OVERVIEW OF DIGITAL INFRASTRUCTURE & VIDEO COMPETITION ACT OF 2006 (DIVCA)

This document provides a brief summary of some key sections of DIVCA.

BACKGROUND

The passage of DIVCA in August 2006 (effective date 1/1/07) completed a two-year process to create a new regulatory environment for video/cable services in California. From its inception, this bill was written by and for the telephone companies and mirrored legislation that they had attempted to pass in other states and at the federal level.

It is important to understand that since 1996 there have been no regulatory impediments to telephone companies providing video/cable services in any community in California. The only thing the telephone companies were required to do was to negotiate a franchise with the local government, just as the incumbent cable operators had been doing for over 45 years.

The telephone companies argued that local franchises take too long to acquire, and thus represent a barrier to competition and expanded customer choice. Since telephone companies traditionally have dealt with the California Public Utilities Commission ("CPUC") and not local governments for telephone licensing, they didn't want to deal with local governments. Instead, they wanted a "one size fits all" license -- granted at the state or federal level -- that would allow them quick access to local public rights-of-way so they can deliver services, primarily to those customers they categorize as "high value" (willing to pay over $150/month for phone/video/internet services, as stated in a 2004 presentation by AT&T to Wall Street analysts).

The process that led to the adoption of the bill was one-sided, done without the benefit of public hearings around the state, and without the reasonable deliberation needed on legislation that is this complex. Throughout the legislative sessions regarding DIVCA, language for committee amendments was not seen publicly until days after legislative hearings were held. During the final two weeks of the legislative session, key amendments had little (if any) public scrutiny. During the last seven working days of the 2006 legislative session, over 300 amendments were placed in the bill.

The Senate co-author of the bill acknowledged on the floor of the Senate that the bill was not complete and that future generations of the legislature would have to address problems in the bill.

THE NEW PARADIGM FOR CABLE FRANCHISING IN CALIFORNIA

After January 1, 2008, a company that wants to provide video service in California -- within an area for which they have not already been issued a local franchise -- *must* obtain a state franchise from the CPUC. DIVCA makes the CPUC the sole franchising authority for these situations.

Any company that currently has a local franchise may seek a *state* franchise for the area covered by their local franchise. The incumbent cable operator may seek a state franchise:

(1) when their local franchise expires, or

(2) on a date that they mutually agree upon with the local franchising authority ("LFA"), or

(3) when a competitive video service provider (e.g., AT&T or Verizon) receives a state franchise and notifies the LFA that it intends to begin providing video service in all or part of that jurisdiction.

If the incumbent cable company seeks a state franchise under this scenario, the local franchise previously issued by the LFA is terminated and replaced by a state franchise. However, PEG (Public, Educational, and Government Access), I-Net, cable service to community buildings, and emergency alert obligations contained in the local franchise previously issued by the LFA stay in place until the "natural" expiration date of the previously issued local franchise.

ANALYSIS OF KEY ASPECTS OF DIVCA

Following is an analysis of certain key aspects of DIVCA.

PEG FUNDING

A. A community with a local franchise that requires their cable operator(s) to provide PEG support funding -- in addition to franchise fees -- can require the cable operator(s) and any holder of a state-issued franchise to continue providing the specified PEG funding for the duration of the local franchise. When the local franchise expires, the LFA may enact an ordinance to continue the PEG support funding amount (but no more than that amount) that was required by the local franchise, as long as it does not exceed 3% of the cable provider's gross revenues.

B. Communities that currently do not require PEG funding support may enact an ordinance at any time to establish such a fee to be paid by all video service providers in their area, as long as the fee does not exceed 1% of a video service provider's gross revenues

C. The PEG support fee (1% - 3% of gross revenues) must be used specifically and only for PEG access purposes, consistent with Federal law. (See discussion below.)

(1) Section 5870 provides mixed guidance as to whether PEG support fees must **<u>in all cases</u>** be used consistent with Federal law.

(2) Specifically, Section 5870 appears to differentiate between communities that, under their local franchises, had received more than 1% of gross revenues for PEG access purposes (which could be used for overall PEG support -- not limited to capital only), and those that did not have PEG support under the local franchise.

(3) Video service providers have claimed that PEG support fees can only be used for "capital" purposes.

(4) The California State Assembly staff report issued after the passage of DIVCA mentions use of PEG support fees for PEG **operations** in a number of places throughout the report. These sections of the report do not refer to a limitation of the use of PEG fees to "capital".

(5) Some local governments, hesitant to risk perceived legal exposure, have chosen to limit their use of PEG support fees to capital only or have opted not to receive PEG support fees at all because of this lack of clarity.

(6) The result of the uncertainty of this language has resulted in the shutdown of a number of PEG access channels and several closures of public access and community media centers across California.

PEG CHANNELS

A. Communities that currently have three or more PEG channels may keep all of them, as long as each is programmed at least 8 hours per day. (Note: DIVCA does not include any requirements about how the channels must be "programmed" to be preserved.)

