

**CITY OF BURBANK  
OFFICE OF THE CITY MANAGER  
MEMORANDUM**

**DATE:** June 27, 2006

**TO:** Mary J. Alvord, City Manager

**FROM:** Michael S. Flad, Assistant City Manager

**SUBJECT: Telecommunications Study Session**

**PURPOSE**

As a follow-up to the March 7, 2006 Utility Users Tax Study Session, staff has prepared an updated Study Session for Council discussion and direction on various developments in the telecommunications industry. Staff will provide an overview of recent state and federal telecommunications-related legislation; the request from AT&T for implementation of their Fiber-to-the-Node (FTTN) Program entitled Project Lightspeed; a status update on the current cable franchise agreement negotiations; and the potential fiscal impacts to the General Fund resulting from existing legislation, litigation and changes in technology.

**BACKGROUND/ANALYSIS**

The attached binder of information is intended to provide Council with both the historical and current telecommunications information needed to have a meaningful discussion during the Study Session. The information and staff presentation has been divided into six sections: Legislation, Cable Agreement, Project Lightspeed, Utility Users Tax (UUT), Fiscal Impact and Background Information. Much like the merging of technologies in the service delivery of telephone, video, data and internet services, the local revenue and control of both UUT and franchise-related revenues are under a combined legal, legislative and technological threat. As was discussed during the March 7, 2006 Council Study Session entitled Utility Users Tax Crisis (included in the UUT section attached), the UUT threat, in particular UUT-related litigation, remains our greatest fiscal concern.

An additional future concern is the unfortunate byproduct of projects like AT&T's Project Lightspeed that will put into place the bandwidth necessary to provide an effective, reliable and efficient Voice over Internet Protocol (VoIP) product. If, or more likely when, traditional telephone shifts to a VoIP format, telephone essentially becomes a data over internet exchange and revenue from telephone-related UUT becomes extremely vulnerable given the current "tax free internet" environment. The fiscal impact of losing UUT is discussed more in the Fiscal Impact section of this report, but it is important to note the complex interrelation of these constantly changing issues and how the change in one, in this case technology, can have a significant impact on another, that is, local revenue. In another example, legislation such as AB 2987, which

is an attempt to accelerate the deployment of new technology, may ultimately be preempted as the result of legal action, claiming the violation of previous legislation, namely Proposition 218.

## **Legislation**

Three pieces of legislation (H.R. 5252, S. 2686 and AB 2987) and supporting documents are included for your review. The three pieces of legislation are very similar. All three remove the current, locally controlled, franchising authority from municipal government and replace it with a uniform franchise structure at either the state or federal level. In short, the federal legislation grants national franchise authority to the Federal Communications Commission and the state-wide franchise would be issued by the California Department of Consumer Affairs. Both H.R. 5252 and AB 2987 have passed out of their originating houses with landslide approval and are expected to ultimately be approved, in some form, this year. While the supporting documentation and information in the Background section of the attached binder outlines the multitude of opinions with regard to the impacts of these pieces of legislation, the following bullet points represent the “Pros and Cons” of their common elements:

### Pros:

- Streamlines the franchise process
- Creates uniform “rules” for service providers state-wide
- Promotes competition and investment in infrastructure
- May result in reduced cost for video services
- May result in improved quality of services
- Most components of existing agreements remain in place

### Cons:

- Creates possibility for “redlining” and discrimination
- Takes away some local control of rights-of-way
- Reduces “Channel 6” funding amount and use
- Results in loss of revenue control – potential for state take-away
- No “drops” or free service required for schools, libraries, etc.

A California Senate vote on AB 2987 is expected to take place before the end of August. H.R. 5252 is currently in committee and the relatively new S. 2686 is expected to be fast-tracked and serve as the Senate’s counter proposal to H.R. 5252. Staff, the City’s lobbyists and City-affiliated professional organizations continue to lobby at both the state and federal level for modifications to the proposed legislation that will protect local revenue and control.

## **Cable Agreement**

A copy of the current Franchise Agreement, which was approved by the City Council in 1995, is included for your information. While similar to many municipal franchise agreements, each City and Council has their own priorities and philosophies on cable regulation and revenue generation. It should also be noted that negotiated agreements, like Burbank’s, often serve to set the envelope for each party’s obligations

and do not necessarily reflect the actual terms being implemented. Burbank, for example, negotiated the right to collect 2% of revenue for the purpose of funding Public Education and Government (PEG) access and has up to three channels "set aside" for PEG programming. At the direction of Council, Burbank has chosen to not collect this revenue (primarily because it is passed directly on to the customers) and limits programming to Channel 6.

