported this revenue. AT&T began calculating and paying franchise fees on unreturned equipment revenue in April 2014 but inappropriately excluded amounts written off from its gross revenues.

Comcast and AT&T miscalculated and underpaid some PEG fees Comcast underpaid about \$13,000 in PEG fees due to Santa Clara and San Mateo Counties and AT&T underpaid about \$4,000 because they billed \$0.88 per subscriber instead of 1 percent, which would have generated more revenue. AT&T underpaid an additional \$23,000 in PEG fees because, although it billed \$0.88 per subscriber, it remitted payment based on \$0.55 per subscriber in San Mateo County instead of 1 percent. The municipal codes for Palo Alto, Menlo Park, East Palo Alto, and Atherton require a PEG

fee of \$0.88 per subscriber, but Santa Clara and San Mateo Counties require the fee to be the higher of \$0.88 per subscriber or 1 percent of gross revenue. AT&T's representative told us that its systems can only calculate the fee based on a single rate for a geographical area, not an "either/or" formula.

AT&T did not pay franchise fees on all gross revenues

AT&T underpaid about \$4,100 in franchise fees because it did not include all revenues, including convenience fees, installation labor, additional outlets, and repair labor, in gross revenues that are subject to franchise fees. The Buske Group estimated the underpayment because AT&T did not provide all requested records needed to calculate the amount due.

Comcast and AT&T owe interest on underpaid franchise and PEG fees

Comcast and AT&T owe interest on the underpaid franchise and PEG fees. DIVCA requires that interest be calculated at an annual rate equal to the highest prime lending rate during the period of delinquency, plus 1 percent. The interest owed should be calculated when the City finalizes the underpayment amounts on which it will pursue collection.

AT&T owes the City for the costs of the audit

AT&T's estimated underpayment of \$48,400 in franchise fee payments equals 6 percent of total franchise fees due during the audit period, which means that AT&T owes the City for the costs related to AT&T's portion of this audit. DIVCA requires a franchise holder to pay the audit costs if it underpaid franchise fees by more than 5 percent. Whether AT&T has to pay the audit costs will also depend on whether it provides additional information that would allow us to recalculate the underpayments based on revenue that is only for the unincorporated areas of San Mateo and Santa Clara Counties, rather than all areas of those counties.

Inaccuracies and omissions in **Comcast and AT&T address** databases can cause payment errors

Comcast uses an address database, commonly referred to in the industry as a "homes-passed" list, to associate subscriber revenues with the jurisdiction that should receive the franchise and PEG fees. However, the database is not complete or fully reliable, which likely caused errors in franchise and PEG fee payments to the Cable Joint Powers members:

- 524 out of 36,930 residential address records for Palo Alto are associated with the East Palo Alto billing code, which means that some Palo Alto revenues and their related franchise fees were misallocated to East Palo Alto.
- About 1,400 residential address records in the Cable Joint Powers area are not in the database, and 246 Comcast database

records are not in the Cable Joint Powers members' residential address records.

Although DIVCA requires franchise holders to maintain records that would allow a local entity to ensure that the franchise holder accurately compensated the local entity, AT&T does not have a homes-passed list or other database to show how each residential address is associated with jurisdictions in the Cable Joint Powers area. AT&T uses a third-party vendor to determine how to allocate revenue when an account is established for a residential address and can only provide addresses that are being billed within a jurisdiction for the point in time when the list is produced. The lack of a comprehensive address list for the areas served limits the ability to assess AT&T's address database to gain assurance that past fees were and that future fees will be appropriately allocated to Cable Joint Powers members. However, the account database that AT&T provided for a point in time during the audit included residential addresses that were associated with incorrect jurisdictions, which would cause inappropriate allocation of franchise and PEG fees.

The City does not effectively monitor the accuracy and completeness of franchise and **PEG** fee payments

The City's cable coordinator reviews Comcast and AT&T franchise and PEG fee payments and follows up with them regarding large variances and late payments. However, the cable coordinator does not obtain and review documents, such as customer count and address billing records and documents that show how Comcast and AT&T calculated gross revenue that is subject to franchise fees, to verify the accuracy of fee payments. Recognized internal control frameworks require organizations to implement monitoring processes that allow timely identification of deficiencies, but the City has relied on the Office of the City Auditor and an external consultant to periodically assess the accuracy of franchise and PEG fee payments. 8 The Office of the City Auditor conducted the last assessment, which included only Comcast, in 2006. Because of the cost of conducting periodic audits and DIVCA limits on the amount of time entities have to submit claims to recover underpayments, ongoing reviews would help ensure the accuracy of fee payments on a routine basis.

⁸ U.S. Government Accountability Office, "Standards for Internal Control in the Federal Government," Washington, D.C., 2014, available at http://www.gao.gov/products/GAO-14-704G.

Committee of Sponsoring Organizations of the Treadway Commission, "Internal Control - Integrated Framework," 2013, available at: http://www.coso.org/IC.htm.

Recommendations

We recommend that the City Manager's Office, in coordination with ASD, IT, and the City Attorney's Office:

- 2.1 Send a letter to AT&T and Comcast describing the results of the audit and demanding payment of the underpaid franchise and PEG fees shown in Exhibit 4, plus interest calculated in accordance with DIVCA requirements.
- 2.2 Include in AT&T's letter a demand for payment of the audit costs that are attributable to AT&T.
- 2.3 Work with Comcast and AT&T to develop methods to ensure:
 - Their address databases accurately reflect all potential service addresses within the Cable Joint Powers geographic areas.
 - They have a separate billing code for each member jurisdiction and accurately report and remit payments to the City of Palo Alto based on those billing codes.
- 2.4 Develop criteria for assessing the accuracy of future Comcast and AT&T franchise and PEG fee payments on an ongoing basis and:
 - Communicate the criteria to Comcast and AT&T and that it will be used to review the accuracy of future payments.
 - Require Comcast and AT&T to report the breakdown of their fees in more detail, including identifying what is and is not included in the gross revenues used to calculate the fees and the reason for any exclusions.
 - Review the franchise and PEG fee payments to ensure that they were calculated on all revenues that are subject to franchise and PEG fees and promptly follow up with Comcast and AT&T regarding any discrepancies.
- 2.5 Request that San Mateo and Santa Clara Counties revise their municipal codes to reflect only a single adopted rate to accommodate the cable companies' billing system capabilities, if the PEG fee continues to be collected (see Recommendation 1.1).

Finding 3

Roles and responsibilities for managing the City's cable communications program are not clearly defined or assigned

The City has not clearly assigned or defined roles and responsibilities for its cable communications program or effectively managed the program to ensure that funds are used appropriately and that program outcomes are consistent with the City's and residents' cable communications needs.

Municipal Code assigns the Office of the City Clerk responsibility for managing cable communications

Municipal Code Section 2.08.110, Office and Duties of the City Clerk, was adopted in 1995 and designates the Office of the City Clerk as responsible for administering the city's cable communications program. However, the City Clerk's Office does not in fact administer the program and administering it does not align well with the City Clerk's other key responsibilities.

Other sections of Municipal Code updated responsibility for program administration and **oversight**

Municipal Code Chapter 2.10, adopted in 2000 and no longer operative after 2008, described cable television franchise awards and identified the cable coordinator as "the individual or individuals designated by the city to administer a cable communications system franchise." This chapter was superseded by Chapter 2.11, which Council adopted in 2007 to implement DIVCA. It states that the cable coordinator is "the city manager or the individual or individuals designated by the city manager to administer oversight of state franchisees in the city." The term, "cable communications program," is not defined in the Code and is not referenced anywhere in the Code other than where the Code assigns responsibility for the program to the Office of City Clerk.

The IT Department performs limited activities related to the cable program

The IT Department administers a contract and approves payments for the City's cable coordinator but does not otherwise actively manage or provide oversight of the cable communications program. ASD administered the cable coordinator contract prior to IT becoming a separate department. When the Municipal Code was updated, the provision in Chapter 2.08 that assigns responsibility to the Office of the City Clerk was not updated to reflect changes in how cable activities were to be administered in the City.

No program performance measures

There are no established goals and objectives to address program activities or performance measures to monitor and assess program inputs, outputs, and outcomes. Having measures would help the department responsible for oversight to ensure that the program

meets its goals and objectives and aligns with the City's mission, business needs, and responsibilities.

Recommendations

We recommend that the City Clerk and City Manager's Office:

- 3.1 Confer and develop a recommendation for the City Council to assign responsibility for the City's cable communications program and require the assigned department to provide appropriate program oversight to ensure that:
 - a. The City's cable communications program objectives are aligned with the City's goals and objectives.
 - b. The assigned department develops performance measures to demonstrate that the program is effective and is meeting the City's goals and objectives.
 - c. There is effective oversight and management of the cable coordinator's contract and activities.
- 3.2 Submit a draft ordinance to the Palo Alto City Council recommending revisions to the Palo Alto Municipal Code based on the revised assignment of roles and responsibilities.

APPENDIX 1 - City Manager's Response



CITY OF PALO ALTO MEMORANDUM

TO:

Harriet Richardson, City Auditor

FROM:

James Keene, City Manager

DATE:

April 22, 2016

SUBJECT:

Cable Audit Response

The staff appreciates the work of the City Auditor in assessing the cable communications program and associated fees and agrees with the findings and recommendations of the audit. The City typically conducts cable franchise and public, education, and government (PEG) fee audits every three to five years. However, this is the first audit that the City has undertaken following the passage of the California Digital Infrastructure and Video Competition Act (DIVCA) of 2006. This law changed the franchising and regulatory structure for the provision of cable services in California. Most cable franchises in California (including our Comcast and AT&T franchises) have moved from local to state franchises since DIVCA was enacted.

The audit brings to the forefront a significant impact related to the shift from a locally negotiated franchise. DIVCA eliminated the means through which localities, like the Joint Powers Authority (JPA), could protect PEG fees from the federal Cable Act's capital cost limitation. Under the JPA's state-issued franchises, the use of PEG money is now restricted to capital costs. Staff agrees to develop and implement criteria for the use of PEG fees to ensure compliance with the federal Cable Act, and to set fees at a level that is consistent with future capital needs.

The audit also raises an important policy question about the ongoing value of PEG channels in our community and the desire to invest in and maintain the current model for the provision of local community media. This is primarily a policy consideration for the Council to consider. Staff will assist Council as requested, in particular with respect to potential operating cost subsidies.

My office has reviewed the audit, provided the responses and will work with the other JPA members to address the audit findings. Staff will report progress on implementation six months after the Council accepts the audit report, and every six months thereafter until all recommendations have been addressed.

AMES KEENE

The City Manager has agreed to take the following actions in response to the audit recommendations in this report. The City Manager will report progress on implementation six months after the Council accepts the audit report, and every six months thereafter until all recommendations have been implemented.

Recommendation	Responsible	Agree, Partially Agree, or Do Not Agree	Status
	Department(s)	and Target Date and Corrective Action	
		Plan	
Finding 1: The Media Center did not restrict in	ts use of \$340,000	of annual PEG fees to capital expenditures a	s required by the federal Cable Act.
We recommend that the City Manager's Office:			
 1.1 Consult with ASD, IT, the City Attorney's Office, and Cable Joint Powers members to assess the need to continue collecting PEG fees and adjust the fee based on a demonstrated need for future capital expenses related to PEG access facilities or discontinue collecting the fee. a. If it is determined that the PEG fee should be adjusted or discontinued, submit a staff report to the City Council with a recommendation to amend the Municipal Code to reflect the revised fee or to eliminate the requirement and recommend to the other Cable Joint Powers members that they do the same. b. If it is determined that the PEG fee should continue to be collected: Amend the agreement with the Media Center to remove the requirement for the City to remit all PEG fees collected to the Media Center. Coordinate with ASD, the City Attorney's Office, and the Cable Joint Powers to develop and implement criteria for the use of PEG fees to ensure compliance with the federal Cable Act, and that the fees are set at a level appropriate for anticipated and necessary capital expenses. Place the PEG fees in a restricted account and distribute them based on Cityapproved capital expenditures that meet federal Cable Act requirements. 	City Manager's Office, ASD, IT, City Attorney's Office	Concurrence: Agree Target Date: 2017 Action Plan: Staff agrees that it should confirm the ongoing need for the PEG fee and ensure it is set at a level that is consistent with future capital needs. Staff will work with the City Attorney's Office to develop a "capital cost" definition that eliminates any cost categories that could be construed as operating costs and will restrict the use of PEG fees to expenditures that meet this definition. Staff will also develop and adopt procedures that define the PEG fee distribution and reporting process. Staff will propose the appropriate revisions to the Municipal Code if it is determined that the PEG fee should be modified in any way.	

Recommendation	Responsible	Agree, Partially Agree, or Do Not Agree	Status
	Department(s)	and Target Date and Corrective Action	
		Plan	
of expenditures be provided and adopt procedures to review the documentation to ensure that PEG fees are spent only as allowed by the federal Cable Act and take immediate corrective action as necessary.			
1.2 Consult with ASD, IT, the City Attorney's Office, and the Cable Joint Powers on whether to	City Manager's Office, ASD, IT, City	Concurrence: Agree	
allocate a portion of the unrestricted franchise	Attorney's Office	Target Date: 2017 Action Plan:	
fees or other funds, instead of restricted-use PEG fees, to subsidize the Media Center's operations or to discontinue subsidizing the Media Center's operations. Based on the resulting recommendation, the City Manager's Office should make recommendations to the Council regarding appropriate future funding, if any, for the Media Center.		Staff will consult with the Cable Joint Powers to determine if there is any interest in subsidizing the Media Center's operations. Staff will propose recommendations to the City Council if needed.	
Finding 2: Comcast and AT&T did not remit the	ne full amount of fr	anchise and PEG fees due.	
We recommend that the City Manager's Office, in coor	dination with ASD, IT, a	nd the City Attorney's Office:	
2.1 Send a letter to AT&T and Comcast describing the	City Manager, ASD,	Concurrence: Agree	
results of the audit and demanding payment of the underpaid franchise and PEG fees shown in Exhibit 4, plus interest calculated in accordance with DIVCA requirements.	IT, City Attorney's Office	Target Date: 4Q 2016 Action Plan: Staff will draft a letter to Comcast/AT&T demanding payment of the underpaid franchise and PEG fees, plus interest (and audit costs in the case of AT&T). Staff will work with Comcast/AT&T to correct their address databases so that future payments are properly remitted and will develop criteria to assess the accuracy of future payments. Staff will work with San Mateo and Santa Clara Counties to adjust their PEG fee rates as needed.	
2.2 Include in AT&T's letter a demand for payment of the audit costs that are attributable to AT&T.			
2.3 Work with Comcast and AT&T to develop methods to ensure:			

Recommendation	Responsible Department(s)	Agree, Partially Agree, or Do Not Agree and Target Date and Corrective Action Plan	Status			
 Their address databases accurately reflect all potential service addresses within the Cable Joint Powers geographic areas. They have a separate billing code for each member jurisdiction and accurately report and remit payments to the City of Palo Alto based on those billing codes. 						
 2.4 Develop criteria for assessing the accuracy of future Comcast and AT&T franchise and PEG fee payments on an ongoing basis and: Communicate the criteria to Comcast and AT&T and that it will be used to review the accuracy of future payments. Require Comcast and AT&T to report the breakdown of their fees in more detail, including identifying what is and is not included in the gross revenues used to calculate the fees and the reason for any exclusions. Review the franchise and PEG fee payments to ensure that they were calculated on all revenues that are subject to franchise and PEG fees and promptly follow up with Comcast and AT&T regarding any discrepancies. 						
2.5 Request that San Mateo and Santa Clara Counties revise their municipal codes to reflect only a single adopted rate to accommodate the cable companies' billing system capabilities, if the PEG fee continues to be collected (see Recommendation 1.1).						
Finding 3: Roles and responsibilities for managing the City's cable communications program are not clearly defined or assigned.						
We recommend that the City Clerk and City Manager's						
3.1. Confer and develop a recommendation for the City Council to assign responsibility for the City's cable communications program and require the	City Manager's Office, City Clerk	Concurrence: Agree Target Date: 4Q 2016				

Recommendation	Responsible Department(s)	Agree, Partially Agree, or Do Not Agree and Target Date and Corrective Action Plan	Status
 assigned department to provide appropriate program oversight to ensure that: a. The City's cable communications program objectives are aligned with the City's goals and objectives. b. The assigned department develops performance measures to demonstrate that the program is effective and is meeting the City's goals and objectives. c. There is effective oversight and management of the cable coordinator's contract and activities. 		Action Plan: Staff will determine where to assign responsibility for the City's cable communications program/activities and propose the appropriate revisions to the Municipal Code. The responsible department will establish performance measures to ensure proper program administration and oversight.	
3.2. Submit a draft ordinance to the Palo Alto City Council recommending revisions to the Palo Alto Municipal Code based on the revised assignment of roles and responsibilities.			

APPENDIX 2 – Media Center's Response



Annie Folger, Executive Director annie@midpenmedia,org 650-494-8686 x-17 900 San Antonio Rd. Palo Alto, CA 94303 www.midpenmedia.org

Date: 3/24/16

To: Office of the City Auditor

RE: Response to City of Palo Alto Cable Franchise and PEG Fee Audit

A. Overview of Comments

The Midpeninsula Community Media Center (Media Center) believes that the audit report, at least as it relates to the use of the PEG fees paid by cable operators as annually reviewed by the Joint Powers. Authority, does not accurately reflect what has occurred in the past or correctly describe applicable law. It misrepresents the accounting system actually used by the Media Center, and misinterprets documents provided to the auditor, as explained in Appendix A to these comments. Worse, it implies motivations on the part of Media Center, or negligence on the part of the members of the JPA, even though there is no indication the auditor did the sort of review of internal documentation required to support those implications. Indeed, the report seems to depart from the objectivity required of an auditor by selectively using information supportive of conclusions the report draws and ignoring readily-available contrary data. For example, the report relies primarily on a study by a far-right Michigan think tank funded by the Koch brothers and their allies to make recommendations as to how the City should proceed with respect to PEG (a) without providing information regarding other studies that call the report cited into substantial question, indicating the auditor did not undertake any reasonable investigation before drawing conclusions from the think tank study; and (b) apparently without utilizing the expertise of The Buske Group, or some other PEG expert to review the audit report's conclusions or to provide information relevant to them. As a result, the report unfortunately reads as an attack on public access masquerading as a financial document.

¹ The Buske Group was retained by the City in connection with the audit and is well-recognized as expert in the field of PEG access. While the report contains a disclaimer regarding The Buske Group's role in the audit discussed below, the disclaimer (footnote continued)

Our central disagreements are as follows:

B. Use of PEG Funds

We object to Finding 1: "The Media Center did not restrict its use of \$340,000 of annual PEG fees to capital expenditures <u>as required by the federal Cable Act</u>." The Media Center did not restrict use of PEG fees to purchases of capital facilities and equipment. However, the Cable Act does not restrict use of PEG fees to capital expenditures, as evidenced by (a) FCC decisions indicating that funds may be used for operating support, *e.g.*, at least with operator consent; and (b) the fact that the City itself entered into a franchise agreement, reviewed by the then City Attorney, that allowed PEG fees to be used for operating support (we understand that the franchise was negotiated by The Buske Group, which could have been asked for information about that negotiation, but apparently was not). While that franchise expired in 2010, the law the audit report refers to was identical at the time it was negotiated; if federal law absolutely prohibited use of PEG fees for operating support, that contract could not have been approved, and it is unlikely that the cable operator would have agreed to the condition. More detail regarding the use of the fee is addressed in the memorandum provided by the law firm of Best Best & Krieger (Appendix B).

