

Texas Municipal Franchise Fees Facts & Auditing



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Topics

- Franchise Fees
- Distinguishing Fees From Taxes
- Telecom Updates
- Texas Utility Regulation
- Auditing Franchisees in Texas

Municipal Franchise Agreements & Fees



- **Municipal Utility Franchises**

- Municipal Authority to Enter Franchises

- ✦ Municipal authority to grant franchises is not a plenary power, but is derived from State Constitution or Statutory Authority under home-rule powers of the municipality. TEX. REV. CIV. STAT. ANN. § art 1175 (West).
- ✦ A “franchise” has been construed to mean a right or privilege conferred by law, and a privilege of doing that which does not belong to citizens generally by common right, to include the right to use public streets and other ways for the purpose of a business affected with a public interest within the municipality. State v. Garrison, 348 P.2d 859, 863-864 (Okla. 1959).

Municipal Franchise Agreements & Fees



- **Municipal Utility Franchises**

- Tax vs. Fees

- ✦ **Are municipal franchise fees considered a “tax” or a “fee?”**

- ✦ **Why does it matter?**

- Prerequisites to passage or levy of taxes

- Application of State Taxpayer Bill of Rights for collection and enforcement. Tex. Admin. Code tit. 34 § 3.10

Distinguishing Fees from Taxes



- **Purpose** - In general, a tax may be distinguished from a fee based on its purpose: taxes are designed to raise revenue for a general governmental purpose and fee is a charge related to the exercise of the locality's police power and the exercise of its governmental function or for performing governmental services.
- **Effect** - Unlike taxes, fees are not necessarily governed by the uniformity and equality provisions in state and federal constitutions. Other rules may not apply. (Taxpayers' Bill of Rights, Administrative Regulations, etc.)
- **Disguised Taxes** - "Fees" have been struck down where they are found to be disguised taxes. *Jacks v. City of Santa Barbara*, --- Cal. Rptr. 3d ---, (Cal. Dist. Ct. App. 2 Dist. 2015) – "taxes marauding around as fees"

Distinguishing Fees from Taxes



- **Most commonly employed test to determine whether a franchise fee is a “tax” or a “fee”**
 - **The *San Juan Cellular Test*: San Juan Telephone Co. v. Public Service Comm’n of Puerto Rico, 967 F.2d 683 (1st Cir. 1992) – revenue vs. regulatory/punitive purposes**
 - ✦ **The classic “tax” is imposed by a legislature upon many, or all, citizens and raises money that is contributed to the general fund and spent for the benefit of the entire community.**
 - ✦ **The classic “regulatory fee” is imposed by an agency upon those subject to its regulation. It may serve regulatory purposes directly by, for example, deliberately discouraging particular conduct by making it more expensive . . . Or it may serve purposes indirectly by, for example, raising money in a special fund to help defray the agency’s regulation-related expense.**

Distinguishing Fees from Taxes



- **Most commonly employed test to determine whether a franchise fee is a “tax” or a “fee”**
 - **Three-Part Test**
 - ✦ **1. What entity imposes the charge**
 - Legislature – indicates a tax
 - Agency – indicates a fee
 - ✦ **2. What population is subject to the charge**
 - General population or all citizens = tax
 - Narrow class of persons or single entity = fee
 - ✦ **3. What purposes are served by the use of monies obtained from the charge (Most critical)**
 - General revenue fund – indicates a tax
 - Special fund or reserve for the defraying related regulatory costs – indicates fee

