# Financial Viability of PEG Access Television in Vermont –Brief Overview for House Ways and Means, 4/22/21

Berkshire Telecommunications Consulting
Peter Bluhm (peterbluhm@icloud.com)

# The PEG Study

- “PEG” means Public, Educational and Governmental programming.
- Study aimed to provide options to “ensure the future financial stability and viability of PEG channels.”
- Report examined:
  - Likely financial future
  - Possible efficiencies and other forms of organization.
  - Possible new financing mechanisms.

# Topics Not Covered in Today's Slides

- Cable history and PEG history
- Multiple roles of PEG organizations
- Viewership
- Efficiency options
- Changes to business model options

# Vermont PEG Funding

- Funding Sources
  - 92% from cable companies.
  - Remaining 8% comes from fees, memberships, donations, and other sources.
- Expenditures total about $8 million. Size of PEG budgets variable.
  - Highest single PEG budget is about $800 K.
  - Lowest single PEG budget is about $75 K.

# Federal Regulation of Cable

- Cable Act of 1984.
  - Also called Communications Act of 1934, “Title VI.”
  - Allocates responsibility between federal government and “franchising authorities.”
  - State has very limited authority over cable rates.
- Title VI sets limits on “franchise fees” imposed.
  - 5% of cable revenues for operations is the maximum.
    - Vermont assigns 100% of this revenue to PEG.
  - “Capital” expenses are excluded from the 5% maximum.
    - In some states, an additional 1% contribution for capital is normal.
  - General taxes are not “franchise fees.”

# State Regulation

- PUC Rule 8.000 (1991)
  - PEG organizations are certified by their cable companies, not the state.
  - Cable companies must:
    - Provide channels for AMO programs.
    - Pay for AMO operating expenses
      - Currently a uniform 5% of gross operating cable revenue.
    - Pay “capital expense” payments and enough equipment for AMO to operate.
      - Actual payment rates vary from zero to 1.25%. Modal rate is 0.5% of gross cable revenue. Capital rates are negotiated between each AMO and cable company pair.
  - AMOs file detailed annual reports with information about their finances and operations.

# Telecom and PEG Evolution Since 1984

1. Digital media and the <u>Internet</u>
   - Video streaming  reduces cable subscription rate and thus reduces PEG revenue.
   - PEGs switch to digital technology and Internet streaming.
     - Increases customer convenience.
     - Expands service area footprint.
2. Telecommunications <u>Competition</u>
   - Every platform can provide every service.
   - Old “silos” (and single industry taxes) look increasingly dated and unfair.

# PEG Revenue History and Forecast

- Recent Revenue to AMOs generally stable  over the last 5 years.
  - One sizeable dip in 2018-19 because of a nationwide accounting change that affected the “cable revenues” of cable companies.
- Revenue Forecast
  - Low-normal estimate for 2026 shows total PEG payments declining to $7.04 MM, a loss of about $0.8 MM.
  - If AMOs also have a 1% inflation in costs, then 2026 deficit could be $1.4 MM, or 17% of current spending level.
- Risks not quantified:
  - FCC restricting state fees and charges imposed on cable companies.
  - Increasing cable company losses of video subscribers.
  - Cable company strategic decisions to shift from cable service to streaming video.

# Financing Constraint #1 – The Cable Act

- “Franchise fee” limited to 5% of cable revenues.
  - Excludes PEG capital costs.
  - Excludes general taxes, like Sales and Use Tax
- FCC’s “Third Order” expands the class of **“in-kind” services** the value of which are to be considered “franchise fees” and which can therefore reduce the level of cash payments to AMOs.
  - Includes any mandated cable service and mandated Internet service.
  - Vermont PUC requires both of these from cable companies in franchise documents (CPGs).
- Third Order still on appeal.
  - Recent oral argument looked bad for FCC.