We likewise object to the finding that the use of the PEG fees was "inappropriate." This finding seems to assume (incorrectly) that the particular uses by the Center were somehow violative of the Cable Act or of California law. In addition, however, the actual obligation of the access center with respect to use of the funds, from Section 15 of the agreement with the Joint Powers Authority is: "Media Center shall use the funds generated from the PEG Fee only in a manner consistent with DIVCA and the Cable Act, such that the PEG Fee shall not be construed to be a "franchise fee" within the meaning of the Cable Act, 47 U.S.C. § 542(g)." Not one penny of the amount paid to the Media Center has been treated as a franchise fee. Under California law, if there is a dispute as to PEG fees, "[a] court of competent jurisdiction shall have exclusive jurisdiction to enforce any requirement under this section or resolve any dispute regarding the requirements..." DIVCA, Section 5870(p). No court has "construed" the PEG payments to be franchise fees and no court has been asked to make that determination.

The finding also seems to assume, incorrectly, that the JPA and the City were unaware or unconcerned with how PEG funds were being used, and that the Media Center used the PEG fees for operations in order to maintain control of capital facilities to its advantage. As explained in Appendix A, this is not a factually supportable conclusion, and it is not even clear that the auditor examined the relevant documents before drawing these erroneous conclusions. The Media Center's two largest sources of funding are an investment fund that was created in connection with the transfer of the cable system from a cable cooperative to a private operator (now Comcast); and PEG fees paid pursuant to DIVCA. The investment fund could have been used for operating expenses and the PEG fees for capital expenses, but as shown by the materials attached in Appendix A, the City preferred the reverse. Consistent with that direction (which necessarily reflected City views as to permissible uses of PEG fees), the Media Center has used much (though not all) of the PEG fees received for operations and the investment fund for capital purposes. The budget for the Media Center has been presented to the JPA and the City each year; while the City and operators have therefore been familiar with the uses, no objection has been raised to that use.

does not explain why The Buske Group was not used in connection with the reliance on the think tank's report, or why other expertise was not sought out.

Finally, when the auditor writes of a violation of the Cable Act, what the auditor means is that the City's franchise fee is capped at an amount equal to 5% of operator gross revenues as defined in federal law. While a PEG fee that is used for capital purposes would not count against the cap, the auditor assumes that non-capital uses would count against the franchise fee, and would take the City over the 5% cap. But this also means that, even under the auditor's view of the law, if the City is collecting less than the 5% federal maximum, the PEG fees can be used for operating support without violating the law.

There are two cable operators that were audited – Comcast and AT&T. The audit of franchise fees did not examine how much either of the operators would have owed under the federal franchise fee definition – the audit only looked at fees owed under DIVCA. To know what would have been owed under federal law, the auditor would have had to examine, among other things how the companies treated revenues from bundled services, which may be treated differently under state and federal gross revenues definitions. Likewise, the audit report would have had to examine the treatment of revenues collected and used to pay PEG fees. That does not appear to have been examined. The auditor would have needed to examine credits taken against franchise fees by AT&T during the audit period for refunds to customers and for other promotional purposes. It does not appear that this was done. Without fully examining what could have been owed under federal law, conclusions as to the fund usage - even if otherwise correct - are simply incomplete.

The Media Center has in fact expended significant capital funds in recent years from the investment fund – enough in the last three years, for example, to equal or exceed amounts spent on operating funds. Setting aside the other flaws in the report, in many respects the conclusions are not a matter of propriety or impropriety, but of accounting for those items through the two funds in a manner with which the City and JPA would be comfortable. The Media Center has already adopted a change in its treatment of funds that would address this issue, based on its understandings of the City's concerns. While the City cannot directly control the Media Center except in a manner consistent with its 501(c)(3) status, it is fair for the City and JPA to review the policies to determine whether they are consistent with accepted accounting principles. We believe that they are, although that need not be decided now.

Media Center therefore believes that more accurate conclusions to which it would not object would be as follows:

- There remains a significant legal question as to how PEG fees may be used in California.
- Without drawing any conclusions as to past practices, or dismissing any rights the City could assert if use of PEG funds was contested, a prudent course from the City's perspective is to dedicate the PEG fees to capital uses, absent a change in law, or some other agreement that City and JPA find acceptable.

An appropriate recommendation would be to direct the City Manager to work with the Media Center through the JPA to comment upon and review the implementation of the Media Center's new PEG policies restricting PEG fee use to capital expenses.

C. Recommendations Regarding PEG Funding

The auditor's report recommends that the City "[a]ssess the need for the City to continue collecting PEG fees, adjust the fee, or discontinue collecting the fee based on the need for future capital expenses related to PEG access facilities."

This recommendation is based on at least two deeply flawed assumptions and factual errors.

The first is the assumption that there is a substantial question as to whether PEG is needed in the current digital environment, and that the "need" is properly assessed by examining viewership. The auditor, who claims no expertise in this area, relies primarily on a 2008 report by the Michigan-based Mackinac Center, which is funded by the Koch brothers, the Bradley and Scaife foundations and other hard-right supporters of what some claim is an agenda to undermine public education, destroy unions, suppress minority voting and deny public access to communication media. Information on the Center and its activities is easily discovered through a simple web search, and it is rather striking that the City was not advised of the potential cloud surrounding the key study cited by the auditor, and which the City has now been asked to endorse.

A central premise the auditor appears to accept is that sources of online digital content, such as YouTube, are equivalent to, and a substitute for, PEG channels. They are not: they are complementary. In the JPA area, for example, the existence of a PEG channel and PEG equipment allows producers to create programming that can be distributed via cable, but then also distributed via other digital media, including public access center websites and YouTube. The PEG funding thus provides resources that allow citizens who would otherwise be unable to produce quality programming to develop free speech content that is then available across platforms – and allows those who rely on television as the main source of information to obtain community specific information through that medium.

Indeed, a more recent study by researchers at the University of Texas in Austin, also readily available on the Internet, concluded that PEG channels retain their importance, and are of particular importance to minorities and to segments of a community with lower income. What the report implicitly finds is that the value of PEG is measured not just by viewership, but by participation in the process of creating the programming, and its contribution to creation of social capital and civic engagement. The absence of any mention of contrary reports, as well as the failure of the auditor to test the report by speaking with an acknowledged PEG expert such as The Buske Group is troubling, not just because it affects whether an analysis of PEG funding is required, but also because it fails to come to grips with factors that would need to be considered in conducting that analysis.

Separately, the auditor did not have or seek information regarding the future capital needs for PEG, nor did the auditor take into account the existing assets that, based on the auditor's own report, ought to be somehow transferred to the control of the JPA. That is an issue the Media Center has been seeking to address through various proposals to obtain credit for its past expenditures of its own investment funds on its facilities and equipment, and would affect long-term capital requirements for the PEG fee. Finally, the auditor assumed that there could never be an arrangement under which PEG fees could be used for

² For a discussion of the Mackinac Center (admittedly from an opposition point of view), see the following: http://meamatters.com/2016/01/13/how-the-kochs-use-the-mackinac-center/ http://www.progressmichigan.org/2013/11/mackinac-center-exposed-whos-running-michigan/ http://www.motherjones.com/politics/2011/12/michigan-privatize-public-education. The audit report also relies on a City survey that contained two questions on viewership of public meetings of just Palo Alto, not the whole JPA area, and a Congressional study showing many access centers have closed for lack of funding. Neither is sufficient to support the recommendations made in the audit report.

³ A summary of the conclusions can be found at: http://www.academia.edu/4489694/_2013_Still_Relevant_An_Audience_Analysis_of_Public_and_Government_Access_Channels.

⁴ https://www.americanpressinstitute.org/publications/reports/survey-research/how-americans-get-news/

operations, an assumption that is incorrect, but that could be an appropriate matter for the City to consider.

The Media Center wholeheartedly favors periodic review of the value PEG brings to the community, but any such analysis needs to look to factors other than viewership alone. Absent an assessment of PEG value, it is premature to decide whether or not PEG funding should be adjusted.

Likewise, the amount of funding required for the future can only be determined after the accounting issues raised by Media Center's new policies have been reviewed. Other recommendations should await that review.

Other comments are italicized and in blue in the annotated copy of the report, which follows.

Annotated Draft Audit Report dated April 12, 2016.

PURPOSE OF THE AUDIT:

The audit objectives were to determine whether and to what degree, from July 1, 2010, through June 30, 2014:

- The City of Palo Alto accurately accounted for its receipt of franchise and public, education, and government (PEG) fees and met its oversight responsibilities regarding the Media Center's use of PEG access fees.
- Comcast and AT&T collected and promptly remitted the appropriate amount of franchise and PEG fees.
- The City established and sufficiently defined roles and responsibilities to administer its cable communications program and state franchises awarded to Comcast and AT&T.

Recommendations with respect to assessing the future need for PEG, or the value of PEG are beyond the defined scope of the audit.

REPORT HIGHLIGHTS

Finding 1: The Media Center did not restrict its use of \$340,000 of annual PEG fees to capital expenditures as required by the federal Cable Act (Page 8) The Media Center inappropriately used an annual average of \$340,000 of public, education, and government (PEG) fees, or \$1.4 million during the audit period, paid by cable television subscribers in the Cable Joint Powers areas, for operating expenses. Neither the City nor the Media Center enforced the federal law that restricts the use of PEG fees to capital expenses associated with PEG access facilities.

See Overview above and BB&K legal analysis (Appendix B). In addition, the report is unclear as to what is meant when it is said that the City or Media Center has responsibility for "enforcing" the federal law. Neither the "Media Center" nor "City" is responsible for enforcing federal law restrictions, or given the authority to unilaterally determine what the law means in a particular instance. Under DIVCA, claims that funds have been misused should be brought in a court of competent jurisdiction. The FCC or a court would likewise be the entity responsible for determining how the restrictions on PEG apply in particular cases.

Key Recommendations to the City Manager's Office:

 Assess the need for the City to continue collecting PEG fees, adjust the fee, or discontinue collecting the fee based on the need for future capital expenses related to PEG access facilities.

See Overview above - premature.

 Coordinate with the other JPA jurisdictions regarding potential amendments to their municipal codes based on adjustments made to the PEG fee requirement.

See Overview above - premature.

 If the PEG fee is retained, establish criteria for how PEG fees may be used and require documentation and review of expenditures to ensure compliance with the federal Cable Act.

Report fails to consider costs associated with this recommendation, if its intention is to require documentation in addition to that already existing. Further, it fails to consider the impact of an approval process on the Media Center given the delay that the approval process would introduce between the time funds are expended and the time that the Media Center would receive reimbursement for them. If a capital repair is required to the building, for example, delay could lead to significant operational issues. Given the capital expenditure policies adopted by the Media Center, it is not clear why this is necessary.

But in any case, this recommendation is unsupported by objective analysis. Auditor did not examine existing documentation in detail (because auditor did not request, and affirmatively chose not to examine, the Media Center's actual accounting for capital expenditures). See Appendix A.

 Determine whether to allocate a portion of the unrestricted franchise fees or other funds to subsidize the Media Center's operations.
 See Overview above – premature.

Finding 2: Comcast and AT&T did not remit the full amount of franchise and PEG fees due. (Page 14)

Comcast and AT&T did not always calculate the fees due in accordance with DIVCA and the municipal code of each of the Cable Joint Powers. As a result, Comcast underpaid about \$141,000 in franchise and PEG fees from July 1, 2010, through June 30, 2014, and AT&T underpaid about \$76,000 from July 1, 2011, through September 30, 2014.

AT&T's underpayments are estimated because it did not provide sufficient records for us to verify the accuracy of franchise and PEG fee payments. In addition, AT&T's underpayments are for all of Santa Clara and San Mateo Counties because it remitted fees collected from subscribers in the unincorporated county areas directly to the counties and could not provide the information needed to calculate the amounts due only to the Cable Joint Powers (see scope limitations section on page 5).

Comcast and AT&T will owe interest, calculated at the highest prime lending rate during the delinquency period plus 1 percent, on underpaid fees, as required by DIVCA. DIVCA also requires that AT&T pay the City for its portion of the audit costs because AT&T's underpayment exceeds 5 percent of the amount that it should have paid.

Key Recommendations to the City Manager's Office:

Send letters to AT&T and Comcast demanding payment of the underpaid

franchise and PEG fees, interest due, and for AT&T, its portion of the audit costs.

- Work with AT&T and Comcast to develop methods to ensure accuracy of their address databases and the basis for determining the revenues on which franchise and PEG fees should be calculated.
- Review franchise and PEG fee payments to ensure they were calculated based on the established criteria and promptly follow up on discrepancies.

Auditor did not examine amount that would have been owed had City collected full amount it could have collected if the federal franchise fee definition (as opposed to DIVCA definition) applied; in the absence of that analysis, any calculation of use of PEG fees is defective, even assuming auditor correctly analyzed the law.

Finding 3: Roles and responsibilities for managing the City's cable communications program are not clearly defined or assigned (Page 21) The City has not clearly assigned or defined roles and responsibilities for its cable communications program or effectively managed the program to ensure that funds are used appropriately and that program outcomes are consistent with the City's and residents' cable communications needs.

Key Recommendations to the City Manager's Office:

- Assign responsibility for the City's cable communications program and require the assigned department to provide appropriate program oversight.
- Submit a draft ordinance to the Palo Alto City Council recommending revisions to the Palo Alto Municipal Code based on the revised assignment of roles and responsibilities.

The Media Center has no comments on these recommendations.

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Cable Franchise and PEG Fee Audit

INTRODUCTION

Audit Objectives

The audit objectives were to determine whether and to what degree, from July 1, 2010, through June 30, 2014:

- The City of Palo Alto accurately accounted for its receipt of franchise and public, education, and government (PEG) fees and met its oversight responsibilities regarding the Media Center's use of public, education, and government PEG access fees.
- Comcast and AT&T collected and promptly remitted the appropriate amount of franchise and PEG fees.
- The City established and sufficiently defined roles and responsibilities to administer its cable communications program and state franchises awarded to Comcast and AT&T.

The recommendations regarding PEG funding for the future appear to exceed the scope of the audit.

Background Legal framework: franchise and PEG fees

The California Digital Infrastructure and Video Competition Act (DIVCA) of 2006 gives the California Public Utilities Commission sole authority to issue video and cable franchises to companies that provide such services within the state. DIVCA requires a franchise holder to pay a franchise fee of 5 percent of its gross revenues to each jurisdiction served, unless the jurisdiction adopts an ordinance that sets a lower fee, as rent or toll for using the public rights-of-way. DIVCA requires franchise holders to provide PEG access channels within each jurisdiction served, and jurisdictions may adopt an ordinance that establishes a fee to support PEG channel facilities. DIVCA limits the PEG fee to 1 percent of the franchise holder's gross revenues for entities that did not assess a PEG fee prior to December 31, 2006.

For a fuller discussion of DIVCA, see the BB&K analysis. In Palo Alto, a fee was being assessed prior to December 13, 2006, and so the fee in Palo Alto is not limited to 1% of a holder's gross revenues. Per Section 2.11 of the Palo Alto Administrative Code, the fee is set at \$0.88 per subscriber/month. The audit report should more clearly describe the rights of the communities to charge more than 1%.

The federal Cable Communications Policy Act of 1984 (Cable Act), 47 U.S.C. § 542, restricts the use of PEG fees to capital expenses associated with PEG access facilities when the fee is assessed in addition to a franchise fee, but allows paid advertising, underwriting, or sponsorships to fund PEG-related activities. Franchise holders may pass both the franchise and PEG fees on to

their cable subscribers.

As the BB&K analysis indicates, this is not correct and the City's own past practices are to the contrary. Even if one assumes that PEG fees were limited to capital, and the maximum 5% franchise fee as defined under federal law were being charged, the audit report does not examine whether the maximum fee permitted under federal law is being assessed. Typically, operators in California do pay less under DIVCA than could be paid if the maximum fee permitted under the Cable Act was being charged. See Appendix C, Letter from Ashpaugh & Sculco, CPAs, PLC.

As the BB&K report explains, the FCC has recently said that its rulings with respect to PEG operating funds do not apply in California or in other state franchising states, although the FCC did not make it clear what rule would apply. However, there is reason to believe the State could authorize fees that might not be permissible under a simple cable franchise, because DIVCA purports to grant rights that an operator would not have if the franchise were limited to the right to install a cable system to provide cable services, as would be the case with a Cable Act franchise.

DIVCA requires franchise holders to maintain records so the local entities can assess the accuracy of franchise and PEG fee payments.

We agree.

Joint Exercise of Powers Agreement The cities of Palo Alto, Menlo Park, and East Palo Alto; the Town of Atherton; and unincorporated portions of San Mateo and Santa Clara Counties created a Joint Powers Authority (JPA) in 1983 to obtain cable television service within these jurisdictions. The JPA members are known as the Cable Joint Powers. Two cable franchise holders, Comcast and AT&T, currently serve the Cable Joint Powers. Palo Alto administers and enforces the state franchises on behalf of the Cable Joint Powers through an agreement among the members. A working group comprised of Cable Joint Powers members considers cable and video service-related issues related to state franchises.

As explained in the BB&K report, the use of the term "enforce" could be misleading in the audit report.

JPA franchise and PEG fees

The Palo Alto Municipal Code (Municipal Code) requires each franchise holder to activate seven PEG access channels on its network. It sets the cable franchise fee at 5 percent of the franchise

holder's gross revenues and the PEG support fee at 88 cents per month per subscriber. The other Cable Joint Powers members have similar requirements, except Santa Clara County requires a PEG support fee that is the higher of 1 percent of gross revenues or 88 cents per subscriber, limited to 3 percent of gross revenues, and San Mateo County requires a PEG support fee that is the higher of 1 percent of gross revenues or 88 cents per subscriber.

No comment.

Roles and responsibilities

The Municipal Code defines roles and responsibilities for managing the City's cable communications program:

- The Office of the City Clerk is responsible for managing the City's cable communications program.
- The City Manager designates a cable coordinator to administer and provide oversight of state franchises in the City.
- The City may designate one or more entities, including itself, to control and manage the use of PEG access channels and any PEG facilities and equipment.

The City, through its Information Technology (IT) Department, contracts with an individual who serves as the City's cable coordinator to oversee and manage the cable communications program. This position was formerly managed in the Administrative Services Department (ASD) but was moved under the oversight of IT when IT became a separate department from ASD.

No comment.

Use of funds and financial reporting

Palo Alto distributes the franchise fees to each of the Cable Joint Powers based on the percentage of fees derived from Comcast's and AT&T's subscribers within each jurisdiction, after:

- Reimbursing Palo Alto for its costs to administer the state franchises, including the fees paid to the cable coordinator.
- · Paying the costs of regulatory and oversight functions.
- Paying for other cable- or video-related activities that benefit the area in which the revenue was generated.

No comment.

In 2001, the Palo Alto City Council designated the Midpeninsula Community Media Center, Inc., (Media Center) as the community access organization to meet the Cable Joint Powers' existing and future PEG access needs. The City's 2011 contract with the Media Center requires Palo Alto to remit all of the PEG fees it receives

from Comcast and AT&T on behalf of the Cable Joint Powers to the Media Center. The City separately contracts with the Media Center for cablecasting services, including broadcasting Palo Alto City council and committee meetings via cable television.

The Midpeninsula Access Corp. was established as an independent 501(c)(3) in 1985 and designated as the entity responsible for PEG in 1986. As part of the transaction that resulted in the transfer of the cable system from the Cable Co-op to TCI, and ultimately to Comcast, the Access Corp merged with Silicon Valley Community Communications Inc. (SVCC) and became the Media Center. The Media Center was redesignated as the entity responsible for managing PEG in 2001, and had two primary sources of funding: an investment fund that it received as part of the system sale and merger with SVCC; and the PEG funding provided under its contract with the JPA. As the BB&K report explains, the transfer to TCI was contingent on PEG funding being provided by the company that could be used for operating support.

Palo Alto currently receives about 50 percent of the allocated franchise fee revenues. Exhibit 1 shows the distribution of franchise fees to the Cable Joint Powers, and Exhibit 2 shows the total PEG fees received and remitted to the Media Center from July 1, 2010, through June 30, 2014.

No comment; table omitted.