As a result of the 77-0 passage of AB 2987 in the State Assembly and the expectation that the bill will be passed in a similar form by the State Senate, Charter Communications has little, if any, motivation to seek a quick resolution to the current franchise negotiation. As currently written, Charter's financial and in-kind obligation to the City will be reduced with the passage of AB 2987. While staff continues to discuss potential deal points with Charter, it is evident that a prompt resolution is unlikely. Similarly, if H.R. 5252 is passed, Charter will most likely receive a nation-wide agreement that is more beneficial in terms of their financial and in-kind obligations. Staff will continue to work toward a negotiated agreement with Charter and return to Council for additional direction when appropriate.

### **AT&T's Project Lightspeed**

Prior to the Study Session, it is the intent of AT&T to meet with each Council Member for the purpose of providing you with an overview of Project Lightspeed. Attached is a copy of AT&T's presentation with regard to this high speed, large bandwidth, internet protocol-based technology. The Background section attached also contains some worthwhile information with regard to this project.

In an effort to avoid redundancy and summarize this issue, some of the Pros and Cons of Project Lightspeed are presented below:

#### Pros:

- Enhanced internet service to residents
- Enhanced telephone service to residents
- Competition for cable television provider
- Potential for reduced television programming costs
- Able to mostly use existing infrastructure/conduit

#### Cons:

- Aesthetic and space impact on public rights-of-way
- No guarantee that all residents will be served
- Eventual VoIP build out could impact UUT
- Impacts during construction
- No timeline for build out

In order to begin the build out of Project Lightspeed in Burbank, AT&T needs to encroach upon City of Burbank-owned right-of-way and access electricity. While this is typically an administrative process conducted at the staff level, AT&T has recently submitted 127 permit applications for encroachment, and staff is requesting City Council input prior to authorizing construction. AT&T has begun discussions with Public Works

Department staff on the potential locations of the new infrastructure. Preliminary discussions with Burbank Water and Power staff have also begun with regard to AT&T's additional power needs.

Attached at the back of the Project Lightspeed section of your binder are a map of the proposed new infrastructure locations and a digital rendering of the new "node" structure. As you will see on the map, the vast majority of proposed locations are located in non-residential, commercial areas. As currently proposed, each new location must be sited within 3,000 feet of a residence, on average, and adjacent to an existing AT&T node. AT&T will then run fiber optic cable through their existing conduit, without the need for trenching, to their existing node and ultimately to the newly installed fiber node equipment. The only visible construction required is a short trench between the existing copper node and the new fiber node, a concrete pad to place the fiber node cabinet on and connectivity to a source of power. Construction at any given location is not expected to exceed 72 hours.

In the attached rendering, it is important to note that the proposed new infrastructure is only the piece of equipment located on the right side of the photograph and labeled "Proposed 52B Fiber Node." The piece of equipment depicted on the left in the photograph represents the existing copper node. These cabinets are currently located in approximately the same locations as the notations on the proposed Project Lightspeed build out map.

There exists a lack of agreement within the municipal community and a great deal of uncertainty state-wide as to whether AT&T is required to obtain a franchise for Project Lightspeed. While it is the intent of recent legislation to include alternatively delivered TV/Video service such as fiber or wireless as part of the federal or state-mandated franchise process, and AT&T has been a vocal supporter of the streamlined franchising, it may not be until these issues are tried in court that we have conclusive resolution.

The result of this political and legal uncertainty, coupled with AT&T's desire to enter the Burbank marketplace as expeditiously as possible, has created an opportunity for AT&T and the City of Burbank to enter into an agreement of mutual benefit. By entering into an agreement with AT&T, similar to the agreements in place in Anaheim and Santa Clarita, the City of Burbank could secure financial and performance obligations from AT&T resembling those found in our current cable franchise agreement and AT&T could begin construction on a relatively accelerated timetable. Staff is in favor of negotiating an agreement with AT&T for the purpose of expediting the implementation of Project Lightspeed, enabling residents to receive increased internet speeds and services, improved VoIP services and a competitive alternative to cable and satellite services. As part of the Study Session, staff is seeking direction from Council to negotiate an agreement with AT&T to begin construction of project Lightspeed.