# Financing Constraint #2 – Universal Service

- Vermont’s USF is funded by surcharge on “intrastate” and “interstate” telephone revenues.
  - An unusual base, but it has been unchallenged now for 26 years.
- Telecommunications Act of 1996 authorized federal and state USF programs, but with <u>many limitations</u> for states.
  - A state rule cannot be *inconsistent* with the Commission's *rules*.
  - Contributions must be “*equitable and nondiscriminator*y.”
  - Support mechanisms must be “*specific, predictable, and sufficient*.”
  - Mechanisms cannot rely on or “*burden*” federal universal service support mechanisms.
- Post-1996 litigation has not clarified these concepts. There is substantial risk in doing anything innovative in the universal service sphere.
  - The FCC appears strongly opposed to letting states fund universal service by a surcharge on Internet access.

# Financing Constraint #3 – Barriers to Entry

- States cannot do anything that prohibits entry into telecommunications markets. 47 U.S.C. § 253.
  - This could potentially include a confiscatory charge or tax.
- “Safe harbor” exemption for management of rights-of-way.
  - Courts might not sustain a ROW tax as unrelated to state’s cost of maintaining the ROW.
- Case decisions
  - Have invalidated franchising requirements, but generally for provisions that give too much discretion to the franchising agent.
  - One court sustained a city charge of 4% of gross revenues against a telecommunications company seeking to install miles of underground conduit.
- FCC has issued decisions suggesting they will preempt many ROW charges.

# Financing Constraint #4 – Internet Tax Freedom Act

- States cannot tax Internet access.
  - Now a permanent provision of federal law.
- Exceptions for:
  - Universal service (but must meet FCC standards)
  - 911 and E-911

# Financing Constraint #5 – FCC Broadband Policy

- FCC issued *Restoring Internet Freedom Order* in 2017.
  - Reversed once again FCC's position on whether Internet access is a "telecommunications service." It's not.
  - Order purported to preempt states from regulating Internet access.
    - Announced federal "preemptive policy of non-regulation."
  - Order preempted States taxing Internet access for universal service.
- On appeal, the FCC was reversed (in part).
  - When the FCC declared Internet access is not a "telecommunications service," it undercut its own authority.
  - FCC authority over the industry and the states is limited.
  - But, FCC's <u>universal service</u> discretion not substantially affected.

# Revenue Option #1 – New 1% Charge on Cable Revenues

- Proceeds would go to the state General Fund, and be appropriated to AMOs.
  - AMOs would have to use the money for capital expenditures.
- Would displace existing cable company payments for capital costs of AMOs.
  - State might have to delay effective dates until existing contracts expire. Net effect an increase in cable company charges of about $0.4 MM.
- Advantages:
  - Similar to charges in some other states.
- Disadvantages:
  - Not competitively neutral – increases burden on cable companies.
  - Involves state treasury in a new kind of transaction with little marginal financial change effected for PEGs.

# Option #2 – New Streaming Video Charge

- A new charge on streaming video, paid to General Fund and appropriated to AMOs.
  - Sales tax already applies to this service.
  - Charge could also apply to satellite video services.
- Advantages
  - Vermont Sales and Use Tax already covers this. This helps solve many administrative and scope issues.
  - This kind of charge has been upheld at least once against a Commerce Clause challenge. Other states considering enacting such charges.
  - Could improve the alignment between the Vermont residents who benefit from PEG service in the modern age – through Internet streaming – with those who pay for that service.
- Disadvantages
  - Cost of administering a new tax

# Option #3 – Raise the VUSF Rate

- VUSF already supports a range of telecommunications services.
  - VUSF is for telephone and broadband.
  - PEG is for video.
- Most of the VUSF funding now goes for E-911, but the VUSF isn't currently raising enough to match E-911 appropriations.
  - VUSF rate may have to increase anyway.
- Disadvantages:
  - VUSF is funded by telephone surcharges. It may not be fair to telephone customers to add this additional burden.
  - Federal limitations on universal service prevents broadening the base of the VUSF to include Internet access payments.