Palo Alto established the Cable Fund as a restricted-use fund for nonrecurring cable-related revenue, such as settlements and grants. The fund is used to carry out specific actions required by the policy. The fund's balance was \$759,000, including about \$4,000 in interest receivable, as of June 30, 2014. In FY 2015, the City began using the Cable Fund to record franchise and PEG fee remittances from the cable companies and to allocate the fees to the Cable Joint Powers and the Media Center, respectively.

No comment.

Exhibit 3 summarizes the main components of the cable communications program, which generates \$2.1 million in revenues and incurs \$436,000 in expenditures annually for the Cable Joint Powers.

Our records show a small difference in PEG fee remittances [about \$2-3000 per year]. However, we do not believe that this discrepancy

is significant to the audit report. Table omitted.

Audit Scope

We assessed the City's oversight of its cable communications program and the use of franchise and PEG fee payments that Comcast and AT&T collected from cable subscribers in the Cable Joint Powers areas and remitted to Palo Alto from July 1, 2010, through June 30, 2014. We also reviewed Cable Fund activity from its inception in 2000. We did not review changes that the City made after the audit period for how it accounts for franchise and PEG fees and use of the Cable Fund.

To be clear: the audit did not review capital expenditures made by the Media Center, or plans for capital expenditures. Rather, it reviewed how the Media Center accounted for the \$0.88 per sub per month it received from the JPA through the City. The Media Center provided information for the audit report regarding the capital expenditures for 2014, but was not requested to provide other information on capital expenditures.

Scope Limitations

Despite repeated requests, AT&T did not provide all information needed to perform a complete review of the accuracy and completeness of the franchise and PEG fees it remitted to Palo Alto. As a result, The Buske Group sometimes estimated AT&T's underpayment of franchise and PEG fees based on common industry practices.

We intended our audit to cover four years, based on DIVCA's data retention provision, but AT&T only provided three years of data based on the DIVCA provision that requires claims for refunds or other corrections to be made within three years and 45 days of the end of the quarter for which compensation was remitted, or three years from the date of remittance, whichever is later. However, AT&T provided information for July through September 2014, which was not originally included in the audit period.

AT&T remitted fees collected from subscribers in unincorporated Santa Clara and San Mateo Counties directly to the counties and could not provide the information needed to calculate the amounts due for the unincorporated areas specific to the Cable Joint Powers. As a result, the audit report includes estimates of AT&T's franchise and PEG fee underpayments for all of Santa Clara and San Mateo Counties, including areas that are not in the Cable Joint Powers.

No comment.

Cable Franchise and PEG Fee Audit

Audit Methodology

To conduct this audit, we:

- Reviewed federal, state, and local regulations regarding collection and use of franchise and PEG fees.
 - The audit is not clear as to what was actually reviewed, and as the BB&K report suggests, the report appears to omit significant information bearing on fee use.
- Assessed the City's process to calculate and remit franchise and PEG fees to the Cable Joint Powers and the Media Center, respectively.
- Reviewed the City's and the Media Center's financial records to determine whether franchise and PEG fees were used appropriately.
 - The auditor did not conduct a complete review of the Media Center's financial records, including records for capital expenditures for relevant periods under DIVCA, although those records were offered. During those periods, capital expenditures have generally exceeded the amount collected through the \$0.88 PEG fee but was accounted for through the investment fund.
- Interviewed the cable coordinator and staff in the Office of the City Clerk, ASD, IT Department, and Media Center to assess operation and oversight of the state franchises and the City's cable communications program.
- Consulted with the City Attorney for legal advice regarding the federal Cable Act and DIVCA.
- Contracted with The Buske Group, a subject-matter expert, to obtain and review Comcast and AT&T records on our behalf to determine if they collected and promptly remitted the appropriate amount of franchise and PEG fees to the City.

While The Buske Group is acknowledged as a subject matter expert, and may have been involved in the development of the current franchise and DIVCA fee ordinance, it does not appear that The Buske Group was consulted in developing recommendations regarding PEG fees, or with respect to the use of the PEG fees, or that other PEG experts were consulted with respect to the PEG recommendations. In that sense, as we discuss below, we believe that the audit report fails to satisfy the standards for government auditing. See Appendix C.

We assessed the reliability of the Comcast and AT&T data by interviewing our hired subject matter expert, who was knowledgeable about the data, and by comparing Comcast and AT&T address and fee allocation data with Cable Joint Powers members' address data to identify any miscoding that could result in payment misallocation. Except as noted in the Scope Limitations section above, we determined that the data were sufficiently reliable for the purposes of this report.

No comment.

Compliance with government auditing standards and independence impairment We conducted this performance audit of cable franchise and PEG fees in accordance with our FY 2014 and FY 2015 Annual Audit Work Plans and generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Except as noted in the Scope Limitations section above, we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We disagree that the audit was conducted in compliance with generally accepted government auditing standards (GAGAS).

GAGAS requires independence on the part of the auditor, including adherence to the principle of objectivity. See Appendix C.

.01 Objectivity and independence principle. A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.

.02 Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest, independence precludes relationships that may impair a member's objectivity in rendering attestation services.

Source: Code of Professional Conduct codified, 0.300.050, Objectivity and Independence. Copyright (c) 2015, American Institute of Certified Public Accountants, Inc. All Rights Reserved.

We believe that the audit report failed to examine relevant historical data and financial data. The auditor, apparently without the necessary expertise in PEG issues that would be required by GAGAS, relied on a report by a right-wing think tank to develop PEG recommendations. The audit report does not show that in evaluating PEG information, or making recommendations about PEG, professionals in the field who actually possessed relevant information were consulted.

The government auditing standards require auditors to be free from external interference or influence that could compromise an auditor's professional judgment or create the appearance that the auditor's professional judgment may be compromised. Subsequent to our providing the Media Center with a copy of the draft audit report and discussing our finding regarding the Media Center's use of PEG fees, the Media Center commissioned Sue Buske, president of The Buske Group, to write a paper supporting the appropriateness of the Media Center's use of PEG fees for what we identified as operating expenses. When Ms. Buske wrote the opinion, which conflicts with our conclusions, she was under contract with our office to perform work for a separate audit objective unrelated to the use of PEG fees, although we had informed her of the nature of our work regarding the use of PEG fees. Prior to beginning her work for the Office of the City Auditor, Ms. Buske had signed an "independence statement" to confirm that she was not biased (i.e., political, ideological, social, or other convictions that might impair her independence related to the subject matter of the audit) and that she would immediately notify the City Auditor regarding any new threats to independence that occurred during the course of the audit or after the report is issued.

Ms. Buske did not notify the City Auditor as required by the independence statement. When we became aware of this situation and asked Ms. Buske about the opinion document, she referred us back to the Media Center. The Media Center indicated that they would rely on Ms. Buske's opinion when responding to our audit finding. Although Ms. Buske's work on the audit was limited to determining whether Comcast and AT&T had collected and promptly remitted the appropriate amount of franchise and PEG fees, we believe that Ms. Buske's opinion document and lack of notification to the City Auditor creates the appearance that the auditor's professional judgment may be compromised. To avoid an independence impairment, we relied on the research and legal advice that we had obtained during the audit and not on Ms. Buske's opinion document.

The last sentence implies that the audit report had taken advantage

of Ms. Buske's expertise until it was discovered she had prepared a paper regarding what may and what may not be treated as a capital expense under DIVCA. That is not the case. Based on our own earlier discussions with the auditor, the recommendations in the report with respect to the access center were largely fixed prior to the time the auditor became aware that the report mentioned had been prepared by The Buske Group. As far as we are aware, Ms. Buske was not consulted on that issue, and even more importantly, on the PEG recommendations before the audit report's conclusions were drawn.

In any case, the disclaimer appears to misunderstand the respects in which we believe Ms. Buske may have information relevant to an objective audit, or to drawing conclusions as to use of PEG funding. First, Ms. Buske was involved in the negotiation of the franchise that resulted in the transfer of the cable system to TCI and ultimately Comcast. She may have been able to shed light on the agreements under which PEG fees were permitted to be used for operating support; that history may affect, among other things, the continuing rights of the City to use the PEG fees for operating support. Likewise, Ms. Buske was involved in the efforts to amend DIVCA to allow PEG fees in California to be used to support PEG. Factually, that discussion may have been relevant in assessing the rights of the City. Finally, Ms. Buske is in a position to shed light on the practices of other communities, which may be useful in assessing whether (as the report suggests) there is only one way to interpret the federal law requirements. If the auditor felt that Ms. Buske was not an appropriate source for this information, the information could have been sought from other sources. The audit report's failure to seek out this factual information may itself require a disclaimer. The Media Center obviously does not rely on Ms. Buske for legal conclusions. In fact, the Media Center did not adopt the recommendations of Ms. Buske with respect to the classification of capital expenses, and is not relying on her report to the Media Center for purposes of this response.

In addition, the audit report goes on to discuss the capital requirements for PEG and the value of PEG. In this area, Ms. Buske is an acknowledged expert, and as far as we can determine, the auditor has no similar experience or expertise. Yet the audit report appears to have been prepared without the benefit of Ms. Buske's expertise (or the expertise of an alternative PEG expert), and without any discussion of either (a) limitations on the auditor's

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experience in the field; or (b) any indication that an analysis of literature was conducted sufficient to draw any conclusions (although at the beginning of the report, the report mentions the importance of examining relevant information). The reliance on the Mackinac Center report, the failure to even mention readily available contrary information cited in the overview, and the failure to seek out necessary expertise calls into question the objectivity of the report under applicable government accounting guidelines, some of which are cited in Appendices B and C.

Finding 1

The Media Center did not restrict its use of \$340,000 of annual PEG fees to capital expenditures as required by the federal Cable Act.

The Media Center inappropriately used an annual average of \$340,000 of public, education, and government (PEG) fees, or \$1.4 million during the audit period, paid by cable television subscribers in the Cable Joint Powers areas, for operating expenses. Neither the City nor the Media Center enforced the federal law that restricts the use of PEG fees to capital expenses associated with PEG access facilities.

See BB&K analysis. This conclusion is not correct. It is not clear what the audit report means by the statement that neither the City nor the Media Center "enforced the federal law." Neither is in a position to decide definitively what the federal law means, neither is required to seek a determination, and both had a significant basis

Because the Media Center's fiscal years run from January 1 through December 31, we were able to review its financial records only through December 31, 2013, although our audit period ran through June 30, 2014. The differences in timing do not affect the issues cited in our findings, although the dollar amounts may differ. This conclusion is misleading. First, the conclusions with respect to 2010-2013 fail to take into account who may bring claims that PEG fees have been overpaid, and when those claims must be brought; timing is important to the conclusion of the report. Under DIVCA, only a video service provider has authority to bring a claim that it has overpaid franchise fees, and the claim must be made within 3 years and 45 days of remittance, or three years from the date payment was due, whichever is later. In this case, it has been more than 3 years and 45 days since the payment of the franchise fees and PEG fees due through December 31, 2013. The audit report does not state that there has been any claim that, as a result of the use of PEG fees, the video service providers overpaid franchise fees for the relevant period. There should therefore be no basis on which the companies could now "construe" the PEG fees to be a franchise fees, and therefore, no basis for concluding that the use of the fees was inappropriate for the period examined. Second, for later periods, there have been significant capital expenditures.

⁶ The Media Center's accounting policies in use during the audit period say that it capitalizes the aggregate cost of assets over \$1,500 and expenses maintenance and repair costs as incurred. A 2008 federal appellate court decision ruled that Congress intended "capital costs associated with the construction of PEG access facilities" to refer to channel capacity designated for PEG use, as well as for facilities and equipment, including vans, studios, cameras, or other equipment, related to the use of PEG channel capacity. This is not correct. The Media Center has capitalized the aggregate costs of individual assets over \$1,500, and capitalizes certain repairs costing more than \$1,500 that qualify as capital expenditures under standard accounting procedures.

for concluding that the use of the Comcast fees, which was consistent with uses approved by the City and consented to by Comcast or its predecessors, was proper. Because AT&T contends it is not a cable operator, neither the City or the Media Center is in a position to decide what AT&T's rights are with respect to franchise fees without a determination as to AT&T's status. Neither has an obligation to enforce the federal law by seeking a determination of the status.

As a correction, the average PEG fee was actually \$342,000 per annum for the audit period.

\$1.4 million of PEG fees used for operating expenses did not comply with federal law From July 1, 2010, through June 30, 2014, Comcast and AT&T collected \$1.4 million in PEG fees from cable television subscribers in the Cable Joint Powers areas.

It is not clear from the facts stated that this is the amount collected, versus the amount remitted. Comcast as a matter of course collects fee amounts through the bills that are not necessarily identical to (and may vary substantially from) the amounts paid to the City. The same is true for AT&T. In many California cities (we know of no exceptions), AT&T made adjustments to PEG fees to reflect credits and discounts provided to customers to bundled services that could have affected the accuracy of this statement with respect to collections.

They remitted the fees to the City of Palo Alto, which gave them to the Media Center, as required by the written agreement with the Media Center. To the extent that the Media Center used the fees for operating expenses, the expenditures did not comply with the federal law that restricts the use of PEG fees to capital expenditures for PEG access facilities. Federal law does not restrict the use of franchise fees, but does restrict the use of PEG fees to capital expenses for PEG access facilities. Because the Cable Joint Powers impose a PEG support fee, the PEG fee must be used only for capital expenses associated with PEG access facilities.

We disagree with this conclusion, which, if accurate, would have applied to the 2001 franchise agreement approved by the City Attorney. See BB&K analysis.

Media Center's records support that PEG fees were allocated to operating expenses Media Center staff provided detailed financial records showing that it allocated PEG fees to operating expenses, including salaries and benefits, professional services, janitorial services, maintenance, outreach, and insurance:

- In calendar year 2013, \$340,000 in PEG funds comprised more than 40 percent of the Media Center's operating revenue.
- From calendar year 2010 through 2013, the Media Center had only \$161,563 in capital expenditures associated with its PEG program, including website redesign, a cablecasting system, computers, software, and camcorders. Although the Media Center received \$1.4 million in PEG fees during this period and had only \$161,563 in capital expenditures,⁷ it requested, and the City paid, an additional \$52,708 from the Cable Fund for a portion of the cost of a cablecasting system that the Media Center purchased.

The second bullet is not accurate. The audit report is based solely on a line from the Fixed Asset register that includes "additions to program equipment." It does not include all capital expenditures, or capital expenditures under federal law that are not classified as such by the Media Center under its "small equipment" purchases. Thus, for example, the audit report does not include facilities investments of \$68,047, or other capital expenditures. For the audit period, through December, 2013, the audit report fails to apply what the audit report considers to be the federal definition of capital to the full books of the Media Center. For 2014, all budgeted capital expenditures are reported (except for small equipment expenditures) and the total for that year is approximately \$427,000, and the same amount was budgeted for 2015.

The \$52,708 paid for a portion of the cablecasting system purchased by the Media Center and covers the allocated cost of the equipment required for the government channels. The reimbursement was consistent with the agreement of the parties. The implication from the use of the word "although" is that the Center should have covered that expense without compensation and that implication is not supported by the audit report, or any other citation. The allocation was consistent with the practices of the parties. This is one of several subtle statements that suggest a bias in the report or a basic misunderstanding of the relationship with the City that are inconsistent with sound accounting practices.

Finally, the audit report recognizes that capital expenses vary dramatically year to year, and the audit report does not reflect

⁷ We did not assess whether these capital expenditures were actually for items that were specific to PEG access facilities.

or examine the capital expenditures over the life of the JPA.

Media Center's capital plan does not show capital needs related to PEG access facilities The Media Center's August 2014 capital plan did not show planned capital expenditures through 2018 or plans to construct or expand PEG access facilities, but Media Center staff said that the Media Center Board had recently approved spending \$579,000 from the Media Center's "investment account" to provide high-definition broadcasting in its studios.

The statement is misleading. The spreadsheet that the Media
Center gave the auditors was captioned a "capital plan" because it
listed the center's fixed assets to date and was a template for
budgeting future expenses. It was an internal document that used
placeholders — "0.00"s in boxes rather than actual numbers — to
mark the years when capital spending was anticipated. The auditor
was informed of the nature of the document, but in the text has
chosen to confuse this document with a capital plan. A description
of how the Media Center accounts for, and obtains approval for,
capital expenditures is contained in Appendix A.

The studio update is a potentially qualifying capital expense for use of PEG fees, but the Media Center did not identify it as such.

It is not clear why a studio update should be identified as "potentially qualifying" on the documents that the auditor chose to review. The expenses would have been identified as capital expenses in the relevant materials presented to the Media Center Board, as described in Appendix A.

Media Center staff provided financial records in April 2015 showing that it had over \$427,000 in capital expenditures in calendar year 2014 and an equal amount budgeted for calendar year 2015 for its studio upgrade project. Although these may have qualified as an appropriate use of PEG fees under the federal Cable Act, the Media Center used its investment fund for these expenditures and used the PEG fees for operating expenses.

It is correct that the 2014 expenditures were allocated to the investment fund. This was consistent with the direction of the JPA, which since 2001 has indicated a preference for capital funding to first come from the investment fund, and the PEG fees to be used for operational funds. Copies of documents showing this preference are attached as part of Appendix A. These documents were not requested by the auditor, and a proffer of them was rejected by the auditor. This practice has been reflected in the budgets provided to

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the JPA for their review; the financial reports of the Media Center are public, and the usage has also been available to the franchise holders.

Agreement with the Media Center requires compliance with DIVCA and the federal Cable Act The agreement between the City of Palo Alto and the Media Center requires the Media Center to use PEG funds in a manner consistent with DIVCA and federal law. It specifically states that PEG fees shall not be construed to be a franchise fee within the meaning of the Cable Act, which allows the PEG fees to be used only for capital costs associated with PEG access facilities.

This combines a conclusion that is incorrect – that the fees may only be used for capital purposes – with the actual requirement in the agreement with the City, quoted in the BB&K report and paraphrased in a misleading way in the audit report. As the BB&K report indicates, we are unaware that any of the PEG fees have ever been "construed" to be a franchise fee, and the audit report does not actually examine that issue, even though, as explained in fn. 4, the time has passed for construing the PEG fees to be franchise fees.

The agreement requires the Media Center to provide the City with an annual plan and budget that lists the activities and programs for which it plans to use funds received from the City during the following fiscal year. Although the Media Center provided its annual plan and budget as required, the City's cable coordinator reviewed the plan based on the Media Center's incorrect definition of capital expenditures, which did not ensure that the Media Center used the PEG fees in compliance with the Cable Act.

The basis for this claim is not explained. It implies that the Media Center was classifying or claiming as capital expenses in its budget line items, items that were in fact operating expenses. This is not the case, as explained in Appendix A. In addition, the audit report clearly stated that no analysis was made of capital expenditures of the Media Center since that was not in the scope of the audit.

The agreement also states that equipment or facilities purchased with PEG fees or City funds belong to the City upon termination of the agreement or dissolution of the Media Center. To the extent that the Media Center used the PEG fees for operating expenses instead of tangible capital expenses, there is less equipment or facilities in the Media Center's possession for potential transfer to the City upon termination of the agreement.

The current arrangement with respect to which fund capital expenditures are attributed reflects a policy preference of the City

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of Palo Alto reflected in the documents attached in Appendix A. It is an odd inclusion given the scope of the audit, and appears designed to suggest a sort of impropriety or scheme in the choice of funding sources used by the Media Center. However, members of the Media Center, although clearly familiar with the reason for the use of the funds, were never interviewed about that use, and the auditor appears to have written the statement without interviewing all relevant people, or seeking to review all relevant documents (the Media Center was not asked to produce documents related to the choice of funds, for example).

In any case, the choice had the effect of significantly reducing the investment fund available to the Media Center. The Media Center has been more than willing to effect a transfer of the assets to the City, which could be appropriately done by using PEG fees to pay for the assets; the payment would then restore the investment fund. This has already been proposed by the Media Center.

