TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: JULY 8, 2002 CMR: 326:02

SUBJECT: ADOPTION OF A RESOLUTION APPROVING A TRANSFER OF CONTROL OF THE EXISTING CABLE FRANCHISE AND SYSTEM HELD BY TCI CABLEVISION OF CALIFORNIA, INC., DOING BUSINESS AS AT&T BROADBAND, FROM AT&T CORPORATION TO AT&T COMCAST CORPORATION

REPORT IN BRIEF

In July 2000, the Council approved a franchise agreement with TCI Cablevision of California, Inc. (TCI), a wholly owned subsidiary of AT&T Corporation (AT&T). In late 2001, the Board of Directors of AT&T, the country’s largest cable operator, and Comcast Corporation (Comcast), the nation’s third largest cable operator, agreed to a merger of the two companies. The City’s Municipal Code requires that control of TCI or its cable system cannot be transferred without the prior consent of the City. The City received an official transfer request from AT&T and Comcast on February 27, 2002; a revised request was received on March 11, 2002. The City has 120 days, or until July 9, 2002, to approve or deny the request. Under federal law, if no action has been taken, and no extension granted, the transfer request is deemed approved 120 days after receipt.

For the past several months, staff has been working with AT&T to evaluate the transfer and its impact on the community. Incorporating direction from Council, and input from the Joint Powers agencies and the public, staff developed a plan for negotiating the terms of the transfer. During negotiations, staff focused on resolution of the following issues: TCI’s compliance with reporting and customer service standards, the potential effect of the merger on TCI’s ability to meet the system upgrade deadline in the franchise, and payment of outstanding invoices amounting to $88,135. Staff has reached a proposed agreement with AT&T that addresses these issues and recommends approval of the transfer with conditions. These conditions include requiring AT&T Comcast to: 1) assume all of the terms, conditions, and responsibilities of the current franchise agreement; 2) assume all of the past, present and future liabilities and obligations of TCI under the current franchise agreement and the Municipal Code; 3) agree that the transfer
will not affect, diminish, or impair the binding nature of the franchise agreement including the system rebuild timeline; 4) pay the JPA $80,500 to settle noncompliance concerns; and 5) report more frequently on customer service standards.

This report transmits a proposed resolution for Council approval consenting, subject to certain conditions, to the transfer of control of the cable television franchise and system held by TCI from AT&T to AT&T Comcast. The AT&T Comcast merger will create the largest cable television company in history. More importantly, it promises the JPA improved customer service and a renewed commitment to the completion of the cable rebuild which will bring improved system reliability and picture quality, expansion of channel capacity, and improved cable modem service and offerings to the JPA community.
RECOMMENDATION

Staff recommends that Council adopt a resolution approving the transfer of control of the existing cable franchise and system held by TCI, doing business as AT&T Broadband, resulting from the merger of AT&T Corporation and Comcast Corporation.

BACKGROUND

In 1983, a Joint Exercise of Powers Agreement (JPA) was entered into by Palo Alto, Menlo Park, East Palo Alto, Atherton, and portions of San Mateo and Santa Clara counties for the purpose of obtaining cable television services for residents, businesses, and institutions within these jurisdictions. The JPA gives Palo Alto the sole authority to grant and administer a cable television franchise on behalf of all of the JPA members.

In 1986, a cable television franchise agreement was executed with Cable Co-op. On July 24, 2000, the City Council approved a transfer of the cable system from Cable Co-op to TCI, a wholly owned subsidiary of AT&T, and a new franchise agreement with TCI.

On May 8, 2000, the Council adopted a cable television ordinance. The ordinance, which amended and added new provisions to Chapter 2.10 of the Municipal Code, ensures the City enforces the same requirements and standards on all cable providers. The new ordinance provides that control of TCI or its cable system cannot be transferred without application to, and the prior consent of, the City.

On December 19, 2001, the Board of Directors of AT&T Corporation (the country’s largest cable operator) and Comcast (the nation’s third largest cable operator) agreed to a merger of the two companies. On February 27, 2002, the City received an application seeking the City's consent to the transfer of control of TCI that would occur as a result of the proposed merger. AT&T and Comcast filed a revised application with the City on March 11, 2002.