B. Communities that currently have less than three PEG channels may initially request up to three channels, which must be activated within three months.

C. PEG channels must be used at least 8 hours per day to remain activated. (The "Note" above in Item A also applies here.)

D. An additional PEG channel must be provided when more than 56 hours per week of locally produced non-duplicated PEG programming (produced or *provided* by local residents or organizations) is shown on a given channel, as measured quarterly.

E. All video service providers must place the PEG channels on the basic tier, locate them on the same channel numbers, and group them together. PEG channels cannot be moved without local government approval, unless required by federal law.

F. All video service providers must provide PEG channels of similar quality and functionality to that offered by commercial channels on the lowest cost tier of service. [Section 5870(g)(3.)]

BUILD-OUT AND NON-DISCRIMINATION REQUIREMENTS

A. When there are state franchise holders with more than 1 million telephone customers that are building fiber-to-the-home systems, their obligation is to provide video service to at least 25% of the customer households in the telephone service area within 2 years of beginning to provide video service, and to 40% within 5 years.

B. When there are state franchise holders with more than 1 million telephone customers that are *not* building fiber-to-the-home, the obligation is to provide video service to at least 35% of households in the holder's telephone service area within 3 years of beginning to provide video service, and to 50% within 5 years.

C. DIVCA contains many caveats in this area, including waivers to be almost automatically issued by the CPUC, the overall effect of which is that it will be many years (if ever) before these build-out requirements will actually be achieved.

D. An LFA may bring a complaint to the PUC concerning a holder's failure to meet the bill's build-out and non-discrimination provisions, or the PUC may investigate on its own.

E. Nothing in DIVCA requires a holder to extend video service outside its wireline telephone service footprint or to match the existing franchise area of an incumbent cable operator.

FRANCHISE FEES

A. The language in the incumbent franchise -- including items such as the definition of gross revenue and percentage -- stay in place and are enforceable, so long as there remains a franchise between the incumbent cable provider and the local government.

B. The holder of a state franchise shall pay a state franchise fee equal to 5% of gross revenues, or the percentage charged by the local government to the incumbent cable operator(s), whichever is less. Upon expiration of the incumbent's franchise, the franchise fee shall be 5% and shall be based on gross revenues for the provision of video service within the jurisdiction.

C. The state franchise fee shall be paid on a quarterly basis to the local government by any state franchise holder.

D. A local government may not demand any additional fees, other than those specifically set forth in DIVCA. However, DIVCA does not limit a local government's ability to impose utility user's taxes and other generally applicable taxes, fees and charges under other provisions of state law, if applied on a nondiscriminatory and competitively neutral manner.

E. Gross revenues for holders of state franchises are defined to include all revenue derived from the operation of the network to provide video service within the jurisdiction that are actually received, as determined in accordance with generally accepted accounting principles ("GAAP"). This includes but is not limited to all charges billed to subscribers for video service, franchise fees that are passed through to subscribers, a pro-rata portion of advertising revenues, and home shopping revenues.

F. Gross revenues do not include revenues not actually received by the holder, even if billed, such as revenues from non-cable services, revenues paid by subscribers to home shopping networks (*NOTE: revenue actually received by the holder from the sale of products or services on home shopping networks are included*), amounts collected from subscribers to recover any taxes or fees other than franchise fees, and launch fees.

G. For bundled services, the gross revenues on video services shall be determined based on "equal allocation" of the package discount, determined by comparing the total price of the individual "classes of service" in the package at advertised rates with the package price. Holders not offering the individual services in a package on a separate (a la carte) basis shall declare a stated retail value for each component in the package based on "reasonable" comparable prices. [DIVCA Section 5860(f)]

FRANCHISE RENEWAL

A. DIVCA initially provided almost no language dealing with the process for the renewal of a state franchise. The co-author of the bill acknowledged on the floor of the California State Senate that the bill was not complete, and that future generations of the legislature would have to address problems in the bill. To date, the state legislature has never revisited DIVCA to add language dealing with state franchise renewal.

B. Federal law dictates two processes for renewal of franchises: a formal process and an informal process. It also outlines criteria for making a determination as to whether a request from a video service provider for franchise renewal should be granted or denied (e.g., compliance with current franchise obligations, adequacy of plans to meet current and future cable-related community needs and interests). Therefore, since federal law controls, arguments were presented to the CPUC that the state franchise renewal process must comply with procedures and criteria outlined in federal law.

C. In 2014, the CPUC adopted rules that rejected arguments that the state franchise renewal process – to be consistent with federal law -- should include an examination of: (1) the franchise holder's compliance with its current franchise obligations; and (2) the holder's plans to meet current and future cable-related community needs and interests. The CPUC ruled that the state franchise renewal process is to be nearly the same as the process for granting an initial state franchise. These rules also state that when it receives an application for a state franchise, the LFA and the general public must file comments on that application *within 15 days*. However, those comments are limited to whether the applicant is in violation of a non-appealable court order issued pursuant to DIVCA.