



MT. HOOD CABLE REGULATORY COMMISSION

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STAFF REPORT AND RECOMMENDATION

To: The Mt. Hood Cable Regulatory Commission
Re: Qwest Competitive Cable Franchise: Recommendation to Portland City Council
For: MHCRC Meeting, September 17, 2007: Agenda Item #9
From: MHCRC Staff (David Olson, Mary Beth Henry, Julie S. Omelchuck)
Reviewed by: Ben Walters, MHCRC Legal Counsel
Date: September 10, 2007

STAFF RECOMMENDATION

Staff recommends that the MHCRC forward the proposed Qwest Cable Services Franchise, in substantially the same form as the PDX-MHCRC-Qwest Cable Services Franchise, dated Sept. 7, 2007 (Exhibit A), to the Portland City Council with a recommendation for approval, subject to Qwest's assent to a separate letter of agreement with the MHCRC addressing funding the designated access providers' capital costs to implement the interconnect for the PEG access channels (see agenda item #10).

Along with the staff-recommended Franchise Agreement (Exhibit A), this staff report includes a staff analysis of the issues raised during the MHCRC's public process (including the public hearing on July 30, 2007 and other comments sent in through August 13, 2007) (Exhibit B), and separate memoranda on certain legal issues from MHCRC legal counsel Ben Walters (Exhibits C & D).

OVERVIEW OF PUBLIC COMMENT

A summary of public comments submitted to the MHCRC regarding the proposed franchise is attached as Exhibit B. At a July 30 public hearing, the MHCRC received comments from many interested organizations and parties (including the incumbent cable operator Comcast) as well as a number of interested citizens. The MHCRC established a closing date of August 13, 2007 for additional public comment. By the closing date, additional input was received from several organizations and individuals, as well as further comments from Qwest and Comcast. Overall public response was generally positive and supportive of the proposed franchise. The public comment included statements from many organizations that might not otherwise be expected to agree (e.g. the Cascade Policy Institute and the Citizen's Utility Board). However, the incumbent cable operator (Comcast) with support in more general terms from its allied cable

trade association (Oregon Cable Telecommunications Association or OCTA) identified several specific issues and objections to the proposed Qwest cable franchise. Comcast's issues and objections were expressed primarily in two detailed letters to the MHCRC, the first dated July 27, 2007 ("Comcast I") and the second dated August 13, 2007 (Comcast II"). A separate set of issues concerning the undergrounding of utilities was raised in the public process by two citizens from Portland's Hillsdale area long associated with Hillsdale neighborhood and business associations, both of whom formerly served on the City of Portland's Utility Undergrounding Citizen Advisory Committee (UUCAC).

STAFF ANALYSIS AND DISCUSSION OF ISSUES RAISED AS CONCERNS

The Commission asked staff to respond to any significant concerns raised in public comments, in conjunction with providing staff analysis, conclusions and recommendations for the MHCRC's consideration.

1. Level playing field and competitive neutrality in existing Comcast and proposed Qwest franchises.

Source: Comcast I and II, OCTA

Brief Restatement of Issue: The current Comcast franchises (e.g. East Portland franchise § 1.5(B)(1), generally require that material provisions of future cable franchises issued by the City be reasonably non-discriminatory and competitively neutral, unless otherwise restricted by law. Comcast (in Comcast I and II) states that the proposed Qwest franchise is not non-discriminatory and competitively neutral with respect to the particular issues and provisions cited by Comcast.

Staff Analysis & Response: See staff response and analysis on each issue cited by Comcast (below). Staff's conclusion is that the proposed Qwest cable franchise, while not intended to be a "mirror image" of Comcast cable franchises which in some respects are more than a decade old, nevertheless, when taken as a whole, is non-discriminatory and competitively neutral with respect to Comcast's commitments.

2. Build Out and deployment/availability of Qwest cable services.

Source: Comcast I & II, OCTA

Brief Restatement of Issue: Comcast complains that the build out and service extension provisions of the proposed Qwest franchise are not comparable to Comcast's service extension and build out requirements, that the "anti-redlining" provisions are inadequate, and that the proposed franchise lacks enforcement mechanisms for build out.