Federal and City law govern the cable franchise transfer process. Federal Communication Commission (FCC) rules give the City 30 days, from March 11, 2002, to notify AT&T concerning any questions related to the accuracy and completeness of the information provided in its franchise transfer application. Under federal law the City is allowed to inquire into the financial, legal, and technical qualifications of the proposed transferee and into any other issues permitted or required by local law or the franchise agreement, as long as such inquiries are not inconsistent with their rights under the First Amendment or the federal Cable Act. Palo Alto is precluded by laws from inquiring into some issues that may be of concern to cable customers, such as the cable operator's decisions concerning the specific content of programming and channel placement (except for public, educational and governmental (PEG) access channels). The Cable Act also precludes the City from requiring the operator to use specific transmission technologies and to make available specific programming offerings (other than PEG access channels).
In addition to seeking information regarding the qualifications of the transferee, the Palo Alto Municipal Code allows the City to consider the potential impact of the transfer on subscriber rates or services; whether the cable operator is in compliance with its franchise agreement and the Municipal Code and, if not, whether the incumbent or the transferee furnishes adequate cure or assurance of cure of any non-compliance; and whether the transfer would adversely affect subscribers, the public, or the City’s interests.

Under the federal Cable Act, the City has only 120 days, from the date the transfer application is complete, to approve or deny the transfer request. If no action is taken and no extension granted within 120 days after receipt of a franchise transfer application, the Cable Act provides that a cable operator's transfer request is deemed approved. The 120-day deadline for the AT&T Comcast transfer application is July 9, 2002.

DISCUSSION

On March 25, 2002, staff informed the Council that the transfer application had been received and presented a number of issues that could be discussed with AT&T during the process (CMR:182:02). The primary issues highlighted were outstanding invoices due the City, the potential effect of the merger on TCI’s ability to meet the system upgrade deadline, and TCI’s compliance with reporting and customer service standards. At the March 25th meeting, Council heard testimony from members of the community who expressed concern about AT&T customer service. In addition to this public testimony, staff has gathered and recorded customer complaints on an ongoing basis, discussed customer dissatisfaction with the JPA Working Group and with numerous cable subscribers in the JPA service area. This public input has given staff a clear message that the community demands improvements in customer service and AT&T must be held accountable for any and all customer service violations.

At the March 25th meeting, the Council directed staff to consider denial of the transfer request or approval with conditions that addressed, but were not limited to, the issues mentioned above. The direction received from Council, combined with JPA and public input, provided staff with an overall framework from which to negotiate with AT&T.

On March 27, 2002, the City requested additional information regarding the AT&T Comcast transfer. The City’s information request dealt with questions related to: 1) the completeness and accuracy of the transfer application; 2) the terms of the merger agreement; and the following key issues: payment of outstanding invoices due the City totaling $88,135, the potential effect of the merger on TCI's ability to meet the late July 2003 system upgrade deadline specified in the franchise, and concerns about TCI's compliance with reporting requirements and customer service standards.

On April 5, 2002, AT&T responded to the City’s information request. In addition, AT&T paid all past due invoices owed the City and provided the City with overdue construction reports. AT&T’s response, however, left the City with two key issues related to the
transfer request. The first deals with TCI’s ability to meet the system upgrade deadline of late July 2003, required by the franchise agreement. The franchise agreement gives TCI three years (from July 24, 2000) to complete the system upgrade. TCI did not, however, submit its system upgrade design and construction plan to the City until April 5, 2002, more than a year-and-a-half after that three-year deadline had started to run, and construction of the upgrade has not yet commenced. Moreover, in a provision of the AT&T Comcast merger agreement, limits are placed on AT&T's capital expenditures until the merger is closed, which may not occur until as late as the March 1, 2003, just three or four months before TCI's system upgrade deadline will expire. Although AT&T has declined to give the City a copy of this provision limiting capital expenditures, AT&T indicated (in the April 5th response) that the provision “does not in any way affect” its obligations with respect to the upgrade requirement in the franchise agreement. In addition, TCI has reaffirmed that it is committed to meeting the system rebuild timeline. Staff plans to closely monitor TCI’s progress in completing the rebuild and will proactively pursue all sanctions available to the City should TCI fail to meet the deadline including the assessment of liquidated damages as allowed by the franchise agreement.

The second issue concerns TCI's apparent non-compliance with several customer service standards and reporting requirements. In an attempt to resolve compliance issues, on May 3, 2002, the City initiated a “formal notice of violation process” in accordance with the requirements of the franchise agreement. The City cited several instances where TCI had not met customer service standards during the last quarter of 2000 and all four quarters of 2001. These alleged violations involve telephone answering times and busy signals, notification requirements for interruptions in service, and standards related to repair and maintenance service requests and scheduling work. In addition, the City claimed that TCI failed to file its annual report for the year 2000. The City requested that TCI cure the violations through: 1) payment of liquidated damages; 2) implementation of corrective actions to assure future compliance; and 3) more frequent reporting on customer service standard performance (quarterly instead of annually), providing for more effective monitoring and accountability. The City also notified TCI that it would hold an administration hearing on July 8, 2002 if TCI failed to cure these violations to the City’s satisfaction. At the hearing, TCI would be asked to show cause why it should not be found in violation. If the Council determined, after conducting the hearing that TCI failed to satisfy its obligations, it could issue an order assessing liquidated damages.