Municipal Franchise Agreements & Fees



- **Municipal Utility Franchises**

- **Tax vs. Fees – in Texas and the 5th Judicial Circuit**

- ✦ **5th Circuit Court of Appeals held that Cable franchise fees are “FEES,” NOT TAXES**
- ✦ **Franchise fees are not a tax, however, but essentially a form of rent or fee: the price or fee paid to rent use of public right-of-ways. See, e.g., *City of St. Louis v. Western Union Telegraph Co.*, 148 U.S. 92, 13 S.Ct. 485, 37 L.Ed. 380 (1893)(noting that the fee paid to a municipality for the use of its rights-of-way were rent, not a tax); *Pacific Tel. & Tel. Co. v. City of Los Angeles*, 44 Cal.2d 272, 283, 282 P.2d 36, 43 (1955)(same); *Erie Telecommunications v. Erie*, 659 F.Supp. 580, 595 (W.D.Pa. 1987), affirmed on other grounds, 853 F.2d 1084 (3d Cir.1988)(same in cable television context).**

City of Dallas, Texas. v. F.C.C., 118 F.3d 393, 397-98 (5th Cir. 1997)

Municipal Franchise Agreements & Fees



- **Municipal Utility Franchises**

- **Tax vs. Fees – in Texas and the 5th Judicial Circuit**

- ✦ Notably, the Court in City of Dallas, Tx v. F.C.C. did not use or even reference the three-part test from San Juan Cellular, and thus other circuits have refused to follow; some of which have held that Franchise Fees are taxes rather than fees.
- ✦ The 5th Circuit subsequently affirmed this classification in Texas Coalition of Cities for Utility Issues v. F.C.C., 324 F.3d 802 (5th Cir. 2003) – holding that the telecommunication companies could lawfully pass the entire 5% franchise fee (capped by the law) onto customers, even that portion of the expense that were unrelated to customer's use of the service – i.e. advertising and home shopping network commission.

Municipal Franchise Agreements & Fees



- **The Telecom Industry**

- Mergers – effects on your current Franchises / Licenses
- Impact of Over the Top Cable on Franchise Revenues
- Wireless Zoning – leases (Rental & License Taxes)
- Right of Way Control (Franchises)

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• **Changes in the Telecom Industry – Merger Efforts**

- AT&T - T-Mobile \$39 Billion
 - AT&T offered to buy 4th place T-Mobile
 - Promised a \$4 billion breakup fee if deal killed
 - Department of Justice and the FCC – killed the deal
- Sprint considered buying T-Mobile this year
 - Concluded the deal could not get Fed approval
- AT&T - DirecTV, \$48.5 Billion
 - Combined with AT&T's U-Verse TV service, the new company would boast 26 million customers

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- **Changes in the Telecom Industry – Merger Efforts**

- Comcast - Time Warner Cable \$45 Billion– 64,000 comments filed at the FCC – **deal killed by FCC April 2015**