Some thought the Media Center was "grandfathered in" to use PEG fees for operating expenses A 2011 Congressional Research Service report said that more than 100 PEG access centers nationwide have closed due to restrictions on the use of PEG fees and the lack of other funding to support operating expenses. Despite the Media Center's acknowledgment of those closings, its executive director and the City's cable coordinator said they believed that the Media Center was "grandfathered in" under DIVCA to use the funds as they had under the City's prior local franchise agreements. However, neither DIVCA nor the City's agreement with the Media Center allow the PEG fees to be used in a manner other than as prescribed in the federal Cable Act, and DIVCA specifically requires that PEG fees only be used "as authorized under federal law."

We disagree for reasons stated in the BB&K analysis attached as Appendix B. As it explains, there are good reasons to believe that the City may be "grandfathered" by among other things, the voluntary agreements (reflected in documents and by practice) to allow use of PEG funds for operations. In addition, the last sentence of the paragraph above is not from the correct section of DIVCA. The City should be advised that the quoted language "as authorized..." is from Pub. Util. Code Section 5870(m), which addresses the allocation of "unsatisfied cash payments for the ongoing capital costs of PEG channel facilities" among incumbents and new operators between the time a new entrant's franchise is issued to the time the obligations of then-existing local franchises end. It is the next section, 5870 (n), which addresses the use of PEG

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Franchise fees, Cable Fund, or Media Center's investment account could have paid for Media Center operations fees required by the local ordinance. It is those fees that are the subject to the report. It is unclear why the report quotes the wrong section. As discussed in the BB&K analysis, the language of Section 5870(n) is different.

Instead of providing all of the PEG fees collected to the Media Center without knowing if there was a specific capital-expense need for the fees, the Cable Joint Powers could have used some of the franchise fees collected to support the Media Center's ongoing operations. It was not within the scope of our audit to review how the Cable Joint Powers members used their allocation of franchise fees, but the Media Center's financial statements do not show that it received franchise fees from any Cable Joint Power members.

No franchise fees were received by the Media Center.

The Cable Fund was another option for supporting the Media Center's operating costs related to PEG channels. The JPA's Cable Fund policy prioritizes support to the Media Center to operate the PEG channels, but the Cable Joint Powers did not allocate Cable Fund revenues to the Media Center for operating expenses. Doing so would have allowed the Media Center to reserve the PEG fees received for capital expenses associated with PEG access facilities and be compliant with the federal Cable Act.

Setting aside the reference to compliance with the Cable Act, which is a restatement of the incorrect conclusion about use of PEG fees, getting funding from the Cable Fund would not be a long-term solution. It is a limited fund with prior commitments.

A third option would have been for the Media Center to use its investment account for its operating expenses. The Media Center already uses this account to offset the portion of its annual operating expenses that exceed its revenues from PEG fees and other sources. The investment account, established through a charitable contribution received when the former Cable Co-op sold its principal assets to AT&T, had a balance of \$6.4 million as of December 31, 2014.

We agree this is a potential option, although the current JPA
Agreement reflects a preference for use of the investment fund for
facilities and equipment. This option is consistent with our
comments above, and inconsistent with some of the conclusions
above, which suggest that the operating/capital use was somehow
done to advantage the Media Center, or without the knowledge of

the members of the JPA.

Customer usage and satisfaction data for PEG channels not tracked Neither the City nor the Media Center collect customer usage and satisfaction data, such as frequency and duration of resident access to Media Center PEG channels, ease of access to PEG channels, and users' overall satisfaction with PEG channel programming and transmission quality. The Media Center provided us with a 2004 telephone survey, which showed that about one-third of all subscriber respondents had watched at least one Media Center channel and 70 percent of those viewers, or 23 percent of those surveyed, had watched a City Council or other public meeting - a lower than anticipated viewership. Consistent with these results, Palo Alto's National Citizen Survey™ show a declining trend in PEG channel viewership. In 2006, 31% of respondents reported that they had watched a meeting of local elected officials or other public meeting on cable television, the internet, or other media during the previous year compared to 16% in 2014.

This data is cited as a lead in to the next point, that this data may raise questions about the ongoing need for PEG channels. But to go from this point to that conclusion, the person interpreting the data would need to have some knowledge of overall television viewership patterns, as well as patterns with respect to public participation in meetings. The report does not claim to have the expertise to analyze the data and does not state that experts were consulted, even though expertise was readily available through The Buske Group, or other experts on PEG and viewership.

As it happens, there are many reasons to believe that viewership of the Media Center survey is comparable to viewership of other access centers like Austin, which suggests added significant social capital to the community. That study is cited in the Overview. An objective report would at least include readily accessible information comparing access viewership to viewership of commercial channels. Those studies also suggest the Media Center fares quite well. The Media Center's 2004 survey of the whole JPA area, not just Palo Alto, showed that:

- About 40% of all subscriber respondents are aware of the Media Center.
- About one-third of all subscriber respondents are "viewers"

Shttp://www.wisconsincommunitymedia.com/assets/docs/Library/viewership%20and%20peg%20access%20channels.pdf

- having watched programming on at least one of the Media Center channels. Almost 70% of these viewers have watched City Council or other public meetings.
- When viewers were asked to grade how well each of five statements described the services provided by the Media Center, the statements "programming that deals with local issues" and "provides a valuable community service" were both given grades of "A" or "B" by well over half of all viewers.
- Current viewers of Media Center channels appear to be "very interested" in watching public meetings and information on local community services, while non-viewers appear to be "very interested" in watching "educational programs" and "art & cultural programs."

The audit report points to declines in viewership based on the City's own surveys, but fails to note that general attendance at meetings is also down, and that viewership continues to exceed attendance: meaning that more people participate via the government channel than in person.

Concerns about ongoing usefulness of PEG channels

The above issues may raise questions about the ongoing need for PEG access channels, particularly because there have been significant changes in technology since the Cable Act and DIVCA were enacted, and other options are now available for residents to obtain local information and programming. A November 2008 Mackinac Center Policy Brief provided insights on the evolving state of PEG channels:9

The auditor does not appear to have the expertise to make such an evaluation absent reliance on outside expertise. As previously stated, the auditor had expertise of The Buske Group available but chose not to seek their advice. Aside from pointing to a report indicating access centers are closing, the outside "expertise" relied on is that of the Mackinac Center. (See the Overview for a discussion of the Mackinac Center.) The auditor describes no effort to check the reliability of the conclusions of a report from such a biased source. The distinction between the auditor's treatment of this report and the long discussion of Ms. Buske suggests either a bias or a lack of care that is inconsistent with GAGAS.

For a discussion of the continuing value of PEG channels in the

Theodore Bolema, Ph.D., J.D., An Evaluation of Legislative Proposals for Higher Cable Fees to Finance Public, Education and Government Access Channels (Mackinac Center Policy Brief, November 10, 2008), available at https://www.mackinac.org/archives/2008/2008-11REGfeesWEB.pdf

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pending appeal of the FCC's Reconsideration Order, see "Brief Amicus Curiae Of The Alliance For Community Media And The Alliance For Communications Democracy" filed March 4, 2016 in Montgomery County, Md. V. FCC, No. 08-3023 (6th Cir.), pp. 5-8. Excerpts from the brief are attached as Appendix D. The reports cited in the brief could have been sought out easily for the audit report. See also, the University of Texas study cited in the Overview.

- Only a small portion of cable subscribers actually watch the programming on PEG channels.
 - This observation requires the drafter (and anyone evaluating the drafter's statement) to have some understanding of what is a "small portion" of subscribers of cable channels in light of overall viewership patterns. Evaluation of the assertion likewise requires some understanding as to the significance of viewership for a hyper-local medium like access. The audit report simply recites the Mackinac Center's assertion without the critical analysis required before conclusions may be drawn from the assertion.
- PEG channels do offer some benefits today, including broadcasts of local government meetings, school concerts, sporting events, graduation ceremonies, and training opportunities for aspiring filmmakers.
 - See the University of Texas study cited in the Overview for an analysis of the benefits of PEG in Austin.
- The idea that PEG channels offer unique choices to viewers is outdated. Much of the programming and local information is available on the internet through websites such as YouTube and through e-mail groups, rendering PEG channels increasingly redundant.

Persons with experience in PEG recognize that the same arguments have been made for years. E-mail groups — one of the purported substitutes for PEG — have been available for almost 30 years (the 1984 Cable Act's legislative history notes the developing information landscape) — yet the information is repeated in the audit report as if it were reliable. As the Overview notes, PEG and online video streaming are complementary — and PEG facilities are actually used in the City to produce programming which is then cablecast via multiple platforms, much as most modern media communicate via multiple platforms. As noted in the Overview, television still remains the main source of public information, and studies from the University of Texas suggest the PEG platform remains

- relevant. The problem with the audit report is not that it raises questions about PEG it is that it purports to have a neutral basis for raising them, and to present well-considered recommendations for moving forward. The contrary is true. This is not a fair or objective analysis.
- There is no real evidence that cable subscribers want more PEG channels or that PEG cable channel viewing will significantly increase following the proposed increase in funding. We doubt this conclusion is accurate, but it is irrelevant to the recommendations made, as we are not proposing to add PEG channels, and merely proposing to maintain funding. It is unclear why this is included.

Recommendations

We recommend that the City Manager's Office:

- 1.1 Consult with ASD, IT, the City Attorney's Office, and Cable Joint Powers members to assess the need to continue collecting PEG fees and adjust the fee based on a demonstrated need for future capital expenses related to PEG access facilities or discontinue collecting the fee.
 - a. If it is determined that the PEG fee should be adjusted or discontinued, submit a staff report to the City Council with a recommendation to amend the Municipal Code to reflect the revised fee or to eliminate the requirement and recommend to the other Cable Joint Powers members that they do the same.
 - If it is determined that the PEG fee should continue to be collected:
 - Amend the agreement with the Media Center to remove the requirement for the City to remit all PEG fees collected to the Media Center.
 - Coordinate with ASD, the City Attorney's Office, and the Cable Joint Powers to develop and implement criteria for the use of PEG fees to ensure compliance with the federal Cable Act, and that the fees are set at a level appropriate for anticipated and necessary capital expenses.

...

¹⁰ This was in reference to proposed amendments to Michigan state law that would have removed several legal limitations on the amount of PEG fees that local governments could charge cable companies to finance local PEG channels. We note that this should have suggested that the report might be political in nature, and would have led a cautious reviewer to examine the sources of funding for the report.

- Place the PEG fees in a restricted account and distribute them based on City-approved capital expenditures that meet federal Cable Act requirements.
- Require that semi-annual documentation of expenditures be provided and adopt procedures to review the documentation to ensure that PEG fees are spent only as allowed by the federal Cable Act and take immediate corrective action as necessary.

As a general matter, these recommendations are based on a faulty legal conclusion, backed up by a Mackinac Center report. The recommendations should be flatly rejected, and replaced with the recommendations contained in the Overview.

1.2 Consult with ASD, IT, the City Attorney's Office, and the Cable Joint Powers on whether to allocate a portion of the unrestricted franchise fees or other funds, instead of restricted-use PEG fees, to subsidize the Media Center's operations or to discontinue subsidizing the Media Center's operations. Based on the resulting recommendation, the City Manager's Office should make recommendations to the Council regarding appropriate future funding, if any, for the Media Center.

See above.

Cable Franchise and PEG Fee Audit

Finding 2

Comcast and AT&T did not remit the full amount of franchise and PEG fees due.

Comcast and AT&T did not always calculate the fees due in accordance with DIVCA and the municipal code of each of the Cable Joint Powers. As a result, Comcast underpaid about \$141,000 in franchise and PEG fees from July 1, 2010, through June 30, 2014, and AT&T underpaid about \$76,000 from July 1, 2011, through September 30, 2014. 11

AT&T's underpayments are estimated because it did not provide sufficient records for us to verify the accuracy of franchise and PEG fee payments. In addition, AT&T's underpayments are for all of Santa Clara and San Mateo Counties because it remitted fees collected from subscribers in the unincorporated county areas directly to the counties and could not provide the information needed to calculate the amounts due only to the Cable Joint Powers (see scope limitations section on page 5).

Comcast and AT&T will owe interest, calculated at the highest prime lending rate during the delinquency period plus 1 percent, on underpaid fees, as required by DIVCA. DIVCA also requires that AT&T pay the City for its portion of the audit costs because AT&T's underpayment exceeds 5 percent of the amount that it should have paid.

As noted in the Overview, in order to determine whether the PEG fees plus the franchise fee exceeded 5%, the City would need to closely examine the fee that would have been paid applying the maximum fee permissible under the Cable Act, and the fee actually paid under DIVCA, as adjusted by the auditor report. For example, based on experience:

- The allocation of bundled revenues under DIVCA often fails to recognize funds that could be treated as revenues under the Cable Act.
- The treatment of PEG fees tends to exclude the amounts collected from subscribers to pay those fees from revenues, although those are gross revenues under federal law.

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¹¹ AT&T provided data for July 1, 2011, through September 30, 2014, based on the DIVCA requirement for local entities to make claims for underpayments within three years and 45 days of the end of the quarter for which compensation was remitted or three years from the remittance date, whichever is later.

 Launch fees (fees paid to cable operators to place programming on the system or at particular channel locations) are often not recognized as gross revenues under DIVCA, and can be substantial.

Without that analysis, it is difficult to draw any conclusions with respect to PEG fee/franchise fee issues.

We have no comments on the remainder of the report.

Appendix A Prepared by Annie Folger

Media Center Funding Process

The attached excerpts from the August 2001 Agreement of Merger and the October 1999 Vision for a New Community Media Center are parts of several documents that show that the City, along with the Cities of Atherton, East Palo Alto and Menlo Park and unincorporated parts of San Mateo and Santa Clara Counties, desired what is now the "investment fund" to be used for purchasing new facilities and equipment first, and for operations secondarily. Should the issue remain in doubt, there are other documents that could be reviewed including the Compromise and Settlement between the City and Cable Co-op, and the City/SVCC Agreement.

Because of this direction the Media Center was given in the above documents, PEG fees have always been primarily assigned for accounting purposes as if they came from the operational fund, although the actual expenditures of capital and operations over time would have effectively allowed those funds to be expended for capital under the definition of capital we have traditionally used for our books. There have been some expenses that could have been classified as capital but which have not been because of the Media Center's policy of expensing expenditures under \$1,500.

Each year, we provide our annual operating budget to the JPA for their review and comment, and to the Media Center Board for their approval. We submit a separate capital budget for known capital expenditures and, as in 2014, include that in the budget package. As in 2014, if we know that a significant capital expenditure may be made in the year, but the amount is not known (because we go through RFP processes for such purchases) we advise the JPA and the Board of that fact. This is also reflected in the attached documents. The Board must be later asked to approve any capital expenditures that are unanticipated, or that are based on RFP responses. In fact, in 2014, a substantial capital expenditure that was allocated to the investment fund was approved and made, as shown in the attached document.

As can be seen from the 2014 budget documents, the sum of the then-known capital expenditures and any net operating loss represents the total dollar amount requested from our Board through the normal budgeting process. See attached examples: 2014 Board Budget Presentation, Proposed 2014 Budget, and Media Center Studio Upgrade 2014-2015. All of the Media Center's annual financial statements are available on our website.

Contrary to the statement of the auditor, the materials that have been presented to the JPA (and to the City) as part of the annual operating budget have shown the total income resources, and total expenditures, and then included a line item showing the amount that would need to come from the investment fund (if any) to make up the difference. That is, it was very clear in every budget that the choice

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that was made at the outset for budgeting purposes – that capital would first come from the investment fund and operations first from the PEG fees and other revenue sources – was still continuing. This was known to the City, and would have been known to the franchised operators.

Documentation Provided to Auditor: Use of PEG Fees (attached)

We performed an exercise by taking the Media Center expenditures and overlaying them into the accounting structure of other Bay Area media centers to determine the following: If we were to use our PEG fees, rather than our investment fund, solely for "qualifying capital-related expenses" (as defined by other Bay Area media centers), would the total of those capital-related expenses equal or exceed PEG fees received?

This exercise revealed that there were more than enough qualifying capital-related expenses as defined by the other Bay Area media centers to equal or exceed the amount of PEG fees received (allowing for year-to-year fluctuations). This is not surprising since the definitions used in other communities classify some items as capital that we do not.

This was just an exercise, based on the definition of "capital" used by other communities in this area. We did not adopt that classification system for our own use. Our own definition of capital that we use is more conservative. In response to a request made in connection with the preparation of the audit report, we made this example available to the auditor. It was explained that this was not a document that was part of our budget approval process or a normal document used by the Media Center, but as stated, merely an exercise in applying the methodology used by other media centers. The audit report appears to misuse this document as our presentation of capital expenses and a reflection of our accounting system—something it was never intended to reflect. As far as we can tell, the audit report does not actually examine our accounting system in any detail.

Capital Policy

Since the merger of SVCC and MPAC and acquisition of the investment fund, it has been our policy to capitalize the aggregate total costs of individual assets of \$1,500 or more, and certain repairs costing more than \$1,500 that qualify as capital expenditures under standard accounting procedures (e.g. the total replacement of the lower roof in 2013). The threshold was lowered to \$100 effective January 2016.

Date: 3/24/16 Page 2

AGREEMENT OF MERGER

THIS AGREEMENT OF MERGER is made as of August 20, 2001, by and between SILICON VALLEY COMMUNITY COMMUNICATIONS, INC., a California nonprofit public benefit corporation ("SVCC"), and MID-PENINSULA ACCESS CORPORATION, a California nonprofit mutual benefit corporation ("MPAC").

RECITALS

- A. MPAC is a California nonprofit corporation organization exempt from income tax under Section 501(c)(3) of the United States Internal Revenue Code, as amended (the "Code"). MPAC's business is comprised of (a) promoting and facilitating open, nondiscriminatory community access to, and administering and managing the public access channels designated under the Cable Television Franchise Agreement effective as of July 24, 2000 between the City of Palo Alto on behalf of the Joint Powers (the "Joint Powers") and TCI Cablevision of California, Inc (as the same may form time to time be amended, modified, renewed, extended or replaced, the "Franchise Agreement") granted by the City of Palo Alto on behalf of the Joint Powers comprising the Cities of Palo Alto, East Palo Alto, Menlo Park, the Town of Atherton, and certain unincorporated parts of San Mateo and Santa Clara Counties as described in the Franchise Agreement (the "Service Area"), (b) administering and managing the institutional channels designated under the Franchise Agreement and (c) performing the functions of the Community Access Organization ("CAO") as so designated under and pursuant to the Franchise Agreement.
- B. SVCC is a California nonprofit corporation exempt from income tax under Section 501(c)(3) of the Code. SVCC's business is comprised of originating and producing local television programming focused on news, sports, people and events in the San Francisco Bay midpeninsula area centered on the Service Area (the "Midpeninsula Region"), including programming distributed over the access channels administered and managed by MPC.
- C. The parties wish to combine their resources into a single organization committed to expanding upon SVCC's and MPAC's current operations and to the establishment, development and promotion of a new community media center capitalizing on the convergence of community, media and technology in furtherance of and as envisioned and contemplated by the Vision for a Mid-Peninsula Community Media Center adopted and endorsed by the Boards of Directors of both SVCC and MPAC (the "Vision Statement"), a copy of which is attached as EXHIBIT A, by effecting the merger of SVCC with and into MPAC in accordance with this Agreement, the California General Corporation Law as it relates to mergers of non-profit corporations (including, without limitation, Section 6010 et seq. of the California Corporations Code) and the parties' respective organizational documents (the "Merger"), with MPAC being the surviving corporation and MPAC being the disappearing corporation.
- D. Immediately upon the Closing, MPAC shall be renamed Midpeninsula Community Media Center, Inc.

