HOUSE RESEARCH ORGANIZATION

interim news

Texas House of Representatives

November 10, 1997

Telecommunications Technology Straining Municipal Franchise Agreements

New developments in technology and business organization are propelling telecommunications utilities beyond the bounds of most traditional municipal franchise agreements, witnesses told the interim Legislative Committee on Municipal Franchise Agreements for Telecommunications Utilities at a September 30 hearing.

The witnesses, who included members of the Texas Municipal League (TML) and the telecommunications industry, agreed that cities have the right to manage and to be compensated for use of their rights-of-way. However, the presence of new players — wireless providers and telecommunications resellers that use another company's facilities to provide services — complicates efforts to develop a "one size fits all" fee for use of city rights-of-way by telecommunications companies.

The committee, established under SB 1937 by Lucio, is charged with recommending to the 76th Legislature changes to franchise policies for telecommunications services provided wholly within municipalities. The ultimate goal envisioned by the industry and cities is a fee structure that would fairly compensate the 1,200 plus Texas cities for the use of municipal rights-of-way while facilitating competition for more than 150 local telecommunications service providers.

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Compensation issues

Jay Doegey, representing TML, told the committee that compensation for use of municipal rights-of-way is required under Art. 3. sec. 52 of the Texas Constitution. Although the Constitution does not bar standardizing fee structures, compensation should be adequate. Cities must be able to count on franchise fees as a revenue source that enjoys a built-in growth factor, he said. Franchise fees currently amount to between 15 and 30 percent of municipal general fund revenues, and any reduction in these revenues could cause a corresponding increase in property taxes.

At the same time, Doegey added, cities want to facilitate competition in the telecommunications arena since they have a vested interest in promoting economic development and have nothing to gain by charging prohibitively high fees or discriminating against carriers. He acknowledged, however, that established models for franchise fees may not reflect the current state of the industry. For example, while telecommunications resellers who use municipal rights-of-way should pay their fair share of a municipal franchise fee, Doegey said, there are legitimate questions about assessing franchise fees on wireless carriers that do not actually use a right-of-way.

Generally the rights-of-way use fees have been based on a percentage of the utility monopoly's gross receipts in the city area, an approach considered acceptable when monopolies delivered a basic service. For example, state law requires electric utility companies to pay cities at least two percent of gross receipts. Up until about 10 years ago, franchise fees for telephone companies also were based

on a percentage of gross receipts. However, as technological advances allowed for new services, such as call-waiting or caller ID, the process of determining what constitutes the gross receipts base became more complicated. As a result, some cities, like San Antonio, have opted for an agreed-to flat fee generally tied to a growth index that fills city coffers at the same or even increased levels of revenue.

San Antonio's franchise agreements with Southwestern Bell, MCI, Brooks Fiber and ICG allow the city to recover a set fee of $13.2 million per year, an amount equal to 50 percent of the city's annual street and drainage budget, Public Utility Commission Chairman Pat Wood told the committee. This total is funded by a per-line fee of $0.96 per month for residences and $3.28 per month for businesses. In addition, the city's contracts also provide for a utility coordination program to minimize street cuts and promises by telecommunications utilities to remove graffiti on their facilities.

Committee members questioned the methods municipalities use to assess fees. Should right-of-way fees reflect the actual cost to the city of acquiring, maintaining and policing the property, be based on the value of the real estate, or be determined according to the volume and type of traffic using the infrastructure? The committee asked the PUC to survey the different methods currently used by cities to determine the franchise fee for use of rights-of-way, including the revenue received by each city, the actual cost to cities for providing the rights-of-way, and the value of the right-of-way real estate.

Competitive pressures

Witnesses representing the telecommunications industry said that the administrative procedures municipalities now use to assess franchise fees work to impede competition.

For example, some cities require resellers to negotiate franchise agreements even though they have no facilities in a municipal right-of-way, according to Charles D. Land, executive director of the Texas Association of Long Distance Telephone Companies (TEXTATEL), a trade association of 31 intermediate and small long-distance telephone companies doing business in the state. Land said that requiring small companies to negotiate franchise agreements with cities individually puts up a tremendous barrier to competition. Furthermore, the franchise fees, which can be as much as $5,000 per city, are a huge burden on a small company.

Resellers of telecommunications frequently wind up being doubled-billed on franchise fees, Land added. Resellers that pay their own municipal franchise fee also are charged part of the franchise fee paid by the facilities-based carrier, generally Southwestern Bell, which includes the fee as a component in its underlying costs. TEXTATEL members want to pay their fair share, Land said, and making costs more equitable requires standardizing and simplifying the franchise consent process.