Staff Analysis & Response: The proposed franchise is as aggressive on this issue as is possible with this applicant in the current legal environment. As demonstrated by the pattern of Qwest negotiations elsewhere, imposing a mandatory build out provision of 100% of the franchise area subject to a fixed timeline will have one result: the elimination of any possibility of a competitive, facilities-based cable alternative. Qwest will simply not make the necessary investment to deploy competitive cable services here with the requirement that Comcast proposes, because the business case necessary to support facilities-based competitive cable services from a second provider (Qwest in this instance) cannot (in Qwest's view) be sustained if a costly fixed build out requirement is imposed that bears no relationship to Qwest's actual

success as a second entrant in the cable services marketplace. It is worth noting that Comcast (and its predecessors) have already reaped the benefit of a 20+ year head start over Qwest in multi-service broadband deployment, with the result that every household in Comcast's franchise is already wired and serviceable. Comcast also enjoys a substantial lead in cable services marketing, packaging and customer retention in what is now (for Comcast) a unique "quad play" environment (Comcast owned cable, broadband Internet, digital telephone and wireless telephony services) but which for Qwest will, at best, become a "triple play" environment (Qwest-owned services will be wireline telephone, DSL Internet and cable services). While staff neither adopts nor denies Qwest's arguments about the business environment facing Qwest as a second entrant, sufficient objective evidence exists to demonstrate that the mirror-image build out conditions urged by Comcast in the name of "competitive neutrality" will have one proximate result: the elimination of cable services competition to Comcast from Qwest, since Qwest will decline to enter the market here under the condition proposed.

That being the case, staff's approach in the franchise is to provide for a non-discriminatory, incentive-based build out where Qwest is rewarded with a longer franchise term if certain construction targets are reached. The penalty facing Qwest for failing to build is the loss of the franchise in 72 months. Staff regards this condition as a significant deterrent to inaction by Qwest, and a significant incentive to build out the system. The proposed Qwest franchise (§4.3) specifically prohibits Qwest from "bas[ing] decisions about construction or maintenance of its Cable System or Facilities based upon the income level of residents of the local area in which such group resides"; and also forbids Qwest from denying cable services "to any group of subscribers or potential residential subscribers based upon the income level of residents of the local area in which such group resides." Section 16.4 of the Qwest franchise similarly requires nondiscrimination in rates and charges for subscribers, and prohibits discrimination based on income or geographic location, as well as other factors. To that extent, the franchise tracks with Comcast's own franchise commitments in that regard, as well as the specific terms of applicable federal statute (47 USC §541(a)(3)).

Moreover, Comcast is well aware that the FCC has recently cast doubt on the lawfulness of fixed build out mandates imposed by franchising authorities on second entrants in the cable services market. These limitations are discussed in a memorandum from the MHCRC's legal counsel to staff, which is attached as Exhibit C. Interested community and public interest groups long associated with concerns in these areas have not joined Comcast in expressing concerns on this subject. Instead, the proposed franchise treatment is supported by groups as diverse as the Oregon Association of Minority Entrepreneurs, the Oregon Alliance to Reform Media, the Citizen's Utility Board, the Urban League of Portland, the Hispanic Metropolitan Chamber, the Cascade Policy Institute and Portland Community Media.

To repeat: the proposed Qwest franchise is as aggressive on build out as Qwest's market position and applicable law allow. With the essential inclusion of the anti-redlining and nondiscrimination provisions (as cited), the proposed Qwest franchise will provide conditions for the advent of facilities-based competition for cable services, along with the associated competitive benefits which will accrue to otherwise captive cable subscribers. Insistence on fixed build out provisions would likely result in Qwest's withdrawal, or possible legal challenges as to the requirement.

3. Gross Revenues definition.

Source: Comcast I

Brief Restatement of Issue: Comcast objects that the proposed Qwest franchise definition of “Gross Revenues” (§3.27) subject to applicable franchise and PEG fees is not specific as to certain elements (e.g. launch fees, marketing reimbursements, etc) which Comcast presently includes in gross revenues for purposes of calculating such fees, and thus it is not “discernable” whether Qwest will be required to pay such fees on the same basis.

Staff Analysis & Response: Qwest will be required to include in its franchise fee and PEG fee base everything that Comcast includes, and will be required to pay on precisely the same basis as Comcast currently pays. Indeed, the proposed Qwest franchise "Gross Revenues" definition is identical to Comcast's East Portland franchise language, with only two exceptions that are unrelated to the specific concerns raised by Comcast and which simply embody current actual Comcast payment practices and reflect current federal law and regulations. Therefore, staff expects Qwest and Comcast to include the same elements of gross revenue in calculating and paying franchise and PEG fees with no advantage/disadvantage to either company.

4. Service to schools.

Source: Comcast I

Brief Restatement of Issue: Comcast objects that there is no build out requirement to all schools in Qwest’s franchise area, and that Qwest will be required to provide service only on request to schools located within an area of actual Qwest deployment (“RT Service Radius”).

Staff Analysis & Response: See in general staff’s discussion of build out requirements (Issue #2, above). Extensions to schools in the franchise area are provided on-demand on a reasonably commensurate basis in any areas where Qwest has actually deployed its cable services. As Comcast itself recognizes, “the provision of ... cable service to schools within the City is a valuable community service” and Comcast (and its predecessors) have enjoyed the benefits, name familiarity and goodwill engendered by such extensions for many years, above and beyond the initial cost of the extension. As a second entrant, Qwest not only faces the potential obligation to provide the connection on demand to any school located in an area Qwest builds, but also the challenge of gaining entrée to a marketing opportunity long dominated by the incumbent cable operator. Taken in context, the provisions are reasonably commensurate.