- 30 million cable subscribers

- After Comcast sells off subs to Charter/Midwest Cable

- 19 of the 20 largest metro areas in US

- 38% of all broadband (high speed) customers

- **How May Deal Impact Users and Tax Revenue:**

- Cost of service

- Cable content – control of programming

- Speed of internet – net neutrality

Municipal Franchise Agreements & Fees

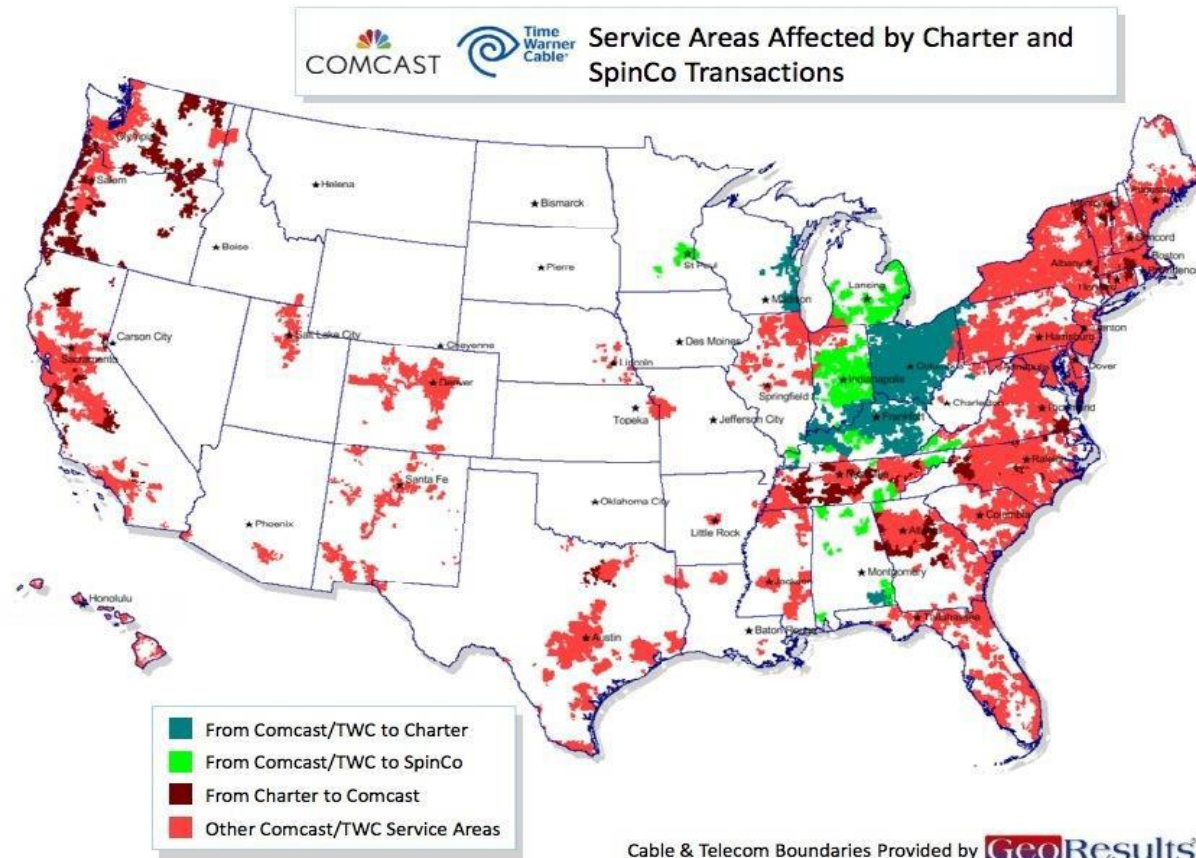


- **Cable Industry Revenue (,000s)**

Year	ResVideo	OtherRev	Total Rev
• 1996	\$24,136	\$2,984	\$27,120
• 1997	\$26,270	\$3,532	\$29,802
• 1998	\$27,626	\$6,152	\$33,778
• 1999	\$30,050	\$7,341	\$37,391
• 2000	\$32,541	\$9,575	\$42,116
• 2001	\$35,734	\$9,743	\$45,477
• 2002	\$36,738	\$11,160	\$47,898
• 2003	\$39,338	\$15,056	\$54,394
• 2004	\$41,813	\$18,212	\$60,025
• 2005	\$43,832	\$21,846	\$65,678
• 2006	\$46,518	\$25,354	\$71,872
• 2007	\$49,105	\$29,719	\$78,824
• 2008	\$51,467	\$34,470	\$86,281
• 2009	\$53,040	\$36,861	\$89,901
• 2010	\$55,470	\$38,310	\$93,780
• 2011	\$56,938	\$40,660	\$97,598

Municipal Franchise Agreements & Fees

NEW MAP SHOWING SERVICE AREAS OF COMCAST, CHARTER, AND SPINCO AFTER DIVESTITURE TRANSACTIONS



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- **Changes in the Telecom Industry – Merger Efforts**
 - On May 26, 2015, Charter announced that they would be acquiring Time Warner Cable
 - Deal worth approximately \$78.7 billion
 - Creation of “New Charter” as the provider