### **Utility Users Tax**

During a Study Session on March 7, 2006 entitled Utility Users Tax (UUT) Crisis, Council received an overview of the tenuous UUT climate. As was presented, and included in the UUT section of your binder, municipalities remain financially vulnerable to

legislative, legal and technological threats to UUT. Since that time, the Internal Revenue Service (IRS) has issued an opinion that states "telephonic communication for which there is a toll charge that varies with elapsed transmission time and not distance (time-only service) is not taxable toll telephone service as defined in sub-section 4252(b)(1) of the Internal Revenue Code. As a result, amounts paid for time-only service are not subject to the tax imposed by sub-section 4251. Accordingly, the government will no longer litigate this issue and Notice 2005-79, 2005-46 I.R.B. 952, which states otherwise, is revoked."

As a result of this opinion, UUT charged on long distance, which represents a majority of our telephone-related UUT, has moved to the forefront of our most endangered revenue sources. In response, the Burbank City Attorney's Office has been working diligently with other cities and attorneys throughout the state in an effort to develop an effective solution prior to the August 1, 2006 implementation date. It is the opinion of staff that an administrative, local solution will be developed and presented for Council approval prior to the July 31, 2006 deadline. Staff will bring back a recommended course of action with regard to this specific IRS opinion and the other UUT threats at that time.

Worth noting one additional time is the potential impact to the telephone UUT revenues resulting from the continued development of VoIP. The deployment of next generation telecommunications infrastructure, like Project Lightspeed, puts in place the mechanism by which a comprehensive implementation of VoIP is possible. Regardless of the legislative and legal vulnerabilities, if the current taxation environment remains in place and traditional telephone shifts to a VoIP platform, Burbank's UUT revenue would be significantly affected.

### **FISCAL IMPACT**

The Financial Services Department has put together a series of charts and graphs detailing the current and projected revenue received by the City of Burbank from UUT and franchise fees. As shown, the \$17,862,401 UUT represents the third largest source of revenue for the City of Burbank behind only Sales and Property Tax. In the 2004-2005 Fiscal Year, the City received approximately \$6.9 million of that amount from telephone-related UUT. The split between wireless and traditional telephone revenue is basically 50/50 and long distance revenue represents a majority of the "wired" UUT. With the existing legislative, legal and technological threats to this revenue, it is the opinion of staff that telecommunications-related UUT is currently our most vulnerable source of revenue.

With respect to cable-generated franchise fees, staff has projected revenue in the amount of \$983,805 for Fiscal Year 2006-2007. This amount is based on 5% of projected gross revenue generated by Charter Communications. As proposed in the current state and federal legislation, both the percentage (5%) and the projected revenue would remain unchanged for Fiscal Year 2006-2007. Opinions vary regarding the long term impacts the infusion of competition will have on franchise revenue. While some feel that competition will drive down the rates charged to customers, ultimately leading to a reduction in revenue, others feel that the addition of new "on demand"

products will result in a net increase in industry revenue. As with all revenue sources, Financial Services Department staff will continue to monitor market trends and adjust revenue projections as appropriate.

Both the federal and state-initiated legislation allow for the implementation of a 1% PEG fee. As stated earlier, the City currently has the franchise agreement authority to charge up to 2% for PEG-related costs, but at Council direction has elected not to do so. If it were the desire of the Council to implement such a fee at the 1% level in the future, the approximate annual revenue generated would be \$200,000. Many cities, including Glendale, have traditionally charged a 2% PEG fee in an effort to leverage General Fund dollars and will be greatly impacted if the pending legislation is adopted with a 1% cap on PEG fees.

Both the federal and state-initiated legislation remove the local franchise requirement to provide additional payments or in-kind services. As currently structured, Charter Communications provides the City with \$25,000 per year for PEG-related capital items and free cable service to all City and school facilities in Burbank. In addition, a PEG grant in the amount of \$200,000 was paid at the beginning of the current cable franchise contract for the purchase of capital improvements and equipment. These requirements will all be eliminated with the adoption of either the pending federal or state legislation. Financial Services Department staff will continue to monitor all potential threats to telecommunications-related revenue and make recommendations to the City Manager and City Council as appropriate.

### **RECOMMENDATION**

It is the recommendation of staff that Council direct staff to begin negotiations with AT&T for the purpose of developing an agreement for the expeditious implementation of Project Lightspeed. Should Council have input with regard to AT&T's encroachment application process, such direction would also be appreciated at this time. As a result of the recent IRS ruling, it is further recommended that Council direct staff to bring back a strategy for the protection of local UUT revenue before the August 1, 2006 City Council meeting. Lastly, staff recommends that continued efforts to modify proposed legislation at both the federal and state level, in an effort to protect local revenue and retain local control of the public's rights-of-way, be maintained.