In its June 3, 2002 response to the notice of violation, TCI stated that it faced significant non-standard operating conditions due to the transition from Cable Co-op and various other occurrences, which it believes excuses its failure to comply with, and to report on its compliance with, customer service standards. However, in the interest of resolving these issues, in order not to delay approval of the franchise transfer, TCI agreed to settle these claims through a payment to the City in the amount of $80,500. In addition, TCI provided the City with a written description of the actions it has taken to assure that it meets customer service standards in the future. These actions include consolidating call centers, increased staffing, and increased training. These actions have already resulted in
improvements as indicated in TCI’s performance in meeting customer service standards in the first quarter of 2002. Finally, TCI has agreed to provide quarterly telephone customer service standard reports in the future.

Staff is satisfied that TCI has furnished an adequate cure regarding these noncompliance concerns and has cancelled the administrative hearing scheduled for July 8, 2002. TCI has committed to and already begun to realize improvements in customer service. In addition, staff believes the payment of $80,500 compensates the JPA for damages resulting from franchise compliance issues and makes TCI accountable for the customer service it provides to the community. The City has informed AT&T that it will continue to vigorously monitor and enforce customer service standards through all of the sanctions available in the franchise agreement.

With these two issues resolved, staff is satisfied that AT&T Comcast has the necessary technical ability, financial capacity, and legal qualifications to provide the required cable service. Since both AT&T and Comcast were able to operate cable systems prior to the merger, staff concludes that they are qualified to do so in the future. Although staff has some lingering concerns about AT&T Comcast’s financial stability, staff did not find any reasonable basis to withhold approval of the transfer.

The AT&T Comcast merger will create the largest cable television company in history. It promises the JPA improved customer service. Comcast’s decentralized customer service model has a better track record than the model utilized by AT&T. Comcast is currently touted as being in the strongest financial position of any of the multiple system cable operators. This means the merger also produces opportunities for capital expansion, which could help ensure that the upgrade of the cable system is completed on time. With the transfer, AT&T has recommitted itself to the completion of the cable rebuild which will bring improved system reliability and picture quality, expansion of channel capacity, and improved cable modem service and offerings to the JPA community. Staff is therefore recommending that Council approve, by adoption of the attached resolution, a transfer of control of the cable franchise and system from AT&T to AT&T Comcast, subject to the following conditions, which include:

1) Acceptance of the terms and conditions of the resolution within 30 days.
2) Consummation of the proposed AT&T Comcast merger by March 1, 2003.
3) Agreement to assume all of the past, present and future liabilities and obligations of TCI under the current franchise agreement and the Municipal Code.
4) Agreement that the transfer will not affect, diminish, or impair the binding nature of the franchise agreement including the system rebuild timeline.
5) Agreement to pay the City $80,500 in return for the settlement and release of customer service standard and reporting claims.
6) Agreement that the payment above shall not be offset against the payment of franchise fees owed the JPA.
7) Agreement to provide telephone customer service standard reports on a quarterly instead of an annual basis beginning the second quarter of 2002.

**RESOURCE IMPACT**

The franchise agreement with TCI provides various forms of compensation (e.g., franchise fees, funding for PEG access services, funding for an institutional network, etc.) for the use of the public’s streets and rights of way. Franchise fee revenues are distributed to JPA member communities on a pro-rata basis based on subscribers, after the costs of administering the franchise are deducted. As of March 31, 2002, the City of Palo Alto has 50 percent of the subscribers, Menlo Park 27 percent, East Palo Alto 11 percent, Atherton seven percent, San Mateo County two percent, and Santa Clara County (Stanford) three percent. City of Palo Alto franchise fee revenues totaled $375,640 in calendar year 2001. Staff has concluded that the transfer of control will not materially impact franchise fees or other forms of compensation.

AT&T has agreed to pay the JPA $80,500 to settle contract noncompliance issues.

**POLICY IMPLICATIONS**

The proposed transfer resolution requires that AT&T Comcast assume all of the liabilities and obligations of the current franchise agreement, including all the requirements related to the rebuild of the cable system and the provisions related to PEG access channels and programming. As such, the transfer of ownership does not represent a change to existing Council policy or practice.

**ENVIRONMENTAL REVIEW**

This is not a project under the California Environmental Quality Act.

**ATTACHMENTS**

Attachment A: Resolution Approving Transfer of Control
Attachment B: TCI Settlement Letter