 - Charter announced on the same day that it would acquire Bright House Networks
 - Deal worth approximately \$10.4 billion
 - Netflix has announced support of the deal – accounts for 37% of all internet traffic in peak evening hours
 - The three companies expect to close the announced transactions by the end of 2015 – provided F.C.C. approval

Municipal Franchise Agreements & Fees



Top Internet Service Provider State-by-State



Source: 56 million web visits

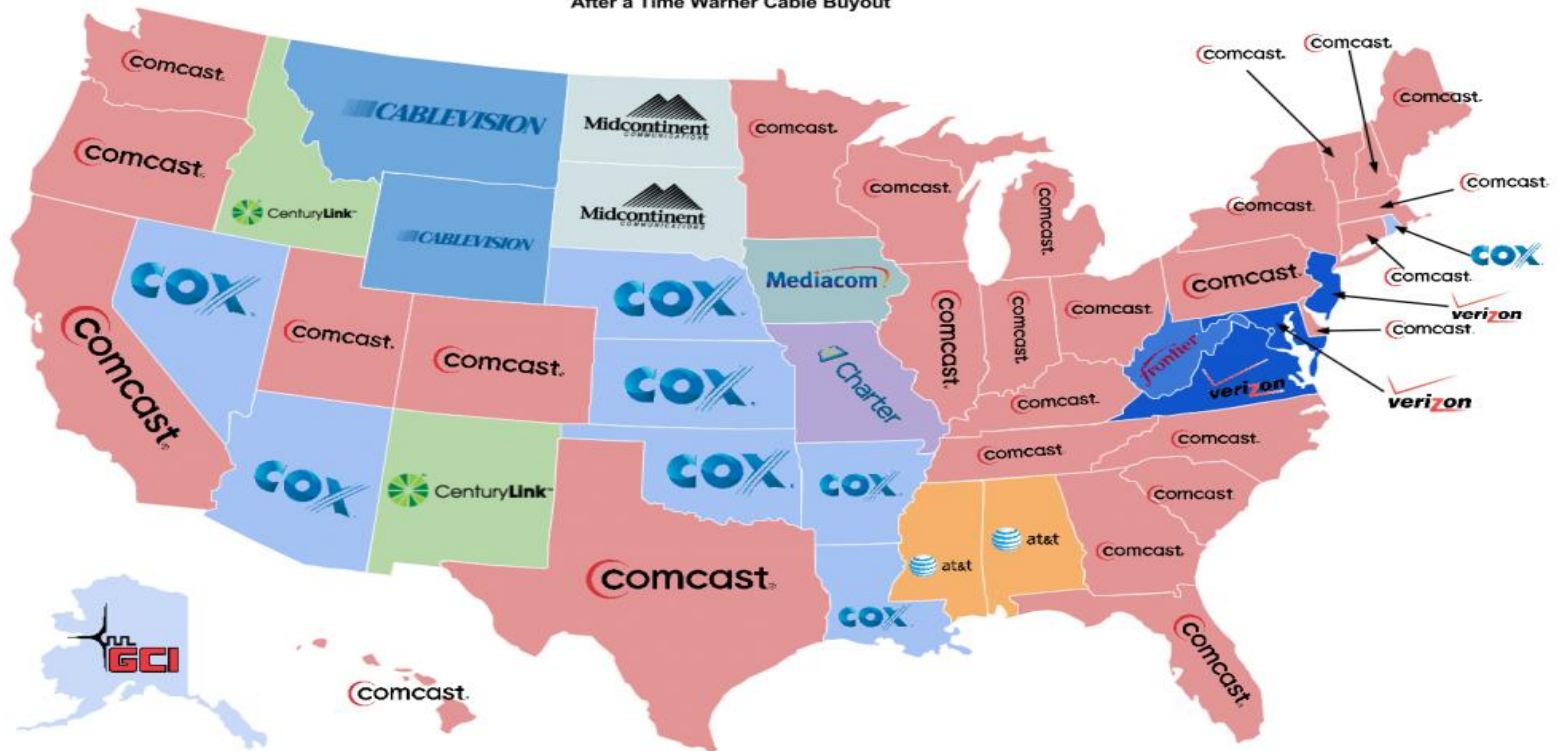
Webpage **FX**

Municipal Franchise Agreements & Fees



Top Internet Service Provider State-by-State

After a Time Warner Cable Buyout



Source: 56 million web visits

WebpageFX

Municipal Franchise Agreements & Fees



- **Taxing the Telecom Industry – Merger Efforts**
- The states with the largest percentage gain of market share for Comcast would be:
- Florida – 97% increase
California – 81% increase
South Carolina – 43% increase
Texas – 29% increase
Indiana – 24% increase

Municipal Franchise Agreements & Fees



- **Auditing Municipal Franchisees**

- **Regulatory Utility Commissions in Texas**

- 1. Public Utility Commission of Texas**

- a. Electricity**

- b. Telecommunications**

- c. Water**

- 2. Railroad Commission of Texas (a/k/a Texas Railroad Commission)**

- a. Gas**

- 3. Texas Commission on Environmental Quality**

- a. Municipal Solid Waste**

Municipal Franchise Agreements & Fees



- **Auditing Municipal Franchisees**
 - **Municipal Audit Authority**
 - **Telecom (certificated telecommunications providers)**
 - ✦ **16 T.A.C. § 26.469(c) – also provides for certain revenue procedures**
 - ✦ **Audit Period – Previous Quarterly Report of Access Line Counts (3 months!)**
 - ✦ **Notice – must be provided to CTP within 90 days of filing quarterly report***
 - **Electric Service Providers**
