TO:       HONORABLE CITY COUNCIL

FROM:     CITY MANAGER       DEPARTMENT:  ADMINISTRATIVE SERVICES

DATE:     JUNE 24, 2002       CMR: 302:02

SUBJECT:  STATUS OF AT&T/COMCAST TRANSFER OF OWNERSHIP PROCESS

This is an informational report and no Council action is required.

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. The member communities share the costs of administering the franchise, proportional to the percentage of overall subscribers. 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.

In 1986, a cable television franchise agreement was executed with Cable Co-op. In 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. Both the City's Municipal Code and TCI's franchise agreement provide 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 and Comcast Corporation 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 AT&T/Comcast merger. AT&T and Comcast filed a revised application with the City on March 11, 2002.
DISCUSSION

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 the First Amendment or the federal Cable Act. The First Amendment and the Cable Act, however, preclude Palo Alto from inquiring into some issues that may be of concern to cable customers, such as the cable operator's decisions concerning what programming to carry 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). Furthermore, since the FCC recently ruled that cable modem service is an information service and not a cable service the City is not permitted to review AT&T’s cable modem service in relation to the transfer application.

In addition to seeking information regarding the qualifications of the transferee, the Palo Alto Municipal Code allows the City to consider, among other things, whether the cable operator is in compliance with its franchise agreement and the Palo Alto Municipal Code and, if not, whether the incumbent or the transferee furnishes adequate cure or assurance of cure of any non-compliance.

On March 25, 2002, staff provided Council with a status report (CMR:182:02) on the transfer process timeline and presented a number of potential areas that could be reviewed with AT&T during the process. The areas highlighted were payment of 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 requirements and customer service standards. At that meeting Council heard testimony from members of the community who expressed concern about AT&T customer service. Council directed staff, in going forward with the transfer review, to either deny the transfer or recommend approval of the transfer with conditions that addressed, but were not limited to, the potential areas mentioned above. This direction has provided staff with an overall framework from which to negotiate with AT&T.

In addition to the public testimony received on March 25, staff has gathered and recorded customer complaints, on an ongoing basis, and discussed customer dissatisfaction with numerous cable subscribers in the JPA service area. This public input has given staff a clear message that the community has a critical interest in seeing customer service improve and for AT&T to be held accountable for past customer service violations. Again, this has been one of the primary areas of focus throughout the transfer review process.
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 the completeness and accuracy of the transfer application, questions about the terms of the merger agreement, and questions regarding the previously mentioned key areas: payment of outstanding invoices due the City totaling $88,135; the potential effect of the merger on TCI's ability to meet the August 2003 system upgrade deadline 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 its response, AT&T provided some (but not all) of the information requested by the City. In addition, AT&T paid all past due invoices owed the City and provided the City with overdue construction reports. AT&T refused, however, to provide several items of information that the City requested. AT&T contends that the City does not need much of the information it requested to determine the qualifications of the proposed transferee and that the City is not entitled to the information requested. AT&T also believes that franchise compliance issues are outside the scope of the transfer, in spite of the fact that the Palo Alto Municipal Code specifically authorizes the City to address franchise compliance matters as part of the transfer process.

AT&T’s response leaves the City with two critical issues. The first deals with TCI's ability to fulfill the system upgrade deadline of August 2003, required by the franchise agreement. The franchise agreement gives TCI three years (from August 2000) to complete the system upgrade. TCI did not, however, submit its upgrade system 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 cannot commence until at least 60 days after the submission of that plan. 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 is not expected to occur until the fourth quarter of 2002, and may not occur until as late as the first quarter and 2003, just three or four months before TCI's system upgrade deadline will expire. AT&T has refused to provide the City with a copy of the exhibit to the merger agreement that contains the key details of this "no capital expenditure" provision. Since TCI has made limited progress in carrying out the system upgrade to date and the deadline to complete the upgrade is only a little over a year away, the "no capital expenditure" provision in the merger agreement is of concern to staff.