VISION FOR A NEW COMMUNITY MEDIA CENTER

Representatives of Cable Co-op and the Mid-Peninsula Access Corporation, contingent upon review of the available funding, have endorsed the creation of a new community media center, which would eventually replace MPAC and Cable Co-op as they are currently structured.

A new non-profit corporation would serve those who live or work in Atherton, East Palo Alto, Palo Alto, Menlo Park, Stanford, and unincorporated parts of San Mateo county. The Center will be housed in a new facility and will provide a variety of services to address the following goals:

- Create and maintain a facility available to all members of the community at which
 people have access to resources that enable and enhance communication and
 expression.
- Generate and maintain a public forum that promotes civic engagement, diversity awareness, a venue for arts and a forum for many voices, adhering to the guarantees of the First Amendment.
- Produce quality programming of particular local interest, some of which will be produced by center staff and some by individuals and groups assisted by center staff.
- Enhance access to government and the political process for all members of the community and enhance dialogue between government and members of the public.
- Provide accessible and affordable training for community members in media production including but not limited to video, radio and website content.
- Collaborate with schools, local government, non-profits, and local arts organizations to produce and disseminate community communications.
- Use any number of media, as resources allow, to accomplish the above goals.

The board governing the new nonprofit corporation would include representatives from each Mid-peninsula community to ensure that all perspectives are represented and that the center remains a truly community institution. The Board could also include additional elected members.

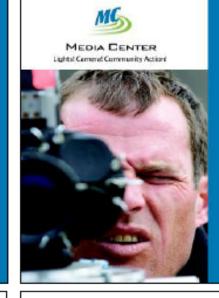
This statement was formally ratified by the Boards of Directors of both Cable Co-op and the Mid-Peninsula Access Corporation in October 1999.

Media Center 2014 Board Budget Presentation





2014 Proposed Budget



Presented to Board of Directors 12/02/13

2014 Budget Assumptions Income

- Continuation of programmatic activities
- Continuation of Gov contracts at current rate
- Conservative estimate for professional services
- New grants: \$45.6K
 - Greenlight Sponsors: \$2.3K Menlo Park: \$9.8K
 - Sports: \$10K
 TBD: \$20K
 - Elections LWV: \$3.5K
- Continuing grants from 2013: \$26.3K
 - Microsoft: \$3.8K
 - Made Into America: \$22.5K
- In-kind contributions: \$40K Legal



2014 Budget Assumptions Expenses

- Salaries
 - No cost of living increase
 - Small health cost increase
 - 6 full time employees
- No Review
 - Review was performed in 2013 for 2012
- Expenses
 - No funds for January 2015 youth event
 - Decrease of \$25.5K from 2013 budget
 - Salaries and salary costs down by \$9.5K
 - Non-capital equipment \$6.5K, \$15.4K less than 2013 budget
 - Operating Supplies increase props and sets budget \$3.5K



Media Center 2014 Board Budget Presentation

Funding Sources (variance from 2013 forecast)

PEG fees: \$340K (\$0K)

Government contracts: \$186.1K (\$4.2K)

Misc. media services: \$67K (\$6.1K)

Members/donors/grants: \$79.4K (-\$8.7K)

In-kind contributions: \$40K (\$0K)

Classes & facility use: \$78.9K (\$3.9K)

Checking int/misc, sales: \$1.6K (\$0K)

Total: \$793K (\$5.5K)



Expenses (variance from 2013 forecast)

Salaries: \$567.2K (\$3.4K)

Salary costs/benefits: \$103.8K (\$6.1K)

Prof. services/in-kind legal: \$166.6K (\$12.2K)

Facility: \$49.5K (-\$2.3K)

Operating: \$23.5K (-\$4.5K)

Equipment: \$13.5K (-\$15.5K)

Advertising/outreach: \$5.5K (\$1.2K)

Insurance/vehicle: \$23.3K (\$2.2K)

Conferences/training/hosp: \$10.9K (\$1.1K)

Total: \$963.8K (\$3.9K)



Proposed Budget vs 2013

	2014 Proposed Budget	2013 Budget		2014 Bud/ 2013 Bud Variance	
Income	793.0	817.2	787.6	-24.2	5.4
Expenses	963.8	989.3	960.0	-25.5	3.8
Net Op Inc/-Loss	-170.8	-172.1	-172.4	1.3	1.6
Investment Distribution	170.8	172.1	172.4	-1.3	-1.6
Net Inc/-Loss	0.0	0.0	0.0	0.0	0.0



Proposed 2014 Capital Expenditures

- Total New Capital Expenditures: \$51K
 - Cablecast system upgrades: \$21K*
 - * Alternative is \$7K/yr, for 4 years
 - Ceiling mounted A/C for server room: \$12.7K
 - Studio upgrade consulting integrator: \$8.8K
 - Computers: \$3.8K
 - Automated video file transcoding & transfer to cablecast: \$3K
 - Replace lobby TV display: \$1.7K
- Coming up in 2014
 - Major studio and control room upgrade
 - Replace aging phone system
 - IT file server infrastructure improvements



Cable Franchise and PEG Fee Audit

Attachment A 65

Media Center 2014 Board Budget Presentation

Request for Approval

 2014 Budget and 2014 Capital Budget, waiving policy for 2% investment distribution amount

Operating budget deficit: \$170.8KCapital budget amount: \$51.0K

Total Fund Request: \$221.8K



THANK YOU!

- The Staff joins me in expressing our heartfelt appreciation for your service on the Board this year and your generous contributions of your valuable time and talent.
- Special thanks to Barbara and the Executive and Finance Committees for their leadership.
- HAPPY HOLIDAYS TO YOU AND YOUR FAMILIES!



Media Center Proposed 2014 Budget

			Т		П		7			2014
								2014		Budget v
								Budget v		2013
	П		1	2013	Ш	2013		2013		YearEnd
	Ц	2014 Draft	4	Approved	Ц	YearEnd	4	Budget	Ц	Forecast
	Ц	Budget	4	Budget	Ц	Forecast	4	Variance	4	Variance
Operating Income and Expense	Н		4		Н		\dashv		\dashv	
Income	H		+		Н		\dashv		\dashv	
PEG Fees - JPA Contract	\$	340,000	4	340,000	Н	340,000	4	0	\dashv	0
Contracted Media Services	Ц	186,100	4	194,920	Ц	181,945	4	(8,820)	Ц	4,155
Misc. Media Services	Ц	67,000	╛	70,500	Ц	60,931	╛	(3,500)		6,069
Contrib/Memberships/Grants		79,400		93,550		88,086		(14,150)		(8,686)
In-kind Contributions		40,000		40,000		40,000	\Box	0		0
Class and Facility Use Fees		78,930		75,120		75,027		3,810		3,903
Misc. Inc. / Net DVD Sales		1,610		3,100		1,600		(1,490)		10
Total Income		793,040		817,190		787,589		(24,150)		5,451
Expenses					Ц					
Salaries	Ц	567,220	╛	575,790	Ц	563,811	╛	(8,570)		3,409
Salary Costs/Employee Benefits		103,840		104,810		97,757		(970)		6,083
Professional Svcs (includes in-kind)		166,600		167,750		154,381		(1,150)		12,220
Facility Expense	L	49,510	╛	52,350	Ц	51,791	╛	(2,840)		(2,281)
Operating Expenses & Supplies		23,480		19,980		27,982		3,500		(4,502)
Equipment Expenses		13,500		31,000		29,008		(17,500)		(15,508)
Advertising/PR/Outreach		5,480	Т	6,680		4,245	\Box	(1,200)		1,235
Insurance and Vehicle		23,330		20,990		21,150		2,340		2,180
Conference/Training/Hospitality		10,880		9,960		9,830		920		1,050
Total Expenses		963,840		989,310		959,955		(25,470)		3,885
Net Operating Income and Expenses		(170,800)		(172,120)		(172,366)		1,320		1,566
Distribution from Investments		170,800		172,120	Ц	172,366		(1,320)		(1,566)
Net, after Distribution from Investments	\$	0		0		0		0		0

Media Center Studio Upgrade 2014-2015

Facili	ties and	d Finan	ce Committe	ee Project Report		
HD Studio Conversion Project ¹				Floor Replacement ²	\$	12,313
Equipment		347,377		Contingency @10%	-	1.231
Tax (8.75%)		30.395		Contingency @ 10%	\vdash	1,231
Estimated Tax Savings (3.5%)		12.158			\vdash	
Installation materials		15,900		Video Server (HW&SW) + Tax 3	5	24,000
Labor		96,390		Contingency @ 10%	,	2,400
AV Integrator Subtotal	¢	477,904		Contingency @ 10%	\vdash	2,400
AV Integrator Subtotal	,	4//,504			\vdash	
Electrical contractor		1,000		Telephone System + Tax 4	5	8,893
Workstations & Software (4)		8.000		Contingency @10%	•	889
Misc Subtotal		9,000			-	
		2,000			\vdash	
Total Project	5	486,904		Networking Equipment + Tax 5	5	6,100
Contingency @7%	-	34.083		Contingency @10%	_	610
Total with Contingency	5	520,987		Toning and your	\vdash	
Total with Contangency	-	520,507			\vdash	
				All Projects Subtotal	\$	538,210
				Contingencies		39,214
				All Projects Total	\$	577,424
Notes:	Ь.			L	<u> </u>	
1. Only 1 bidder. Payments spread or	wer 4 mon	th period	with first 25% i	n November.	 	
2. Four (4) bids considered.					\vdash	
2. Tour (4) bius considered.					\vdash	
3. Cost reflects a 20% discounted					\Box	
demo system with 6 mos warranty.					l	
Next year, we will likely					l	
recommend the purchase of 3-year					l	
support agreement for \$8,000					l	
which would begin May 2015					l	
William Woods Segimmay 2025					_	
					\vdash	
4. Three (3) bids considered. Recomm	mended s	vstem is V	olP technology		\vdash	
(5)					\vdash	
5. The HD Studio Conversion, New						
Phone System, and Video Server					l	
necessitate an upgrade to our data						
network infrastructure. Cost						
reflects special pricing program for				l		
non-profits.						
- Parison					\vdash	
	-				\vdash	
				1		

Media Center Use of PEG Fees July 2010-October 2013

			2010		2011		2012		2013		2014
ΙI			Allocated To		Allocated To		Allocated To		Allocated To		Allocated To
ΙI		Jul - Dec 10	PEG PEG	Jan - Daniel	PEG	Jan - Dec 12	PEG	Jan. Dan 13	PEG	Jan - Oct 14	PEG PEG
ᆜ		Jul - Dec 10	PEG	Jan - Dec 11	PEG	Jan - Dec 12	PEG	Jan - Dec 13	PEG	Jan - Oct 14	PEG
_	ense	_		-	_	-	_	-	_	$\overline{}$	
Н	5501 · Salaries										
\vdash	5500 · Full-Time Salaries	134,006.50	74,000.00	389,155.34	74,000.00	386,289.06	74,000.00	389,233.57	74,000.00	327,006.41	74,000.00
\vdash	5500-1 · Bonus Pool	0.00		0.00	_	20,700.00	_		_		_
\vdash	5520 - City Hall Video Operators	24,585.20	******	44,366.16		39,410.08	2 2 2 2 2 2	42,130.10		37,183.66	4 222 22
\vdash	5545 · Programming	22,745.67 x	22,746.00	3,152.28	x 3,152.00	2,642.67	2,643.00	2,584.40	2,584.00	1,803.40	1,803.00
\vdash	5530 - Equip Monitor/GovScroll	4,572.08 x	4,572.00	12,962.25	x 12,962.00	11,743.45	11,743.00	7,550.08	7,550.00	5,737.51	5,738.00
\vdash	5546 - Tiltrak	7,692.29 x	7,692.00	15,524.96	x 15,525.00	15,713.99	15,714.00	17,493.75	17,494.00	14,031.75	14,032.00
\vdash	5540 · Instructors	9,967.97		10,038.24	_	17,366.80	_	11,360.13	_	8,768.25	_
\vdash	5576 · Youth Interns			0.00	<u> </u>	373.28		360.00		0.00	
\vdash	5560 - Studio Techs	5,774.37 x	5,774.00	10,021.44	x 10,021.00	9,660.39	9,660.00	14,692.73	14,693.00	15,223.40	15,223.00
\vdash	5565 - PT Production Staff	13,547.99		40,923.62		27,254.35		29,885.70		26,087.07	
\vdash	5566 · Misc. Tech Support/IT	37,316.30 x	37,316.00	26,788.84	x 26,789.00	3,524.50	3,525.00	0.00	0.00	953.25	953.00
Н	5573 - Web/Index Staff	1,140.66 x	1,141.00	3,196.56	x 3,197.00	3,409.45	3,409.00	4,298.06	4,298.00	3,202.97	3,203.00
\vdash	5574 - Prof. Svcs. Coord.	9,526.71		19,808.47		17,875.80		21,365.00		23,121.13	
Н	5575 - Youth Svcs. Coord.	0.00		0.00	_	0.00	_	13,790.00	_	21,018.00	_
\rightarrow	Total 5501 - Salaries	270,875.74		575,938.16	_	555,963.82		554,743.52		484,136.80	
\vdash	3600 - Salary Costs/Employee Benefits		_	-	_	-	_	-	_	-	_
\vdash	3610 - CA Unemployment Insurance	856.42 x	484.00	5,634.96	x 1,425.00	5,810.82	1,261.00	5,098.46	1,109.00	5,043.78	1,198.00
Н	5620 · ETT	32.89 x	19.00	156.45	x 40.00	161.34	35.00	154.57	34.00	162.81	39.00
Н	5630 - FICA	20,593.75 x	11,650.00	44,233.68	x 11,186.00	42,491.33	9,224.00	42,414.73	9,222.00	37,031.12	8,793.00
ш	3640 - Workers Compensation	4,148.76 x	2,347.00	7,308.46	x 1,848.00	10,626.88	2,307.00	10,229.20	2,224.00	8,263.20	1,962.00
Н	5650 - Medical Benefits	17,595.78	9,717.00	38,706.41	7,360.00	42,168.38	8,078.00	39,858.83	7,578.00	33,231.97	7,520.00
Ш	5660 - Vacation	(1,142.61)		(2,796.52)	_	954.93	_	(1,179.61)		7,433.97	
$\overline{}$	Total 5600 - Salary Costs/Employee Benefits	42,084.99		93,243.44	_	102,213.68	_	96,576.18	_	91,166.85	_
Ш	3400 · Professional/Outside Services			-	_	-	_	-	_	$\overline{}$	
Ш	5456 · Instructors	2,400.00		200.00		4,012.50		9,218.75		9,660.50	
Ш	5410 · Legal Services	64,396.80		59,551.86		15,011.75		37,485.51		0.00	
Ш	5420 - Financial Services	23,418.75		42,150.00		40,575.00		40,908.61		25,593.75	
\vdash	5430 - Misc. Professional Services	29,746.70		56,750.03		60,922.17		67,603.42		80,745.99	-
\vdash	5433 - Support Services/Consulting	1,160.00 x	1,160.00	0.00	x 0.00	0.00 s	0.00	5,662.50	5,663.00	11,250.00	11,250.00
Н	5450 - Tech Support/Services	0.00 x	0.00	250.00	x 250.00	250.00 3	250.00	0.00	0.00	637.50	638.00
\rightarrow	Total 5400 · Professional/Outside Services	121,122.25		158,901.89	_	120,771.42	_	160,878.79	_	127,887.74	-
Н	5100 - Facility Expense				1	22.22.52	1	22.22.65			
$\vdash \vdash$	5115 - Utilities	14,516.40 x	14,516.00	31,525.77	x 31,526.00	33,369.29	33,369.00	30,981.65	30,982.00	26,058.95	26,059.00
$\vdash \vdash$	5120 - Facility/Maint. Supplies	1,060.03 x	1,060.00	2,138.42	x 2,138.00	2,484.48	2,484.00	2,050.92	2,051.00	2,385.75	2,386.00
$\vdash \vdash$	5122 - Building Security	644.28 x	644.00	1,320.72	x 1,321.00	1,386.60	1,387.00	1,458.32	1,458.00	1,536.62	1,537.00
\vdash	5123 - HVAC Main. Contract	1,592.00 x	1,592.00	2,157.50	x 2,158.00	2,012.00	2,012.00	3,077.00	3,077.00	490.00	490.00
\vdash	5124 · HVAC Repairs	465.00 x	465.00	500.00	x 500.00	0.00	0.00	690.00	690.00	0.00	0.00
\vdash	5125 - Janitorial Services	4,815.00 x	4,815.00	8,295.00	x 8,295.00	8,320.00	8,320.00	8,315.00	8,315.00	5,800.00	5,800.00
Н	5127 - Bldg Maint/Repairs/Svcs	316.81 x	317.00	1,971.88	x 1,972.00	3,346.50	3,347.00	2,002.84	2,003.00	1,389.22	1,389.00
\vdash	5130 - Fire Alarm System	651.46 x	651.00	1,081.02	x 1,081.00	1,203.30	1,203.00	1,117.48	1,117.00	1,212.48	1,212.00
\vdash	5131 - Landscape Services	540.00		1,080.00	1 1 1 1 1 1 1	1,080.00	1 222 25	1,080.00	4	900.00	
\vdash	5135 - Property Tax	597.54 x	598.00	1,188.65	x 1,189.00	1,210.83	1,211.00	1,238.11	1,238.00	618.39	618.00
\rightarrow	Total 5100 - Facility Expense	25,198.52	_	51,258.96	_	54,413.00	_	52,011.32	_	40,391.41	
Н	5200-1 - Operating Expenses & Supplies		_		_		_		_		
	5208 - Financial Service Charges	2,938.57		6,437.71		6,978.72		7,661.49		7,448.88	

