

**FCC Local and State Government Advisory Committee
Advisory Recommendation Number 21:**

Unauthorized Cable Television Franchise Fee Pass-Throughs

1. At its March 28, 2000 meeting, the Local and State Government Advisory Committee (“LSGAC”) of the Federal Communications Commission (“Commission”) considered the issue of cable television subscriber bills reflecting franchise fees from Non-Subscriber revenues.

2. The Commission sought public comment on the City of Pasadena’s Petition for a Declaratory Ruling. In re Petition of the City of Pasadena, CSR 5441-R, released October 20, 1999 (“Pasadena Petition”). The LSGAC submits this Recommendation for the Commission’s consideration.

3. The LSGAC believes there is obvious unfairness and consumer deception in any billing practice which misstates the amount of a franchise fee or which attempts to cross-subsidize a competitive service by shifting costs to a monopoly service. The Commission should reject arguments that franchise fees are “taxes”. A franchise fee is not a tax, but an expense of doing business that is “essentially a form of rent.” *City of Dallas v. Federal Communications Commission*, 118 F.3d 393, 397-398 (1997).

4. Franchise fees are the rent cable operators pay for the use of public rights-of-way. Operators should not pass through to basic subscribers those rental expenses associated with non-subscriber services.

5. A cable operator should not allocate 100% of its franchise fee expense to just one of several sources of revenue. The Commission should use the instant petition to clarify that monopoly service cable providers do not have discretion under the Commission’s cable rate regulation rules to pass through expenses related to competitive services to the subscribers of monopoly basic services.

a. Generally Accepted Accounting Principles (“GAAP”) require that rent, like any expense of doing business, be proportionately allocated among the various sources of revenues.

b. Similarly, antitrust and regulatory principles prohibit the use of cross-subsidies between competitive and monopoly services. To allow more than a proportional pass-through is to permit an explicit cross-subsidy. The operator is cross-subsidizing its competitive services by hiding costs in its monopoly cable service.

c. The Commission’s own cable rate regulations reference the “franchise fee

expense associated with revenues from the sale of services”. This allocation principle is consistent with other Commission allocation approaches.

6. Many cable operators are misstating the amount of the franchise fee attributable to basic tier customers. This deceptive practice should be explicitly prohibited.
 - a. Local Franchising Authorities do not, and by statute cannot, impose franchise fees beyond 5% of the cable operator’s gross revenues derived from the operation of the cable system to provide cable services. Yet, it is common practice for cable operators to assert the franchise fee is 5.25%.
 - b. This problem is exacerbated when the operator passes through non-subscriber related franchise fees, as in Pasadena where the cable operator is asserting a franchise fee of 5.75%.
 - c. It harms the Commission’s credibility in the eyes of the public when operators are permitted to line itemize percentage claims that exceed the explicit federal statutory limit on franchise fees. The Commission should order operators who choose to itemize the franchise to do so with a simple statement, such as, “5% of this bill is attributable to franchise fees levied by local governments.”

RECOMMENDATIONS:

Federal law directs the Commission to regulate basic cable rates in a manner that is reasonable and based on “proper allocation,” or proportionate division, of any fees, taxes or charges to the transactions between the cable operator and the subscriber. The Commission’s rules on pass-throughs were designed to follow this directive. Cable operators should not pass through franchise fees in a manner that is disproportionate nor that deceptively misstates the amount of the franchise fee. The Commission should grant the City of Pasadena’s Petition and prohibit the deceptive practices as described in this Advisory Recommendation.

Adopted by the LSGAC on May 3, 2000.

Kenneth S. Fellman
Chairman