 - ✦ **TEX. UTILITIES CODE § 33.008(e) – may audit conduct an audit of all records in relation to payments made within two (2) years prior to commencement of the audit.**

Municipal Franchise Agreements & Fees



- **Auditing Municipal Franchisees**
 - **Municipal Audit Authority**
 - **Gas Utilities**
 - ✦ **TEX. UTILITIES CODE § 102.202 & 203 – may conduct an audit of all records in relation to payments made within two (2) years prior to commencement of the audit.**
 - ✦ **No Audit period is specified by regulatory laws – look to Franchise Agreement – typically 3-5 years, but could be up to 7 years under breach of contract law.**
 - **Municipal Solid Waste**
 - ✦ **30 T.A.C. § 330**
 - ✦ **Specified within Franchise Agreement – nothing in Tex. Regs. About audit period**

Municipal Franchise Agreements & Fees



- **Auditing Municipal Franchisees – Initiation**
 - **Audit Notification Letter and Request for Records**
 - ✦ **Notification should be specific as to period under audit and the should set mandatory dates for specific stages of audit***
 - **Confidentiality & Non-Disclosure Agreements**
 - ✦ **Typically the initial step in every Franchise Fee audit – whether conducted by governmental entity or private auditor**
 - ✦ **Universally requested by service providers across all industries**
 - ✦ **Can and will require legal efforts to negotiate and review these agreement**
 - ✦ **Watch out for pitfalls and traps that may hinder the audit**

Municipal Franchise Agreements & Fees



- **Auditing Municipal Franchisees - Records**
 - **Personally Identifiable Information (P.I.I.)**
 - ✦ **Many utility companies will refuse to release records which contain P.I.I., even pursuant to tax or fee examinations**
 - ✦ **Some will requests the City to issue an administrative subpoena prior to the production of such documents**
 - ✦ **Citing Federal Law (e.g. Title 47, U.S.C.A. 1 *et seq.* Federal Telecommunications Act & F.C.C.)**