Media Center Use of PEG Fees July 2010-October 2013

 		2010		2011		2012		2013		2014
l		Allocated To		Allocated To		Allocated To		Allocated To		Allocated To
l	Jul - Dec 10	PEG 10	Jan - Dec 11	PEG	Jan - Dec 12	PEG PEG	Jan - Dec 13	PEG 10	Jan - Oct 14	PEG
 	_	PEG		PEG		PEG		FEG		PEG
5209 - Customer Bad Debt Expense	0.00		733.50		3,475.57		3,010.25		(40.00)	
5288 - Telephone/Phone System	2,374.44	2,374.00	5,050.26	5,050.00	3,972.41	3,972.00	4,521.77	x 4,522.00	3,986.39	x 3,986.00
5267 - Billable Expenses	0.00		0.00	_	0.00	_	4,057.10	_	3,063.38	_
5268 - Miscellaneous/Give-aways	307.09	_	1,122.02	_	2,674.17	_	2,214.74	_	0.00	_
5269 - Mileage Reimb.	614.02		310.29	_	682.41	_	452.44	_	223.14	_
5272 - Office Supplies/Maintenance	2,341.19	_	4,527.93	_	5,392.75	_	6,989.72	_	4,203.51	_
5276 - Postage and Delivery	505.40 282.01	_	766.29 389.92	_	765.77 1.762.65	_	1.095.63	_	1,024.90	_
5282 - Decorations/Furnishings		_		_		_	-,	_	-1	_
5211 - Books & Publications	2.00	_	83.13	_	0.00	_	0.00	_	0.00	_
Total 5200-1 - Operating Expenses & Supplies	9,364.72	_	19,421.05	_	25,704.45	_	30,809.31	_	21,279.41	_
5200-2 - Equipment Expenses										
5247 - Recycling Fees - misc.	19.00	19.00	0.00	0.00	0.00 x	0.00	50.00	x 50.00	0.00	x 0.00
5236 - Equipment Maintenance	1,640.57	1,641.00	546.35	546.00	1,069.03 x	1,069.00	2,205.07	x 2,205.00	2,751.90	x 2,752.00
5241 - Equipment/Studio Set Rentals	0.00	0.00	0.00	0.00	50.94 x	51.00	95.00	x 95.00	5,000.00	x 5,000.00
5244 - Non-Capital Equip.(under \$1500)	9,231.09	9,231.00	7,685.46	7,685.00	20,728.17 x	20,728.00	20,196.79	x 20,197.00	3,301.56	x 3,302.00
5245 - Software	0.00	0.00	0.00	0.00	0.00 x	0.00	1,443.28	x 1,443.00	1,475.70	x 1,476.00
5248 - Expendable Prod. Equip/Supplies	6,323.25	6,323.00	8,121.65	8,122.00	9,045.03 x	9,045.00	4,880.20	x 4,880.00	5,217.22	x 5,217.00
Total 5200-2 - Equipment Expenses	17,213.91		16,353.46		30,893.17		28,870.34		17,746.38	
5200-3 - Advertising/PR/Outreach		_		_		_		_		_
5280 - Collateral/Graphics/Printing	102.00		310.48		355.61		616.99		997.14	
5206 - Advertising and Marketing	1,308.89		375.00		1,282.69		509.00	_	797.50	_
5264 - Internet/Website/Dish	1,171.39	1,171.00	1,804.57	1,805.00	1,735.67 x	1,736.00	1,738.86	x 1,739.00	1,332.76	x 1,333.00
5231 - Entry Fees	300.00		290.00	_	300.00	_	195.00	_	265.00	_
5222 - Membership/Fees/Dues	350.00		1,057.00		1,256.00	_	1,007.00	_	644.00	
Total 5200-3 · Advertising/PR/Outreach	3,232.28		3,837.05		4,929.97	_	4,066.85		4,036.40	
5200-4 - Insurance and Vehicle					-	_		_	$\overline{}$	
5292 - Van/Truck Expense	1,005.25	1,005.00	933.96	934.00	598.20 x	598.00	951.18	x 951.00	586.31	x 586.00
5262 - Directors/Officers Insurance	1,274.25	1,274.00	2,401.50	2,402.00	2,343.00 x	2,343.00	2,364.00	x 2,364.00	1,863.25	x 1,863.00
5261 - Media Liability Insurance	2,066.50	2,067.00	3,898.32	3,898.00	3,649.00 x	3,649.00	3,686.44	x 3,686.00	2,783.56	x 2,784.00
5260 - Property Insurance	7,283.16	7,283.00	13,976.04	13,976.00	13,928.86 x	13,929.00	14,570.99	x 14,571.00	9,534.65	x 9,535.00
Total 5200-4 - Insurance and Vehicle	11,629.16		21,209.82		20,519.06		21,572.61		14,767.77	
5200-5 - Conference/Training/Hospitality										
5297-1 · Volunteer/Producer Exp.	3,371.95		2,539.94		3,843.06	_	3,016.85	_	603.31	
5284 - Hospitality/Vol. Studio Crews	685.32		1,244.74		2,000.48	_	1,349.34	_	1,316.66	
5296 - Board Recognition/Mtg. Expenses	79.36		138.06		274.39		55.39		62.66	
5297 - Staff Recognition/Mtg Exp.	1,741.33		333.28		330.53		774.79		268.02	
5220 - Prof. Development/Training	525.00		630.00		1,903.00		470.00		1,508.79	
5221 - Conferences/Travel	492.00		1,703.91		1,433.54		2,444.39		921.66	
Total 5200-5 - Conference/Training/Hospitality	6,894.96		6,589.93		9,785.00		8,110.76		4,681.10	
Total Expense	507,616.53		946,753.76		925,193.57		957,639.68		806,093.86	
7051 - Depreciation	82,142.69	82,143.00	84,341.22	84,341.00	83,880.56 x	83,881.00	113,678.70	x 113,679.00	0.00	x 0.00
SUM	589,759.22	317,807.00	1,031,094.98	346,694.00	1,009,074.13	336,183.00	1,071,318.38	367,762.00	806,093.86	223,677.00
PEG fees		166,882.88		336,645.11		351,654.00		340,337.79		289,508.79
Overuse/(Underuse)		150,924.12		10,048.89		(15,471.00)		27,424.21		(65,831.79)
Capital Purchases	34,381.39		8,300.00		81,299.72		164,406.96		64,647.03	

Appendix B

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(909) 989-8584

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March 23, 2016

ANALYSIS OF TREATMENT OF PEG FEES UNDER CABLE ACT AND DIVCA

Prepared for the Midpeninsula Community Media Center Gail A. Karish Joseph Van Eaton Partners, BEST BEST & KRIEGER LLP

You asked us to comment on the legal conclusions contained in the draft auditor's report dated April 12, 2016, and in particular, the legal conclusions that the federal Cable Act requires that PEG fees be limited to capital expenditures (Audit, Executive Summary); and that the Midpeninsula Community Media Center ("Media Center") had used the funds inappropriately.

We disagree with these conclusions. The Cable Act does not require that PEG fees be limited to capital expenditures. The state franchising law likewise does not require that PEG fees be limited to capital expenditures. Finally, the contract under which the Media Center provides service does not limit the Media Center to using the fees for capital purposes.

What is fair to say, however, is that it can be a matter of debate as to when and under what circumstances PEG fees may be used to defray operating expenses. Therefore, while the conclusions are not correct, a locality could decide that PEG fees should be used for capital purposes as a matter of prudence.

Question 1. May PEG Fees Be Used For Operating Support Without Violating the Cable Act?

The answer should be "yes," and the opposite conclusion in the audit that leads to the conclusion that the Media Center used fees "inappropriately" is contradicted by the City's own past actions, as well as Federal Communications Commission ("FCC") decisions.

The Cable Act allows a locality to require a cable operator "under the terms of any franchise to pay a franchise fee" equal to 5 percent of the cable operator's gross revenues derived from the operation of a cable system to provide cable services. 47 U.S.C. §542(a)-(b). A franchise fee is defined as "a tax, fee, or assessment of any kind imposed by a franchising authority or other governmental entity on a cable operator or cable subscriber, or both, solely

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because of their status as such." 47 U.S.C. §542(g). Fees imposed on cable operators and other utilities are not franchise fees, so long as the fee is not unduly discriminatory. It also does not include:

"in the case of any franchise in effect on October 30, 1984, payments which are required by the franchise to be made by the cable operator during the term of such franchise for, or in support of the use of, public, educational, or governmental access facilities;" 47 U.S.C. §542(g)(2)(B); or

"in the case of any franchise granted after October 30, 1984, capital costs which are required by the franchise to be incurred by the cable operator for public, educational, or governmental access facilities;...§542(g)(2)(C)."

In other words, under the Cable Act, where a franchise was initially issued post-1984, a community can collect a fee to support PEG in addition to the franchise fee if (a) the fee does not fit the definition of a franchise fee; or (b) if the fee fits within one of the two exceptions above. To be a franchise fee, among other things, the fee must be in return for cable franchise rights, must be imposed on a cable operator, and must be imposed on the operator because of its status as such. Orders interpreting the franchise fee provisions have consistently recognized the point, and recognized that the "operational" limits are not as absolute as the audit assumes.

While the relevant provisions of the law cited above have not changed since 1984, the FCC has issued three orders explaining how those provisions are to be interpreted, two in 2007 and one late in 2015. In the Matter of Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd 5101 (2007) (the "First Order"); In the Matter of Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992, Second Report and Order, 22 FCC Rcd 19633

¹ The first exception allows use of PEG fees for any "support of the use" of PEG, and would include operating support. The exception applies to franchises issued before 1984, but renewed thereafter, as a franchise by definition refers to an initial authorization or any renewal of that initial authorization. 47 U.S.C. §522(9).

² For example, the Cable Act was not meant to prevent a locality from charging a fee for use of the rights of way to provide telecommunications services. Comcast is currently challenging fees established by the City of Eugene, Oregon that reach that company's use of the rights of way to provide Internet services.

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(2007)(the "Second Order"); and In the Matter of Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992, Order on Reconsideration, 30 FCC Rcd 810 (2015)("Reconsideration Order").

The First Order applied only to new entrants in states where franchises are still controlled by local governments and explicitly did not apply to state-issued franchises. With respect to locally-issued franchises, the FCC noted that localities could require PEG monetary capital support in addition to the franchise fee in a new franchise, but also cited with approval City of Bowie, Maryland, 14 FCC Rcd 7675 (Cable Service Bureau, 1999) which confirms that voluntary payments made by a cable operator in support of PEG would not be counted against the 5% franchise fee cap. That point was underlined by ¶109 of the First Order (which states that the order addresses only "the proper treatment of LFA-mandated contributions in support of PEG services and equipment")(emphasis supplied). That is, the First Order recognized that an operator could voluntarily consent to use of PEG funds for operating support without triggering a reduction in franchise fees, but could not be required - mandated - to do so.

The Second Order largely determined which portions of the First Order apply to incumbent cable operators. While the Commission repeated that "non-capital costs of PEG requirements must be offset from the cable operator's franchise fee payments," Second Order, ¶13, it re-cited the Bowie holding, and added an additional twist: the Commission recognized that existing operators were not automatically permitted to take offsets or to withhold payments that might otherwise apply, as "franchise agreements involve contractual obligations and also note that some terms may have been implemented as part of a settlement agreement regarding rate disputes or past performance by the franchisee. As a result, we believe that the facts and circumstances of each situation must be assessed on a case-by-case basis under applicable law to determine whether our statutory interpretation should alter the incumbent's existing franchise agreement..." Second Order, ¶19.

To put it another way, if a franchise or separate agreement permits PEG funding to be used for operating support, an automatic offset should not be permitted or required. The facts and circumstances under which the funds are permitted to be used for operating support must be considered. Taking the First and Second Orders together, PEG fees can be used for operating support without counting towards the 5% franchise fee cap where the operator permits that use voluntarily, or where the use is a legitimate quid pro quo as part of, for example, a settlement.

A broader question, not yet fully resolved, is whether PEG obligations imposed under state "streamlined franchising" schemes should be treated as "voluntary arrangements" such that



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use of the fees is not subject to the capital/operating distinction. In the Reconsideration Order, the FCC considered whether its interpretation of the franchise fee provisions of the Cable Act should apply in states that (like California) had implemented a statewide franchising regime. The Commission stated:

...it is necessary to clarify whether the findings regarding franchise fees under Section 622, PEG and I-Net obligations under Sections 622 and 611, and noncable related services and facilities under Section 602 apply to state level franchising. We clarify that those rulings were intended to apply only to the local franchising process, and not to franchising laws or decisions at the state level.

Reconsideration Order, ¶ 7. In a mysterious and inconsistent footnote, the FCC added "Nothing in this Order on Reconsideration, of course, changes the fact that in litigation involving a cable operator and a franchising authority, a court anywhere in the nation would be required to apply the FCC's interpretation of any provision of the Communications Act that would be pertinent (e.g., Section 622), including those interpretations set forth in the First Report and Order and Second Report and Order." This footnote creates ambiguity (and is being challenged in a pending appeal of the Reconsideration Order and the Second Order). However, in light of the explicit holding in ¶ 7, it cannot be said that the FCC's decisions on operating support for PEG apply in California generally, or in Palo Alto more specifically. Rather, it appears that the application of the FCC's general rulings may depend on the circumstances.3

³ The FCC, if faced with the question, might decide that because state franchising laws reach entities that are not cable operators, and grant rights that go beyond the right to use the rights of way to install a cable system for the purpose of providing cable services, fees for PEG fall within the "utility fee" exception to franchise fees, or are otherwise not subject to limitations that would otherwise apply under Title VI to fees that are imposed upon cable operators because of their status as such. The agency could also decide that, because an operator always has the option of insisting upon the protections afforded by the Cable Act, its acceptance of a streamlined franchise amounts to a voluntary agreement to its terms, including terms related to PEG. This might be particularly true where, as in California, a state adopts a uniform system that allows an operator to avoid individualized negotiations and avoid assuming new obligations that otherwise could be imposed (such as institutional network obligations) through the federal franchise process. Support for this view can be found in a recent opinion of the California Attorney General which concluded that payment of a PEG fee established by a local government under DIVCA is "an obligation that [each applicant] voluntarily agreed to pay as a condition of being awarded a franchise," see 99 Ops.Cal.Atty.Gen. 1 at 8 (2016).

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The City's own actions, and the actions of Comcast and its predecessors, confirm the common understanding that under certain circumstances. PEG fees provided to an organization like the Media Center can be used for operations without violating the Cable Act. As noted above, the federal law is essentially unchanged in relevant part since 1984. In 1986, the City issued a franchise to a cooperative, which provided cable service within the City until the year 2000. In the year 2000, the Cable Co-op sold its assets to TCI, and the City entered into a franchise and several other agreements with TCI. The City concluded that a transfer from a coop to a private company would only be in the public interest if the Media Center were kept whole; and so approval was contingent (among other things) on TCI agreeing as part of the transfer that inter alia, PEG funding could be used for PEG support generally. The specific support requirements were placed within the franchise agreement, but the voluntary consent to use of the PEG fees for any PEG-related purpose was central to, and part of the transfer agreement. The parties specifically agreed in the franchise that the PEG fees were not, and would not be treated as franchise fees. The July 24, 2000 City Manager's report reflects the understanding that the agreements would provide "funding for PEG access services." Comcast voluntarily accepted the conditions to which its predecessor had agreed when the franchise was transferred to it in 2002. When the City adopted its DIVCA ordinance in 2008 – a year after the FCC orders discussed above had issued - it maintained the existing uses of the PEG fees. Had the City (or City Attorney) or Comcast believed that the Cable Act provided an absolute bar to use of PEG funding for operational purposes, or required that funds used for operating be offset against franchise fees, the provisions with respect to PEG fees could not have been agreed to by the City, the prior City Attorney, TCI or Comcast.

AT&T accepted a franchise subject only to the conditions contained within DIVCA. discussed below, so the agreements that led to the transfer of control of the cable system from the Cable Co-op to Comcast are not relevant to it. However, AT&T strongly takes the position that it is not a cable operator subject to Title VI – most recently in a filing in a rulemaking that is pending before the FCC. In the Matter of Promoting Innovation and Competition in the Provision of Multichannel Video Programming Distribution Services, MB Docket No. 14-261, Reply Comments of AT&T Services, Inc. (April 1, 2015), pp 15-21. While the authors of this report disagree with AT&T's contention, it is certainly true that no California court has ruled that AT&T's service is a cable service under DIVCA, and the matter appears to be before the FCC in the above-mentioned and other pending proceedings. The regulatory status of AT&T's system therefore has not been finally resolved.

If AT&T's system is not a cable system, and its services not cable services, it would still owe a franchise fee and PEG fee under DIVCA, because DIVCA imposes these obligations on entities that may not be "cable operators" under federal law. However, the Cable Act's franchise

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fee provisions apply only to cable operators and cable systems. If the AT&T U-Verse system is not a cable system, and AT&T not a cable operator, the federal franchise fee/PEG fee provisions that are the subject of the report do not apply to AT&T. The auditor's report assumes they do apply to AT&T. The auditor may well believe the FCC or a court will reject AT&T's contentions. But the auditor's report cannot say with certainty that AT&T's view is wrong. The absolute and unqualified conclusions in the report are necessarily based on the assumption not only that AT&T is wrong, but also that the City may resolve the question of AT&T's regulatory status under federal law.. Further, the conclusions are made without even notifying the City that the issue is contested and is the subject of a pending FCC proceeding.

In sum, the absolute conclusions in the audit that use of PEG fees for non-capital purposes violates the Cable Act, or that the Media Center use of the fees was inappropriate are incorrect. The most that can be said, perhaps, is that different reviewers might come to different conclusions - but that is a far cry from what the audit says.

Question 2: Does use of the PEG fee for operating support violate California law?

There are good reasons to conclude it does not.

The Digital Infrastructure and Video Competition Act of 2006 (DIVCA) was modified on August 28 2006, just prior to its adoption by the California Senate. Before amendment, the legislative counsel's digest stated that the bill would "authorize local entities to establish a fee to support the capital costs of public, educational, and governmental access (PEG) channel facilities, in the amount of 1% of gross revenues, or more in specified circumstances..." As part of the amendments, the word "capital" was struck from the digest. 4 This and other changes adopted on August 28 were consistent with earlier amendments to the legislation, that, with one exception not relevant to this analysis, 5 systematically removed the word "capital" from the discussion of PEG funding. For example, the May 31, 2006 version of the bill provided that, for providers subject to state franchising, "a local entity may, by ordinance, establish a fee to support the capital costs of public, educational, and governmental access..." AB 2987 § 53058.4(m). The word "capital" was stricken from this provision by an amendment adopted on August 23, 2006.

⁴ http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab_2951-3000/ab 2987 bill 20060828 amended sen.html

⁵ Section 5870(m) describes how ongoing capital funding requirements are to be divided in cases where a new entrant has come into the market, and the incumbent is still operating under a pre-DIVCA franchise. The section is not relevant in Palo Alto, where companies now operate under DIVCA franchises.

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At the end of the legislative process, reports clearly recognized that localities could negotiate PEG fees for operations under then-applicable law, and indicated that the legislature did not intend to change that status quo. Thus, the Rules Committee Analysis on Third Reading of AB 2987 notes "[c[urrent law authorizes local franchising authorities to negotiate channel set-asides for PEG access as well as support for PEG operations," and explains that under DIVCA local governments will be permitted to set fees "for PEG purposes."

A member of the audit team, Sue Buske, was directly involved in discussions at the legislature that resulted in the amendments made just prior to bill passage, and while her views would not be legally determinative as to how the bill should be interpreted, it may have been useful to the auditor to consult Ms. Buske in reviewing the history of the law, and in determining whether the absolute conclusions drawn were actually justified.

As codified at Pub. Util. Code § 5870(n), the law now provides in relevant part:

A local entity may, by ordinance, establish a fee to support PEG channel facilities consistent with federal law....The fee shall not exceed 1 percent of the holder's gross revenues, as defined in Section 5860. 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 first sentence makes it clear that a fee that does not violate federal law would not violate California law. As discussed above, federal law does permit PEG fees to be used for operations without counting towards the franchise fee cap at least under some circumstances (as when an operator agrees to that use). In addition, because the FCC has determined that its

http://leginfo.ca.gov/pub/05-06/bill/asm/ab 2951-3000/ab 2987 cfa 20060828 211945 sen floor.html While the legislative history and digest clearly do not determine how DIVCA will ultimately be interpreted, the report should have at least pointed out that the state legislature believed that localities were negotiating and could negotiate arrangements that would allow use of PEG fees for operations.

⁷ In addition to Ms. Buske, members of the law firm of Miller & Van Eaton were involved in those discussions; some of the members of that firm are now part of BB&K, including the authors of this memorandum

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interpretation of the franchise fee provisions of the Act do not apply in California, it is impossible to definitely conclude that use of PEG funds for operational support would be inconsistent with federal law.

Perhaps more importantly, the final sentence indicates that in communities where there was a fee "to support PEG channel facilities" as of December 31, 2006 (as there was in Palo Alto), the community may establish a fee to support "PEG activities." Given the legislative history described above, there are very good reasons to conclude that the state at least intended to allow communities where PEG fees were already being used for PEG support (including noncapital support) to continue to use the fees for agreed-upon purposes. That is, existing arrangements for PEG funding would be extended into the future: if valid prior to DIVCA, those uses would remain valid after DIVCA as a general matter.

Question 3: Does Use of PEG Fees for Operating Support Violate Local Law or Agreements?

Even if state or federal law allowed PEG fees to be used for operating support in Palo Alto specifically, or in California generally, the City of Palo Alto or the members of the JPA could always choose to limit the way PEG funds are used. Palo Alto has not done so yet.

Chapter 2.11 of the Administrative Code of the City of Palo Alto, Section 2.11.070 provides simply that the "PEG support fee shall be used by the city for PEG purposes consistent with state and federal law." It imposes no independent restriction on use.