5. Institutional Network.

Source: Comcast I

Brief Restatement of Issue: Comcast objects that Comcast has constructed and maintains an Institutional Network (“I-Net”) under its existing cable franchise, and that Qwest’s franchise does not initially require Qwest to duplicate Comcast’s I-Net. Comcast complains that Comcast incurs costs to comply with the I-Net requirements, and that Qwest will not incur these costs.

Staff Analysis & Response: The funding provided by PEG Capital funds (at the same level Qwest will be paying under the proposed franchise) fully defrayed the construction of the existing Comcast I-Net, and the current fees paid to Comcast by I-Net users fully defray Comcast’s costs of operating the I-Net. Qwest will be required to provide I-Net construction,

connections and services only when it makes sense to do so, and the proposed Qwest franchise provides that any and all Qwest I-Net costs in those circumstances can and will be fully defrayed in the same manner. These are precisely the conditions under which Comcast built and is operating the I-Net at the present time. The provisions are reasonably commensurate.

6. Indemnity provisions.

Source: Comcast II, OCTA

Brief Restatement of Issue: Comcast (and its state trade association OCTA) complain that the indemnity provisions of the proposed franchise improperly delegate legislative decisions to Qwest, give rise to an appearance of impropriety, allow Qwest to “control” any lawsuit brought against the City under the franchise, and provide Qwest a “preferred” position in any litigation, giving rise to the appearance of a “sweetheart deal” (Comcast’s description).

Staff Analysis & Response: The MHCRC’s legal counsel has provided a memorandum for staff generally responding to these comments, which is attached as Exhibit D. The City of Portland (like other local governments) takes steps to minimize fiscal risks to taxpayers that might arise from lawsuits challenging certain city actions in connection with licensing certain commercial transactions (e.g. legal challenges to the Qwest franchise). The provisions included in the proposed Qwest franchise are relatively standard, and consistent with provisions included in the overbuilder franchises developed by the MHCRC in 2000. The provisions are also consistent with provisions included in cable franchises elsewhere between local governments and other cable-overbuilders (e.g. Verizon). Finally, the indemnification provisions in the proposed franchise are similar to indemnity protection consistently sought by Comcast in its contracts. Staff concludes that this type of contractual protection is commercially common. Thus, the provisions in the proposed franchise are reasonable.

7. Local origination programming.

Source: Comcast II

Brief Restatement of Issue: Comcast argues that it’s required to provide Local Origination Programming as a category of programming, and the Qwest franchise has no parallel provision.

Staff Analysis & Response: Comcast’s franchise agreement (East Portland §5.3(C)) recites the company’s position that the specified requirement is invalid and unenforceable. Although the City has not waived enforcement of the requirement, Comcast and its predecessors have at no time in the 10+ year history of the franchise made any focused effort to demonstrate that the company has satisfied the requirement. Since Comcast and its predecessors have long argued the provision is invalid and unenforceable, and have made no consistent, targeted effort to satisfy the requirement, the lack of a local origination programming requirement in Qwest’s franchise does not present any materially significant difference in the respective franchise obligations.

8. Analog & digital carriage requirements.

Source: Comcast II

Brief Restatement of Issue: Comcast argues that the franchises are dissimilar (and Comcast is disadvantaged) because Qwest will not be required to carry both analog and digital channels

when more than 50% of analog commercial programming channels are converted to digital transmissions.

Staff Analysis & Response: Qwest's system will be all-digital from the start, just as Comcast's own system is itself migrating to the increasingly-dominant digital platform as convergent digital technology becomes more widespread and applicable federal deadlines loom. Comcast continues to enjoy the benefit of a captive analog subscriber base developed in a monopoly service environment over decades, enabling Comcast to exercise considerable influence and control over the transition of any remaining analog-dependent Comcast subscribers to more expensive digital platforms. Thus, in staff's view, Comcast is in a far better market position than Qwest with respect to entrée to existing analog subscribers, even where "down-conversion" may be necessary as subscribers cling to older analog televisions. Comcast's objection treats fundamentally dissimilar systems as if identical. In this context, the franchise provisions are reasonably commensurate.

9. Live origination capability.

Source: Comcast II

Brief Restatement of Issue: Comcast argues that under the Qwest franchise as proposed, Qwest is obliged to provide only a maximum of six (6) live origination programming points, whereas Comcast's requirements is virtually unlimited, and that Comcast currently provides such capability for approximately 30 sites and connectivity (via the I-Net) for approximately 178 sites.