The entire industry is concerned about the need for basic rules to promote fairness and competitive neutrality, according to Henry Flores, representing the Texas Telecommunications Industry Coalition on Right-of-Way Issues, a group that includes virtually all telecommunications and cable companies operating in Texas. Flores said the current patchwork system of figuring and assessing fees is unfair: some providers are dissuaded from entering the marketplace because of the lack of uniformity in city requirements, while others without facilities in the rights-of-way are forced to obtain franchises or consents from cities. These inequities create an upward price spiral in right-of-way assessments, which is ultimately is borne by the consumer, he said.

Flores said the industry's main objectives in revising telecommunications law are developing competitively neutral and non-discriminatory fee arrangements, eliminating bureaucratic barriers, establishing uniformity of contracts, and limiting franchises to utilities with facilities in the rights-of-way.

Considerable interest is being generated by one special situation: wireless telecommunication providers that actively compete with wired companies but do not actually use city rights-of-way to deliver their product. Some observers question the competitive neutrality of exempting a wireless provider from a franchise fee paid by a wired provider for the same or similar service. Others speculate that competitive neutrality issues are applicable only if the circumstances are the same — i.e., actual use of municipal right-of-way — and that wireless communications could prove to be incompatible with city authority to levy franchise fees.

Legal Developments

Historically, cities have collected fees from utility companies for using city property to place poles, wires, and underground cable. State law (VACS Art. 1175) gives Texas home-rule cities the power to control and receive compensation for the use of any street, alley or highway by a utility company. In 1978, the PUC ruled that telecommunications utilities could reasonably pass through to customers local gross receipts taxes (i.e., franchise fees), but required that the taxes appear as a separate line item on city customer bills. The PUC also ruled that the municipal charge could not apply to ratepayers living outside city boundaries.

The Texas Public Utility Regulatory Act of 1995 (PURA 95), which revamped telecommunications law to allow for the transition to competition, preserves the historical right of cities to be compensated for use of their rights-of-way. The act bars cities from becoming telecommunications providers and prohibits discrimination against a telecommunications utility. The Federal Telecommunications Act (FTA) of 1996 also guarantees the right of state or local governments to manage public rights-of-way and to receive fair and reasonable compensation on a competitively neutral basis. Under the federal statute, state or local jurisdictions may not prevent any entity from becoming a telecommunications provider.

According to PUC Chairman Wood, about one-third of the 161 telecommunications operating certificates issued since deregulation have gone to providers that own their facilities. These include Kingsgate, AT&T, MCIMetro, Sprint, GTE and Southwestern Bell. Wood said the PUC has not received any complaints alleging discriminatory franchise fees, but noted that competition is still in a nascent stage of development.

Wood did point, however, to the recent case of *AT&T v. City of Austin* (No. A 97-CA-532 SS). On August 21, 1997, U.S. District Judge Sam Sparks granted a temporary injunction against a municipal ordinance requiring that AT&T enter into a franchise agreement with the city in order to resell services over lines owned by Southwestern Bell. The issue, Wood said, is one of competitive neutrality. AT&T was faced with paying the franchise fee twice: once when buying Bell service, because the fee is embedded in the price, and then again directly to the city.

Judge Sparks concluded:

> The city's interest in regulating local telephone service providers is limited by federal and state law to managing and demanding compensation for the use of the City's public rights-of-way. The City's unsupported assertion that a non facilities-based provider is "using" the City's public rights-of-way is wholly unpersuasive. In fact, it is a metaphysical interpretation of the term "use" that defies logic and common sense. True, neither the FTA nor PURA 95 specifically categorizes or distinguishes between facilities-based and non facilities-based providers, but the law does make distinctions among the various powers that may be exerted by each successive level of government. In enacting the Ordinance, the City overstepped its bounds.

In a similar case decided September 19, Wood added, the Federal Communications Commission (FCC) ruled that the city of Troy, Michigan, could not enforce an ordinance imposing telecommunication requirements on a cable company. The FCC expressed concern that such an ordinance could create an "unnecessary third tier of regulation that could deter or discourage competition."

Committee Charges

The interim Legislative Committee on Municipal Franchise Agreements for Telecommunications Utilities is charged under SB 1937 with making recommendations to the 76th Legislature regarding the state franchise policy for municipalities with respect to telecommunications services provided wholly within cities by telecommunications utilities, including television cable companies. SB 1937 encourages nondiscriminatory competition among telecommunications utilities by reducing barriers to providing service within municipalities, establishing fair and reasonable compensation for municipal rights-of-way, and ensuring that consumers benefit from competition among telecommunication utilities within municipalities.

Committee tasks include investigating:

- the need for consistency in terms and conditions, including authorized compensation methodology, in municipal franchise agreements;
- impacts of and legislative authority to modify existing municipal fees and other requirements;
- types and amount of costs incurred by municipalities for use of their rights-of-way;
- the type, basis, and amount of revenue generated;
- municipal authority to impose conditions on or require compensation from telecommunication resellers that do not own facilities in the right-of-way; and
- other issues necessary to promote the public interest and to support telecommunications competition.

The committee has planned hearings around the state. The next meeting is scheduled for November 20 in McAllen.

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