Likewise, the agreement with the Media Center and the JPA, Section 15.1(B) provides that the "Media Center shall use the funds generated from the PEG Fee only in a manner consistent with DIVCA and the Cable Act, such that the PEG Fee shall not be construed to be a "franchise fee" within the meaning of the Cable Act, 47 U.S.C. § 542(g)." It imposes no additional restrictions on use of funds. The audit report does not suggest that the past uses of fees have been "construed" to be franchise fees, and so cannot conclude that use of the fees has been inappropriate.

In fact, the audit report does not claim that franchise fees due to the City have in any way been reduced because of the use of PEG fees. And at this point, at least for most of the audit period, such a reduction could not occur. Under DIVCA, Pub. Util. Code § 5860(i), a franchise holder must bring a claim that it has overpaid franchise fees within three years and forty-five days of the remittance of the fees. At least as we understand it, no claims have been raised or preserved by the franchise holders, so that PEG fees paid through 2013 could not be treated as

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franchise fees. At least through the end of 2013, the PEG fee has not been construed to be a franchise fee. In concluding that the use was inappropriate, the audit report failed to take this into account.

Miscellaneous Issues.

The audit report suggests that the City had a duty to enforce the provisions of DIVCA or of the Cable Act. Technically, DIVCA imposes only one enforcement obligation on local governments: it requires local governments to enforce the customer service provisions of the statute. Pub. Util. Code § 5900(c). DIVCA provides that "[a] court of competent jurisdiction shall have exclusive jurisdiction to enforce any requirement under [the PEG section] or resolve any dispute regarding the requirements set forth in [the PEG section]. Pub. Util. Code 5870(p). To the extent interpretive authority as to the meaning of the DIVCA PEG requirements might lie elsewhere, it would be with the California Public Utilities Commission, and not the City. Likewise, the FCC and the courts would ultimately determine how the franchise fee provisions of the Cable Act are to be interpreted.

Of course, the City obviously has the right to audit uses of franchise and PEG fees, and to audit payments of franchise and PEG fees. But beyond that, there is not a right to declare what the law is, or a duty to bring actions to obtain definitive interpretations of the law, and the audit report should not suggest the contrary. In this case a" duty to enforce" would require the City to expend taxpayer dollars to, inter alia, obtain a declaration that AT&T's system is a cable system subject to the franchise fee limits of federal law.

- The audit report fails to consider past practices and the relevance of those practices to the conclusions in the report. As suggested above, as part of a transaction that gave TCI, and ultimately Comcast, control of the system from a locally-controlled cooperative, the companies agreed to terms (in a time-unlimited transfer agreement, and a time-limited franchise agreement) that permitted PEG fees to be used to support PEG operations. If the use of PEG fees were ever challenged, particularly in light of the language in DIVCA preserving PEG support, the City would have a good argument that the consent to use remains in place. In addition, of course, it would be able to point to practices before 2010, and from 2010-2013 that implicitly continue that consent – as we understand it, the use of the fees is publicly revealed in the Media Center's budgets, which have been directly presented to the City and have been available to each franchise holder. The report should not suggest in any respect that consent has been, or could have been, withdrawn.
- The audit report should not suggest that the City has somehow failed in its duties to monitor PEG uses. The report does not contain any information that suggests the



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auditor closely examined emails or other communications between the City and the JPA or the Media Center; or even internal information relevant to the treatment of PEG fees (even though at least one part of the audit team is likely to be familiar with those internal discussions). Absent that examination, the report cannot fairly conclude that the City somehow failed to consider how PEG funds were being used (it obviously knew how they were being used). The most that can be said is that the audit report reflects a different interpretation of the law than is reflected in past actions taken by the City. It is tempting for any report to claim superior knowledge, and to blame the past on negligence; but in order to meet the standards of objectivity required of auditors, such a claim must be based on careful examination of all facts, and not just implied without support. No such examination meeting audit standards is reflected in this report.

The audit report does properly focus on the treatment of PEG fees going forward. While the audit report's absolute conclusion that PEG fees may not be used for operating support is incorrect, as is its conclusion that the use of PEG fees by the Media Center for the audit period was inappropriate, that does not mean that it is inappropriate for the City to consider different approaches to the use of PEG fees. The Cities of Los Angeles, Glendale and Inglewood have all faced litigation regarding the use of PEG fees, and while none of those cases has led to a final judgment that provides definitive guidance in this case, 9 it is fair for any City to take the fact of litigation into account in setting policies. It would certainly be reasonable for the audit report to say that a prudent course with respect to use of PEG fees would be to limit the use of those fees to capital expenditures, at least absent a court determination, a clarification by the FCC or CPUC, or a reaffirmation of the use by incumbent cable operators. 10 If the audit report had merely said that, it would not be legally objectionable. But the broad and inaccurate claims

⁸ We understand a letter discussing auditing standards in more detail will be included in comments submitted to the City, and will explain that drawing conclusions without having undertaken a full examination of relevant circumstances is inconsistent with the duty of objectivity in government auditing. The Media Center did attempt to determine whether the auditor examined other facts or materials before the conclusions reflected in the report were drawn.

⁹ Los Angeles, for example, settled its litigation with an agreement that permits it to use PEG fees for non-capital purposes.

This course is also appropriate in light of the provisions of 47 U.S.C. § 555a (limiting claims) against localities to injunctive and declaratory relief).



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made regarding propriety of use, and what the law is in California with respect to use of PEG fees should not be accepted by the City. 11

¹¹ The danger of accepting those conclusions is real. In the Los Angeles litigation, Time Warner was seeking offsets for the value of free services provided to the City prior to 2010, under a pre-DIVCA franchise. That offset was based on the FCC interpretations of what constitutes a franchise fee. If, as the audit suggests, the federal law is absolute, and the City had a duty to enforce it notwithstanding provisions of the local franchise and of state law, the consequences could reach far beyond PEG issues. The conclusions do not have to be accepted in order for the City to conclude that, as a matter of prudence, PEG fees should be used for capital purposes going forward.



March 22, 2016

Annie Folger, Executive Director (annie@midpenmedia.org) Midpeninsula Community Media Center 900 San Antonio Rd. Palo Alto, CA 94303-4917

Review Auditor Report Subject:

Dear Ms. Folger:

You have requested Ashpaugh & Sculco, CPAs, PLC ("A&S") to provide comments on the City of Palo Alto's draft auditor's report dated April 12, 2016 regarding the auditor's statements concerning performing the audit in conformance with generally accepted government auditing standards ("GAGAS") and concerning franchise fees under California's Digital Infrastructure and Video Competition Act of 2006 ("DIVCA") as compared the amount determined under the federal standard. Let me first explain my experience and qualifications.

I am licensed as a certified public accountant in the States of Florida and Missouri and have over 20 years experience in reviewing franchise and PEG fees for over 200 local government entities across the country. This includes such reviews in California for the Cities of Los Angeles, Santa Clara, Los Altos, Napa and Carson, the County Los Angeles, the Marin Telecommunications Agency and the Sacramento Municipal Cable Telecommunications Commission. I assisted in the review and drafting of language in DIVCA.

WAS THE AUDIT CONDUCTED IN COMPLIANCE WITH GAGAS

My source for the following comments are the professional standards presented in the 2011 revision of Government Auditing Standards promulgated by the Comptroller General of the United States United States Government Accountability Office1, commonly referred to as the "Yellow Book". I have concerns regarding the representations of the auditor that the audit was conducted in compliance with GAGAS.

GAGAS requires the auditor adhere to ethical principles and maintain objectivity and independence as stated in the Yellow Book.

Ethical Principles

1.11 Because auditing is essential to government accountability to the public, the

Available at http://www.gao.gov/yellowbook.

Ms. Annie Folger March 22, 2016 Page 2 of 4

> public expects audit organizations and auditors who conduct their work in accordance with GAGAS to follow ethical principles. Management of the audit organization sets the tone for ethical behavior throughout the organization by maintaining an ethical culture, clearly communicating acceptable behavior and expectations to each employee, and creating an environment that reinforces and encourages ethical behavior throughout all levels of the organization. The ethical tone maintained and demonstrated by management and staff is an essential element of a positive ethical environment for the audit organization.

- 1.12 Conducting audit work in accordance with ethical principles is a matter of personal and organizational responsibility. Ethical principles apply in preserving auditor independence, taking on only work that the audit organization is competent to perform, performing high-quality work, and following the applicable standards cited in the auditors' report. Integrity and objectivity are maintained when auditors perform their work and make decisions that are consistent with the broader interest of those relying on the auditors' report, including the public.
- 1.13 Other ethical requirements or codes of professional conduct may also be applicable to auditors who conduct audits in accordance with GAGAS. For example, individual auditors who are members of professional organizations or are licensed or certified professionals may also be subject to ethical requirements of those professional organizations or licensing bodies. Auditors employed by government entities may also be subject to government ethics laws and regulations.

Objectivity

1.19 The credibility of auditing in the government sector is based on auditors' objectivity in discharging their professional responsibilities. Objectivity includes independence of mind and appearance when providing audits, maintaining an attitude of impartiality, having intellectual honesty, and being free of conflicts of interest. Maintaining objectivity includes a continuing assessment of relationships with audited entities and other stakeholders in the context of the auditors' responsibility to the public. The concepts of objectivity and independence are closely related. Independence impairments impact objectivity.

Independence

3.02 In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be independent.

3.03 Independence comprises:

a. Independence of Mind

The state of mind that permits the performance of an audit without being

Ms. Annie Folger March 22, 2016 Page 3 of 4

> affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

b. Independence in Appearance

The absence of circumstances that would cause a reasonable and informed third party, having knowledge of the relevant information, to reasonably conclude that the integrity, objectivity, or professional skepticism of an audit organization or member of the audit team had been compromised.

3.04 Auditors and audit organizations maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by reasonable and informed third parties. Auditors should avoid situations that could lead reasonable and informed third parties to conclude that the auditors are not independent and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work.

The Media Center's response to the draft audit report indicates that certain comments and recommendations were supported by limited data. In particular, certain PEG recommendations were based primarily on a 2008 study from a think tank that has been subject to criticism for bias. Based on my review of the draft report, the Media Center's statements appear justified based on the text of the report although I caution I have not independently reviewed the materials or the research performed by the auditor. There is, for example, no discussion of research done to identify other studies, or to determine whether the 2008 study could be relied upon.

In addition, the auditor appears to have had access to mitigating data concerning the use of funds, i.e. Media Center had capital expenditures paid for by its unrestricted fund (referred to as the investment fund). This information appears to have been ignored by the auditor.

In my view, each of these are significant faults in independence and objectivity that render the findings and recommendations of the audit report with respect to the Media Center of limited reliability.

Franchise Fees under DIVCA

The audit report finds fault with Media Center's use of PEG fees for operating expenses. Assuming that PEG fees must be used for capital purposes (an issue I understand is being addressed separately), use for operational funding can have no impact except to the extent that (a) total operational dollars plus (b) total franchise fee revenues (c) exceed 5% of gross revenues as determined under federal law. The audit report seems to assume that the base for determining the limitation needs to be franchise fees Ms. Annie Folger March 22, 2016 Page 4 of 4

determined under DIVCA, which is incorrect.

Franchise fees under DIVCA are 5.0% of gross revenues. 2 Gross revenues are defined in DIVCA.³ However, the definition in DIVCA – at least as I have seen it interpreted and applied by DIVCA franchisees - is treated as being subject to limiting factors that would not apply if one determined franchise fees under the federal "gross revenues" standard. For example, cable operators in my experience often exclude the following from gross revenues used to determine franchise fees under DIVCA, although in my view the revenues could be included under the Cable Act's franchise fee provisions:

- PEG fee revenues (amounts paid by subscribers to the cable operator);
- Launch/distribution fees (amounts paid by programmers to cable providers to (1) carry the channel and (2) to place the channel in certain proximity to like programming, e.g. place a sports channel with 10 channels of ESPN);
- GAAP (DIVCA, in certain instances allows cable operators to report revenues as determined by GAAP, and some operator classify items that could be treated as revenues as contra-expenses under GAAP); and,
- Reductions to revenues for discounts, refunds and rebates, including free service to apartment managers and employees.

DIVCA at 5860 (f) also sets forth a specific formula for the determination of video revenue in a bundled package of services where video is combined with one or more non-video services. This formulaic approach is absent from the federal standard.

While one may dispute the typical application of DIVCA by operators, 5% of gross revenues under the federal standard will generally be greater than 5% of gross revenues under DIVCA. Since franchise fees under DIVCA would be less, the difference would be available for PEG fees to be used for operating expenses without any perceived violation of the Cable Act. I could not calculate that difference, but some amounts often excluded, like PEG fees and launch fees, may be significant in particular years, particularly if bundling impacts are properly considered.

Please let me know if you have questions on the above.

Sincerely,

ASHPAUGH & SCULCO, CPAs, PLC

Garth T. Ashpaugh, CPA

DIVCA 5840 (g)

DIVCA 5860 (d), (e) and (f).

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No. 08-3023 (L) (Cons. No. 15-3578)

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MONTGOMERY COUNTY, MARYLAND ET AL., Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, Respondents.

ON PETITION FOR REVIEW OF AN ORDER OF THE FEDERAL COMMUNICATIONS COMMISSION

BRIEF AMICUS CURIAE OF THE ALLIANCE FOR COMMUNITY MEDIA AND THE ALLIANCE FOR COMMUNICATIONS DEMOCRACY IN SUPPORT OF PETITIONERS

James N. Horwood Tillman L. Lay Spiegel & McDiarmid LLP 1875 Eye Street, NW Suite 700 Washington, DC 20006 (202) 879-4000 Attorneys for Amici Curiae

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under review, if allowed to stand, would harm PEG access and the important public interests it serves.

THE FCC'S RULINGS THREATEN THE CABLE ACT GOALS T. SERVED BY PEG ACCESS.

Α. PEG Access is Critical to the Cable Act's Goals of Promoting Diversity and Localism.

In 1984, Congress enacted the Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779, codified as amended, at Title VI of the Communications Act of 1934, 47 U.S.C. §§ 521 et seq. (the "Cable Act"). To further the goal of providing "the widest possible diversity of information sources and services to the public," 47 U.S.C. § 521(4), the Cable Act ratified local governments' authority to require cable operators to provide system channel capacity for PEG access as a condition for franchise approval, 47 U.S.C. § 531(b). The Act also prohibited operators from "exercise[ing] any editorial control over any" constitutionally protected expression appearing on access channels, 47 U.S.C. § 531(e). The Cable Act thus affirmed the role of public access channels to "provide groups and individuals who generally have not had access to the

electronic media with the opportunity to become sources of information in the electronic marketplace of ideas."7

Consistent with the purpose of public access channels as open forums for speech, franchises or local regulations traditionally provide that public access channels may be used by the general public on a nondiscriminatory basis for any non-commercial, constitutionally protected programming. Local franchises also typically require operators to set aside channel capacity for governmental and educational channels, which provide local residents with the ability to view their local government councils and commissions in action and to receive local educational and school-related programming.8

PEG access advances Congress' Cable Act goal of providing a wide diversity of information and services by responding to the unique needs and interests of each local community. The role of PEG access in developing technological and media literacy has never been more important than it is today. PEG access centers provide constructive outlets for community youth to learn media skills. Seniors actively create programming on a range of issues. PEG channels provide an outlet for otherwise unserved or underserved segments of a

⁷ H.R. Rep. No. 98-934, at 30 (1984), as reprinted in 1984 U.S.C.C.A.N. 4655, 4667 ("1984 House Report"). 8 Id.

community (such as foreign-language speakers) to produce and watch programming responsive to their unique needs and interests. PEG channels give nonprofit organizations an outlet to reach clients and other community members in need of assistance.

PEG channels also furnish a platform for civic debate about local political issues. During local elections, PEG channels provide opportunities for candidates to address the public directly and fully, without being limited to a 30-second sound bite. Thus, PEG channels are a vital platform for causes and organizations that would otherwise not be part of public discourse. Viewpoint diversity is a longestablished public interest goal of the Cable Act.

The role of PEG channels is particularly important today, when the amount of programming on commercial television channels that is devoted to local public affairs is small and shrinking. The commitment of PEG programmers to promoting social services, election information, arts and civic events, public safety and other issues close to home demonstrates what is possible when local individuals and community groups, rather than just larger commercial media outlets, are given the opportunity to participate in the television medium.

The quantity of uniquely local original programming that PEG provides to communities is substantial. A 2010 sampling performed by amicus ACM revealed that an average PEG access center ran 1,867 hours of first-run local programming

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on its PEG channel(s) each year. That translates into an average of 35 hours of first-run local programming per week—an impressive number that clearly reflects the robust amount of community involvement with, and the value that communities place on, PEG. Whether they are in an urban area, suburb or small town, PEG channels are focused on the local communities they serve, cablecasting town hall and council meetings, local election coverage, school activities and other local events that rarely receive full coverage on local broadcast or other commercial media. Because of the variables in the number of PEG channels operated in any specific jurisdiction, it is difficult to extrapolate nationwide, but amicus ACM has estimated that PEG access channels generate over 2.5 million hours of original local programming per year.9

Due to their uniquely local nature, PEG channels are an irreplaceable source of local election coverage. Indeed, PEG content often serves as the only source of local community news and information, so limiting its reach harms the local electorate. Amicus ACM conducted a fall 2012 survey of over 200 of its member PEG centers' 2012 election coverage and programming. The survey revealed that 85% of PEG centers produced and/or aired 2012 election programming, and that

⁹ Examination of the Future of Media and Information Needs of Communities in a Digital Age, GN Docket No. 10-25, Comments of ACM 15-17 (FCC filed May 21, 2010).

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more than 75% of PEG centers collaborated with other organizations to offer election programming, with the League of Women Voters, the Local Chambers of Commerce, local community colleges and universities most often cited as key partners. 10 PEG centers participating in the survey represented a mix of public, educational and governmental non-commercial cable channels from around the country, including urban and rural centers.

In sum, PEG channels are a critical and irreplaceable source of truly local programming. Any harm—or even merely an increased risk of such harm—to PEG arising from the FCC's Second Order or Recon Order would therefore be inimical to localism and local democratic participation, and therefore to the goals of the Cable Act.

В. The FCC's Rulings that Institutional Networks and Other In-Kind Cable-Related Franchise Requirements are a "Franchise Fee" Threaten the Ability of PEG Centers to Fulfill the Cable Act's Goals.

As Petitioners' note, in the Second Order and Recon Order the FCC appears to have ruled that certain in-kind cable-related franchise requirements—such as institutional network ("I-Net") requirements and complimentary cable service to

¹⁰ See ACM, Alliance for Community Media Survey Results Demonstrate Impact of Community Media Centers (Jan. 10, 2013), http://www.allcommunitymedia.org/latest-news/alliance-for-community-mediasurvey-results-demonstrate-impact-of-community-media-centers (last visited Mar. 3, 2016).

APPENDIX 3 – Auditor Comments Regarding Media Center's Response

We disagree with the comments in the Media Center's response to the Cable Franchise and PEG Fee audit. However, we have opted to respond only to a few key points. Our lack of response to each individual comment in the Media Center's response should not be construed to mean that we agree with the Media Center's comments. Our comments below focus on four key points: 1) the purpose of the audit, 2) the timeline for when the City became subject to the federal Cable Act restrictions on the use of PEG fees, 3) the Media Center's and others' previous comments regarding PEG fee restrictions, and 4) the Office of the City Auditor's compliance with Government Auditing Standards.

1. Purpose of the Audit

Media Center Response: The Midpeninsula Media Center's (Media Center) response raises concerns that the audit misrepresents the Media Center's accounting system, misinterprets documents provided to the auditor, and did not do the sort of review of internal documentation required to support the implied motivations on the part of the Media Center or negligence on the part of the JPA members. The response questions, several times, what we audited vs. what the Media Center thought we should audit.