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, primarily related to telephone answering times and busy signals. In this notice, the City requested that TCI cure the violations through 1) implementation of
corrective actions to assure future compliance; 2) payment of liquidated damages for failure to comply during the last quarter of 2000 and all four quarters of 2001; and 3) more frequent reporting on customer service standard performance (quarterly instead of annually), providing for more effective monitoring and accountability.

In its June 3 response to the City's notice, TCI described 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 appear to have resulted in improvements as indicated in TCI’s performance in meeting customer service standards in the first quarter of 2002. Regarding 2000 and 2001 standards, TCI contends that it faced significant non-standard operating conditions due to the transition from Cable Co-op and various other occurrences, which AT&T believes justifies its inability to comply with, and to report on, its compliance with customer service standards. The City does not accept AT&T’s explanation for not meeting customer service standards in 2000 and 2001.

Staff continues to meet with AT&T in an attempt to resolve these remaining franchise transfer issues and to gain AT&T’s commitment to report on customer service standards quarterly. If the City is not successful in resolving the customer service and reporting issues, the “formal notice of violation process” calls for an administrative hearing before the Council. At this hearing, TCI would be asked to show why it should not be found in violation of the Franchise Agreement. If the Council determines that TCI has failed to satisfy its Franchise Agreement obligations, it may issue an order assessing liquidated damages. However, should AT&T and the City reach a negotiated settlement on these remaining issues and the City Council accepts the terms of the settlement as a condition of the transfer request the administrative hearing on franchise violations would not be necessary.

Under the federal Cable Act, the City only has 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. In the case of the AT&T/Comcast transfer application, the 120-day deadline will expire on July 9, and AT&T has indicated that it will not pursue an extension of that deadline. Staff plans to return to Council on July 8, within the 120-day deadline, with a recommendation regarding the transfer request. A public hearing will be held at that time in order to give the community and other JPA member agencies an additional opportunity to provide feedback to the Council regarding the transfer. In addition, staff has notified TCI that the administrative hearing on the customer service and reporting issues, should it be necessary, is also planned for July 8, 2002, prior to Council action on the transfer of ownership process.

The staff recommendation on the transfer of ownership process will follow one of the three approaches discussed below.
Approve the Transfer with Conditions Acceptable to AT&T: With this approach, staff would recommend approval of the transfer, subject to conditions, but those conditions would be ones AT&T Comcast has indicated it would accept. Chief among these is that AT&T Comcast would assume all of the past, present and future liabilities and obligations of TCI under the current franchise agreement. This approach would be selected only if the City believes that, with the transfer, the community will receive the same quality and type of services provided by AT&T. This approach is viable if the City is able to resolve both of the remaining issues to its satisfaction as part of a negotiated settlement with AT&T.

Approve the Transfer with Conditions Unacceptable to AT&T: Another approach would be to recommend approval of the transfer with conditions, even though AT&T Comcast has indicated that they will not accept those conditions. Among the additional conditions would be a proposed resolution and compromise of the customer service and system upgrade issues. The advantage of this approach to the transfer is that it allows the City to address and resolve its concerns related to TCI's compliance with franchise agreement obligations. The disadvantage is that, depending on the conditions imposed by the City, AT&T Comcast could refuse to accept them, posing the risk of litigation. This option would likely be presented if a negotiated settlement is not reached with AT&T on the remaining issues.

Denial of the transfer request: The final option would be to recommend rejection of the transfer request. A transfer can only be denied under certain circumstances. Unfortunately, the law is unsettled as to precisely what circumstances would entitle a city to deny a franchise transfer request. As a result, denial of the transfer request is highly likely to result in litigation.

The action staff will recommend will hinge upon the outcome of the ongoing negotiations with AT&T.

RESOURCE IMPACT

The City’s franchise fee revenues totaled $375,640 in calendar year 2001. The City has contracted with a law firm for legal support during the transfer of ownership process. Also, staff support is being provided by the Administrative Service Department and the City Attorney’s Office.

POLICY IMPLICATIONS

During the transfer process, the City will require 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, it is expected that the transfer will not represent a change to existing Council policy or practice.
ENVIRONMENTAL REVIEW

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

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cc: JPA Members