Municipal Franchise Agreements & Fees



- **Auditing Municipal Franchisees - Records**
 - **Personally Identifiable Information (P.I.I.)**
 - ✦ **Federal Law prohibits the disclosure by providers of electronic communications and other telecom services (TV, Wireless, Phone, VOIP, etc) and storers of electronic data from divulging:**
 1. **The Content of Communications**
 2. **Certain Personally Identifiable Information**
 3. **Other Privately Stored Data**
 - ✦ **Absent a SUBPOENA from the authority – Sounds Legit, Right?**
 - **How does this conflict with statutory and regulatory audit authority?**

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- **Auditing Municipal Franchisees - Records**
 - **Personally Identifiable Information (P.I.I.)**
 - **Federal Courts have broadly construed PII to include**
 - ✦ **1. Customer Name**
 - ✦ **2. Phone Number**
 - ✦ **3. Address**
 - ✦ **4. Other Personal Information**
 - *Scofield v. Telecable of Overland Park, Inc.*, 973 F.2d 874, 876 (10th Cir. 1992)

Municipal Franchise Agreements & Fees



- **Auditing Municipal Franchisees - Records**
 - **Personally Identifiable Information (P.I.I.)**
 - **BUT, courts have clarified that the primary interest sought to be protected does not extend to merely whether a person is a cable or telecom subscriber. *Metrovision of Livonia, Inc. v. Wood*, 864 F.Supp. 675, 681 (E.D. Mich. 1994)**
 - ✦ ***Is this merely strategy or roadblock employed by the utility company to delay or discourage compliance audits, or is this a legitimate concern on their part?***
 - That depends . . .

Municipal Franchise Agreements & Fees



- **Auditing Municipal Franchisees - Records**
 - **Personally Identifiable Information (P.I.I.)**
 - **By examining legislative history, courts have held that the disclosure prohibitions for PII were intended to protect privacy interests of subscribers as it relates to the “content of communications,” such as texts, calls, cell location, and emails, as well as:**
 - ✦ 1. Details about bank transactions
 - ✦ 2. Shopping habits
 - ✦ 3. political contributions
 - ✦ 4. viewing habits
 - ✦ 5. Other significant personal decisions

Municipal Franchise Agreements & Fees



- **Auditing Municipal Franchisees - Records**
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Municipal Franchise Agreements & Fees



- **Auditing Municipal Franchisees - Records**
 - **Personally Identifiable Information (P.I.I.)**
 - **The 10th Circuit Court of Appeals has held that telecom providers, and the like, are required to disclose certain customer info to**
 - ✦ **1. Programmers and Auditors to Check Records**
 - ✦ **2. Attorneys and Accountants**
 - ✦ **3. Purchasers in Connection with a System Sale**
 - ✦ **4. and to **FRANCHISING AUTHORITIES TO DEMONSTRATE COMPLIANCE****
 - ✦ **ALL WITHOUT PRIOR CONSENT OR NOTICE TO THE SUBSCRIBER**

Municipal Franchise Agreements & Fees



- **Primary Issues on Audits**

- **Interpretations of the Ordinance/Agreement and Enabling Laws – i.e. Gross Receipts and Exclusions there from**
 - ✦ **Fee on Fee – i.e. reporting fees passed along to customers as revenues absent a statutory or lawful exemption**
 - **City of Dallas, TX v. F.C.C., (5th Cir. 1997).**
 - ✦ **Exclusions of Various revenue categories – misc. fees**
- **Failure to Make Widespread Corrections of Noncompliance After Audits have Exposed Them in Other Jurisdictions**
 - ✦ **Any entity that hasn't been audited within 5 years**
 - ✦ **Entities that have had compliance issues on other jurisdictions**

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- **Waste Hauler Audits**

- These Entities are Notorious for Excluding Revenue
- Our AVG Audit findings on these entities exceeds \$100k
- We have a former waste hauler who conducts the audits
- Typically many ways to exclude host fees and/or franchise
- Good to conduct an audit every 5-6 years
- Pricing structures result in *no net cost* to client
- Hauler and Landfill Audits
- Commercial & Residential

Questions?