Auditor Comments: Performance audits, by their nature, are intended to mitigate risk to the organization for which the audit is performed. The City of Palo Alto is ultimately responsible for ensuring that PEG fees are used in compliance with the federal Cable Act. In recognition of this obligation, section 2.11.070(b)(2) of the City's Municipal Code states, "The PEG support fee shall be used by the city for PEG purposes consistent with state and federal law" [emphasis added], and section 2.11.040(c) states, "The failure of the city, upon one or more occasions, to exercise a right or to require compliance or performance under this Chapter 2.11 or any other applicable law [emphasis added] shall not be deemed to constitute a waiver of such right or a waiver of compliance or performance." Because the City of Palo Alto would incur any sanctions imposed by cable providers for noncompliance with the federal Cable Act, the audit objective to determine whether the City met its oversight responsibilities regarding the Media Center's use of PEG access fees was designed to mitigate the risk to the City of Palo Alto, not the risk to the Media Center. However, because the City remits 100 percent of the PEG fees to the Media Center, we were obligated to look at how the Media Center spent the funds to answer our audit objective.

To determine if the Media Center spent the PEG fees in accordance with the federal Cable Act, we reviewed the Media Center's annual reports from 2003 through 2013 and the Statement of Activities from the Media Center's 2012 financial statements. Those reports showed that the Media Center always classified PEG fees as operating revenue; did not classify the PEG fees as restricted, which would have been appropriate given the federal restrictions on the use of PEG fees; used the fees to support its operating expenses; and had limited capital expenses, other than those used to purchase and renovate its building, which was before the Cable Act limited how PEG fees can be used. We met with the Media Center's executive director and finance manager to discuss the audit objectives and our preliminary findings and requested that they provide any additional documentation that would support that they had spent the PEG fees only for capital expenses. Media Center staff provided a copy of its five-year capital plan, which did not show planned capital expenditures. When we told them that the document did not support that they had used PEG fees for capital expenses, they provided a copy

of the spreadsheet that they also attached to their response, titled "Media Center Use of PEG Fees, July 2010-October 2013." This spreadsheet supports that the Media Center spent the PEG fees only for operating expenses, which is prohibited under the federal Cable Act. The Media Center did not provide us with copies of the budget documents that they included in their response; however, those documents also support our conclusion that the Media Center used the PEG fees only for operating expenses.

The Media Center's response states in several places what they thought we should have audited instead of what we audited, including what evidence we should have obtained to support our findings and conclusions. The Government Auditing Standards require auditors to not allow external influences or pressures to impact an auditor's ability to make independent and objective judgments, which includes determining the audit objectives, the methodology to be used to address those objectives, and the evidence needed to be gathered and reviewed or analyzed to address the objectives. Although the Media Center's executive director tried to influence our findings during the audit, and the Media Center's response continues that trend, the auditors are responsible for evaluating the subject matter of the audit and objectively drawing conclusions based on all the facts and circumstances, even if those conclusions conflict with management's assertions.

2. Timeline for When City Became Subject to PEG Fee Restrictions

Media Center Response: The Media Center's response states 1) that the federal Cable Act does not restrict use of PEG fees to capital expenditures, 2) that PEG fees may be used for operating support with operator (i.e., cable franchise holder) consent, and 3) that the City entered into a franchise agreement that allowed PEG fees to be used for operating support and, in fact, "preferred" that the Media Center use the PEG fees rather than its investment fund for operating expenses.

Auditor Comments: The Media Center's above assertions are incorrect:

- 1) We worked closely with the City Attorney, who engaged a consulting attorney who specializes in communication law, to ensure that our interpretation was accurate and that the federal Cable Act does indeed restrict the use of PEG fees to capital expenses if the local entity collects the full fivepercent franchise fee. The City of Palo Alto collects the full five-percent franchise fee, and the City Attorney, with advice from the consulting attorney, confirmed that our interpretation regarding the restricted use of PEG fees is correct.
- 2) Lack of action on the part of the cable providers does not mean that they knew how the Media Center had spent the PEG fees. There is no evidence to support that the cable providers consented to the PEG fees being used for operating expenses, or that the cable providers even knew how the Media Center had used the PEG fees. Transferring PEG fees to the Media Center is based on an agreement between the City of Palo Alto and the Media Center and did not require knowledge or agreement from the cable operators.
- 3) The federal Cable Act limited the use of PEG fees to capital expenses for new franchise agreements that became effective 60 days after its enactment on October 30, 1984. The Palo Alto City Council adopted a new franchise agreement in July 2000 when the cable television system was transferred and assigned from Cable Co-op to TCI. The agreement required TCI to pay \$0.88 per month per residential subscriber "for PEG Access facilities and equipment" and allowed the City to use the funds "for any lawful PEG Access purposes." This agreement, which acknowledged the restrictions

regarding the use of PEG fees, is the point where the restriction became effective for the City of Palo Alto. DIVCA, which California adopted in 2006, says that PEG fees may be established "to support PEG channel facilities consistent with federal law [emphasis added]. The City entered into an agreement with the Media Center in 2002, which required the Media Center to "operate and administer the PEG facilities and channels in compliance with applicable laws" and in compliance with the franchise agreements between the City and the Cable Companies." When that agreement expired, the City entered into a new agreement, in 2011, which required the Media Center to use the PEG fees "only in a manner consistent with DIVCA and the Cable Act." These provisions in the City's agreements with the Media Center support that the City always intended for the Media Center to comply with the federal Cable Act restrictions on the use of PEG fees. Because DIVCA was enacted more than 20 years after the Cable Act and because it is a state law, it had no impact toward changing the restrictions on the use of PEG fees.

3. Media Center's and Others' Previous Comments Regarding the PEG Fee Restrictions

Media Center Response: The Media Center's response and its attachment from the law firm of Best Best & Kreiger states that the federal Cable Act does not restrict the use of PEG fees to capital expenses, and that we should have consulted with The Buske Group for an interpretation of the law.

Auditor Comments: It was more appropriate for us to obtain advice from an attorney regarding the legal interpretation of the law than it would have been for us to obtain an interpretation from The Buske Group, which is a telecommunications consulting firm. The comments in the Media Center's response contradict statements that the Media Center's executive director, an attorney from Best Best & Kreiger, and Sue Buske from The Buske Group have made in the past regarding the restrictions on the use of PEG fees:

- The Media Center's executive director, knowing that the Cable act does indeed restrict the use of PEG fees to operating expenses, has actively advocated for changing the federal law to allow PEG fees to be used for operating expenses in additional to capital expenses.
- Gail Karish, one of the attorneys who provided comments in the response from Best Best & Kreiger; Sue Buske, president of The Buske Group; and Annie Folger, the Media Center's executive director, were panelists in a November 2013 workshop that focused on cable franchise and PEG fees. Excerpts from the workshop, which was recorded and is available at https://www.youtube.com/watch?v=w7gpH WqLNg, include:
 - Gail Karish: "The franchise fees, there's a federal cap, and there is also in the state law five percent, right? So that's what you can pay; that's what you can collect in franchise fees. You can collect PEG fees in addition to that, that will not be credited as franchise fees as long as they are spent on capital [emphasis added]I. If you spend something that you call a PEG fee on something other than capital, then the risk is that the operator will say, 'Well, you know what? That's really a franchise fee and it goes towards our five percent franchise fee cap . . . It's now become, now if falls under a franchise fee kind of category and we're gonna assume we can have a credit against the franchise fees that we're paying to the local government.""

- Sue Buske: In reference to PEG fees "I think that it is subject to interpretation. But the issue really becomes do you want to take the risk? Okay? At the end of the day, do you want to take the risk, and are they going to send the cable cops after you?"
- o Annie Folger: "In the local franchise, he language said that the fee could be used for any PEG purpose . . . So we have been telling ourselves that because our local franchise allowed us to spend that \$0.88 per subscriber for operations, we would continue to do so until challenged otherwise, and that's exactly what we've been doing . . . But it would be, you know, a painful experience to have to figure out how, it's essentially about \$327,000 annually now that we get in PEG fees as a result of this pass-through fee, that we'd be hard pressed to say it's being spent on capital each year."

The above comments support that the Media Center had prior knowledge of the appropriate use of PEG fees but chose to use them inappropriately.

4. Office of the City Auditor's Compliance With Government Auditing Standards

Media Center Response: The Media Center's response includes a letter from Garth Ashpaugh, CPA, which asserts that although the Media Center had capital expenditures paid for by its unrestricted fund, "this information appears to have been ignored by the auditor." By citing several paragraphs from the Government Auditing Standards, he also suggests, without directly saying it, that this means the audit did not comply with the ethical principles and the independence standard in the Government Auditing Standards. He makes these assertions while also acknowledging that he had not reviewed the materials or the research that we performed.

Auditor Comments: The audit report acknowledges that the Media Center had a small amount of capital expenses during the audit review period that potentially could have qualified as PEG fee expenditures and later provided financial records showing its capital expenditures for calendar year 2014, but that the Media Center chose to use its unrestricted (investment) fund, rather than the PEG fees, for those expenses. When we first discussed our finding with the Media Center a

nd told them that our conclusion was that the Media Center had not complied with the Cable Act restriction for use of PEG fees, we gave them the opportunity to provide additional documentation to support that they were in compliance. The additional documentation that they provided continued to support our conclusion that the Media Center had used the PEG fees only for operating expenses.

Neither Mr. Ashpaugh's response summarizing his background, nor his biography on the National Association of Telecommunication Officers and Advisors' website indicate that he has any experience conducting performance audits that comply with Government Auditing Standards (our internet search did not locate a website for his accounting firm, which could potentially provide more information on Mr. Ashpaugh's experience). The Office of the City Auditor has undergone several peer reviews that confirmed our ongoing compliance with the Government Auditing Standards in the work it performs. Further, City Auditor Harriet Richardson is a recognized expert in the requirements of the Government

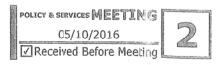
⁹ This comment refers to the local franchise agreement established in 2000 with TCI, which stated that the fees could be used "for any *lawful [emphasis added]* PEG Access purposes." Because the federal Cable Act restricted the use of PEG fees, using them for operations was not a *lawful* PEG access purpose.

Auditing Standards, as demonstrated by her recent appointment by the Comptroller General of the United States to the Government Auditing Standards Advisory Council. There is no basis for Mr. Ashpaugh's suggestion that the audit did not comply with the ethical principles and independence standard in the Government Auditing Standards. The Government Auditing Standards require auditors to exercise professional skepticism in the work they do, which includes being alert to, for example, audit evidence that contradicts other audit evidence obtained or information that brings into question the reliability of responses to inquiries. Exercising our professional skepticism led us to provide multiple opportunities for the Media Center to provide reliable responses to our inquiries. However, during the audit, they changed the reasons they provided for why they used the PEG fees for operating expenses, which led us to take extra care toward providing assurance regarding our conclusions.

APPENDIX 4 – Legal Response



AT PLACES MEMORANDUM Office of the City Attorney City of Palo Alto



Policy and Services Committee Meeting Date: May 10, 2016

May 10, 2016

POLICY AND SERVICES COMMITTEE Palo Alto, California

RE: Cable Franchise and Public, Education, and Government (PEG) Fee Audit

Dear Committee Members:

Attached is a memorandum from the City's telecommunications counsel.

Respectfully submitted,

/s/

Molly S. Stump City Attorney

MSS/sh Enclosure

cc: James Keene, City Manager Beth Minor, City Clerk

SPIEGEL & MCDIARMID LLP

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MEMORANDUM

Via Email

TO:

Policy and Services Committee of the City of Palo Alto City Council

CC:

Molly Stump, Esq., City Attorney

FROM:

Tillman L. Lay

DATE:

May 10, 2016

SUBJECT:

Response to Media Center's Legal Issue Comments on City Auditor's

Franchise and PEG Fee Audit Report

The City Attorney's Office has asked me to respond briefly to the key legal issues raised by the Media Center and its attorneys at Best & Krieger. I will be available by telephone to address these issues in greater detail at the Policy and Services Committee meeting on May 10, 2016.

The Media Center raises a number of legal issues, some of which have merit. None of those legal issues, however, disturbs the central conclusion of the audit: during the audit period and prospectively, PEG fees spent on anything other than PEG capital costs are a "franchise fee" under the federal Cable Act and therefore subject to the Act's 5% cap on franchise fees.

To avoid exceeding the 5% federal Cable Act cap on franchise fees, PEG fees should be spent only on capital costs.

The federal Cable Act generally restricts PEG fee use above the 5% franchise fee cap to capital costs, unless another exception applies. 47 USC §542(g)(2)(C). There is an exception to this rule for compensation given by the operator in the context of franchise settlement and release agreements. See 47 USC §542(g)(2)(D). Palo Alto had a waiver and release provision in the City's 2000 AT&T franchise (later assigned to Comcast), but that agreement expired when that franchise expired in 2010. Because Comcast now has a state DIVCA franchise, there is no longer any local franchise

Response to Media Center's Legal Issue Comments on City Auditor's Franchise and PEG Fee Audit Report May 10, 2016 Page 2

agreement between the City and Comcast through which a waiver, settlement, or release could be used to shield PEG fees from the Cable Act's PEG capital cost restriction.

Although the Media Center suggests otherwise, PEG fees under DIVCA are subject to the same use limitations as the federal Cable Act, for two reasons. First, the federal Cable Act franchise fee cap applies to DIVCA, and to California cable operators, under the Supremacy Clause of the U.S. Constitution. Second, DIVCA itself provides that the PEG fee it permits localities to adopt must be "consistent with federal law" – in other words, the federal Cable Act. Cal. Pub. Util. Code §5870(n).

The Media Center is correct that both the federal Cable Act and DIVCA permit operators to make voluntary payments in support of PEG access in excess of the franchise fee PEG restrictions in the Cable Act. But this exception is limited to additional benefits voluntarily offered by the cable operator and not compelled by law or otherwise required by the franchising authority. The City's 88-cent PEG fee does not fit this description, as it is compelled by law (the City ordinance imposing the fee), and the Media Center has presented no evidence suggesting that, after expiration of Comcast's 2000 franchise, either Comcast or AT&T voluntarily offered or agreed to pay for PEG operating expenses.

A California Attorney General Opinion, 99 Ops. Cal. Atty. Gen. 1 (Jan. 15, 2016) (Opin. 13-403), cited by the Media Center, does not conclude otherwise. In Opin. 13-403, the AG concluded that the PEG fee allowed by DIVCA is not a "tax" within the meaning of Proposition 26 because rather than being a "levy, charge or exaction . . . imposed by the local government," the PEG fee that DIVCA permits localities to adopt by ordinance is an obligation that the franchise holder had previously "voluntarily" agreed to "in exchange for a cable franchise as part of the state's franchising process." (Emphasis added.) While that may be true for purposes of determining whether the PEG fee is a "tax" under Prop 26, the test for what is a "tax" under Prop 26 is not the same as the test for what is a "franchise fee" under the federal Cable Act. A monetary PEG fee paid by a cable operator "in exchange for a cable franchise" - which is what the AG opinion says the DIVCA PEG fee is - would seem to be a "franchise fee" under the Cable Act. 47 USC §542(g)(1). Moreover, the Attorney General's suggestion that requiring voter approval of the PEG fee might be inconsistent with the federal Cable Act would seem to support the proposition that the DIVCA PEG fee is subject to the same limitations as PEG payments under the federal Cable Act, i.e., that PEG payments are a "franchise fee" unless used for capital costs. Contrary to the Media Center's suggestion, the AG opinion therefore appears to assume that the PEG-related provisions of the federal Cable Act govern DIVCA's PEG provisions.

Response to Media Center's Legal Issue Comments on City Auditor's Franchise and PEG Fee Audit Report May 10, 2016 Page 3

Although the Cable Act gross revenue base may be larger than the DIVCA gross revenue base, any difference is likely small.

The Media Center is correct that, for purposes of determining whether its use of the PEG fee for operational expenses counts against the 5% franchise fee cap, it is the federal Cable Act "gross revenue" definition, not the DIVCA "gross revenue" definition, that counts. And the Media Center is therefore also correct that, to the extent that the federal Cable Act "gross revenue" term has a larger potential revenue base than DIVCA's "gross revenue" definition, the amount of any franchise fee "overpayment" resulting from the Media Center's use of the PEG fee for operational expenses could only be determined by deriving a separate calculation of the maximum permitted franchise fee under the broader Cable Act revenue base.

But with one exception described below, it's far from clear that the federal Cable Act term, "gross revenue," is any broader than DIVCA's "gross revenue" definition. The major difference between the two is that there is no statutory definition of "gross revenue" in the Cable Act, while there is a detailed one in DIVCA. But it does not follow that, merely because DIVCA's "gross revenue" definition is quite detailed while the federal Cable Act's term "gross revenue" is not, the Cable Act's "gross revenue" term will necessarily yield a larger gross revenue base on which the franchise fee is calculated than the DIVCA definition. The Media Center's outside accountant suggests that the federal Cable Act's "gross revenue" term might include program launch fees and might treat bundled service revenues differently than the DIVCA definition does. It is true that neither of those issues relating to the federal Cable Act "gross revenue" term has been decided by the FCC or the courts. What the Media Center does not mention, however, is that cable operators have uniformly taken positions on launch fees and bundled services under the federal Cable Act "gross revenue" definition that are either consistent with, or even less generous to local governments than, the way that DIVCA treats those items under its "gross revenue" definition.

There is, however, one exception where the maximum permissible federal Cable Act "gross revenue" base does pretty clearly seem to exceed the maximum permissible DIVCA "gross revenue" base. That exception relates to treatment of the DIVCA PEG fee and other fees and taxes imposed on the cable operator. Under the Cable Act's "gross revenue" definition, the law is clear that any taxes or fees imposed on the cable operator (rather than on the user or the transaction) are an operating expense of the operator and therefore need not be deducted from "gross revenue" in calculating franchise fees owed. City of Dallas v. FCC, 118 F.3d 393 (5th Cir. 1997). DIVCA, in contrast, excludes all taxes and fees imposed on the cable operator (except for the 5% franchise fee) from "gross revenue." Cal. Pub. Util. §5860(e)(6). Because the DIVCA PEG fee is "not imposed by this section [§5860]," it would appear to be a "fee ... imposed by [a] governmental entity on the holder of a state franchise," and thus deductible from the DIVCA "gross revenue" base. Thus, the maximum permissible Cable Act gross revenue base – which is the ceiling against which any alleged overpayment of "franchise fees"

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resulting from the Media Center's use of those fees for operational expenses should be measured – is at least 88 cents/month/subscriber higher than the maximum permissible DIVCA gross revenue base. (The "at least" qualifier is added because there may be other taxes or fees that Comcast or AT&T also deduct in calculating the DIVCA franchise fee owed the JPA that would not be deductible from their gross revenues in calculating the federal Cable Act 5% cap.) The Media Center does not provide any dollar estimate of how much of a difference this would make, though it appears any difference would be relatively small, on the order of 5% of the total amount of PEG fees paid per year.

It is true that AT&T claims it is not a "cable operator" within the meaning of the Cable Act, but the prudent course for the City is to treat AT&T as subject to the Cable Act's PEG fee limits.

Despite AT&T's assertion to the contrary, the FCC has strongly suggested, and one court has ruled, that AT&T's U-verse video service is a "cable service," and that AT&T is therefore a "cable operator" subject to the Cable Act. And even if AT&T were not a "cable operator" under the Cable Act, it is a "video service provider" under DIVCA, and the Cable Act's limitation on PEG fee use may still apply to AT&T through DIVCA.

The Media Center is correct that the DIVCA statute of limitations may bar an action by the cable providers.

We agree that the DIVCA statute of limitations on a claim for overpaid franchise fees may have run, cutting off all or most of any potential refund claim Comcast and AT&T might otherwise have for a refund of franchise fees. The City also has other potential federal and state law defenses against any franchise fee refund claim by Comcast or AT&T, as well as a potential Cable Act claim that Comcast and AT&T must return to subscribers any refund they receive from the City. But the existence of these potential claims and defenses does not alter the conclusion that the City should promptly bring the PEG fee program into compliance with federal Cable Act provisions limiting the non-franchise fee use of PEG fees to capital costs.

TLL:smh