# Option #4 – Pole Attachment Charge

- Vermont telecommunications providers use utility poles.
  - Rocky soil, lots of ledge. Buried cable is expensive in Vermont.
  - Includes cell companies that use cables to reach their antennas.
- Revenue estimate: $4.4 MM/yr. (= $10/att./year x 440 K att.)
- Advantages:
  - More competitively neutral than charges on cable companies or on telephone companies.
- Disadvantages:
  - A new tax. Attachers already pay pole attachment fees, about $15/yr/att.
    - Increased costs for all telecoms, including CUDs.
  - Give credit against PEG payments to comply with 5% franchise fee limit.
  - Possible “federal-aid” highway restrictions.

# Option #5 – Multipart Option

1. Create Vermont Telecommunications Public Benefit Fund (TPBF).
    - Funded by a pole attachment charge. Estimated rate is $10 per year per attachment.
        - Must allow cable companies to reduce PEG payments dollar for dollar.
    - Legislature appropriate TPBF to PEGs to replace lost cable operating revenues.
2. Repurpose the VUSF as an E-911 fund.
    - Broaden the base - add Internet access revenue. Will reduce burden on customers of traditional non-Internet telephone services..
    - Transfer other, non-E-911, VUSF program costs from the TPBF.
3. New capital fee of 1% on cable company gross revenue from cable revenue of cable companies, for PEG.
    - Legislature appropriate TPBF to AMOs to replace lost cable capital payments.
4. Repeal the Telephone Personal Property Tax.
    - Hold the General Fund harmless by a transfer from the TPBF.

# Financial Effects – Example @ $10/yr/att.

| Program Element | Policy Change | TPBF (millions) | PEG (millions) | General Fund (millions) |
|---|---|---|---|---|
| 1 | New Pole Attachment Charge | $ 4.41 | | |
| | Offsetting Reduction in Cable Company Operating Payments to PEGs | | $ (1.32) | |
| | Appropriation to PEGs | $ (1.32) | $ 1.32 | |
| 2 | Miscellaneous Programs (Lifeline, TRS) Shifted to TPBF | $ (0.57) | | |
| 3 | New PEG Capital Fee | $ 1.20 | | |
| | Eliminate PEG Capital Payments | | $ (0.86) | |
| | Appropriation to PEGs | $ (1.20) | $ 1.20 | |
| 4 | Repeal Telephone Personal Property Tax | | | $ (2.40) |
| | Fund Transfer from TPBF to Gen.Fund | $ (2.40) | | $ 2.40 |
| **Total** | | $ 0.12 | $ 0.34 | $ - |

# Recommendations

- Encourage AMO’s to continue their efforts to improve cost efficiencies and seek additional sources of funds.
- Option (#5) deserves serious consideration.
  - Modernizes the state’s telecommunications tax structure.
  - Broadens the base of AMO payments in a way that reflects the increasing use of the Internet as a medium for video programming, including PEG video.
  - Encourages AMOs to expand their program benefits into surrounding towns that have broadband but lack cable television service.

# Questions?

# Interlude – Connection Charges

- Replacing gross receipts funding with per-connection funding has been popular in some states.
  - Maine and some other states use a per-line connection charge on telephone numbers to fund its state universal service fund.
- A connection fee on Internet access could distribute the burden of VUSF funding more fairly, but that step is blocked by the FCC.
- A per-connection fee on telephone customers, replacing the VUSF gross revenues fee, could be a slight improvement over the status quo, but is beyond the scope of this PEG study.

# Interlude – Telephone Personal Property Tax

- TPPT provides no revenue to PEG programs.
- Current rate is 2.37 % of the "net book value" of a telephone company.
- "Net book value" is a regulatory concept, designed to allow a rate regulated company to make a fair recovery on its initial investment.
  - It was clearly defined and easy to administer in the 1960s.
- Net book has complex features:
  - Exclusion of a large amount of "non-regulated" property used for Internet service, any video services.
  - Accumulated depreciation greatly reduces book value on an older network.

# Telephone Personal Property Tax

- Disadvantages as a PEG resource.
  - Not competitively neutral. Many competitors do not pay.
  - Revenue declining.