Staff Analysis & Response: In its objection to Qwest's section 6.4(A) (previously 7.4(A)), Comcast has confused two separate and distinct franchise obligations. The required six PEG access channel origination points in Qwest Section 6.4(A) is the same franchise obligation as is contained in Comcast Section 7.3(A) (not section 7.6(C) as indicated by Comcast). Both the proposed Qwest franchise and Comcast's current franchise contain the obligation for the cable company to interconnect with the designated access providers' "headends," where they program the channels, in order for the channels to be available on the company's cable system.

10. PEG capital audits.

Source: Comcast II

Brief Restatement of Issue: Comcast argues that the audit provisions for PEG capital payments are dissimilar, and Qwest may arrange for and conduct audits of PEG capital payments while there is no similar audit provision in Comcast's current franchise.

Staff Analysis & Response: Under the Comcast East Portland franchise, Comcast is authorized to review and inspect applicable City records, as well as the records of the recipients of PEG Access Capital funds (East Portland Franchise § 9.5). While the provisions of the proposed Qwest franchise in this area are updated and more specific as to the process to be pursued, there is ultimately no substantial or material difference in the rights of Comcast (and Qwest under the parallel provision) to inspect or audit City or PEG Grant records to ensure that PEG funds are appropriately expended for lawful PEG and I-Net purposes. The requirements are reasonably commensurate.

11. Reimbursement for audits.

Source: Comcast II

Brief Restatement of Issue: Comcast objects that there is a cap on the reimbursement to the City of the cost of audits under certain circumstances, but no similar cap in the parallel provision of the Comcast franchise.

Staff Analysis & Response: The language is not precisely the same as the language in Comcast's franchise because, among other reasons, more than ten years have elapsed since Comcast's original franchise language was written, and portions of the language here and elsewhere have been re-examined, negotiated and updated. In the elapsed time span, no Comcast audit has resulted in the City seeking to recover its audit costs, at any level. Comcast is to be commended for its meticulous accounting practices. Comcast's current agreement expires less than 36 months after Qwest's agreement is proposed to become effective, and Comcast will prior to that time (in a renewal negotiation likely to begin next year) have the opportunity to discuss inclusion of updated language here and elsewhere in a renewed franchise agreement. The requirements are otherwise reasonably commensurate.

12. Transfer/sale provisions.

Source: Comcast II

Brief Restatement of Issue: Comcast objects that certain provisions governing the transfer or sale of all or portions of Qwest's cable system are different from the provisions of Comcast's franchise, or that there are no parallel provisions in Comcast's franchises.

Staff Analysis & Response: The language is not precisely the same as the language in Comcast's franchise because, among other reasons, more than ten years have elapsed since Comcast's original franchise language was written, and portions of the language here and elsewhere have been re-examined, negotiated and updated. Comcast's current agreement expires less than 36 months after Qwest's agreement is proposed to become effective, and Comcast will prior to that time (in a renewal negotiation likely to begin next year) have the opportunity to discuss inclusion of updated language here and elsewhere in a renewed franchise agreement. In the meantime, the differences between the franchises are not material.

13. Forfeiture provision.

Source: Comcast II

Brief Restatement of Issue: Comcast argues that the forfeiture and City-purchase provisions in the current Comcast franchise are not paralleled in the proposed Qwest franchise.

Staff Analysis & Response: See staff Analysis and Response to Issue #12 (above). Differences between the franchise provisions are not material. The requirements are reasonably commensurate.

14. Annual Report requirements.

Source: Comcast II

Brief Restatement of Issue: Comcast argues that the scope of financial information set forth in the reports required of Qwest under the proposed franchise is narrower than the requirements applicable to Comcast.

Staff Analysis & Response: See staff Analysis and Response to Issue #12 (above). Differences between the franchise provisions are not material. The requirements are reasonably commensurate.

15. Subscriber privacy provisions.

Source: Comcast II

Brief Restatement of Issue: Comcast objects that the provisions governing protection of personalized information differ between Comcast's franchise and Qwest's proposed franchise.

Staff Analysis & Response: See staff Analysis and Response to Issue #12 (above). Differences between the franchise provisions are not material. The requirements are reasonably commensurate.

16. Changes in law.

Source: Comcast II

Brief Restatement of Issue: Comcast argues that the "change in law" provisions differ between Comcast's franchise and Qwest's proposed franchise.

Staff Analysis & Response: See staff Analysis and Response to Issue #12 (above). Differences between the franchise provisions are not material. The requirements are reasonably commensurate.

17. Mediation.

Source: Comcast II

Brief Restatement of Issue: Comcast argues that the mediation provisions differ between Comcast's franchise and Qwest's proposed franchise.

Staff Analysis & Response: See staff Analysis and Response to Issue #12 (above). The mediation provision in the Qwest franchise, as well as the arbitration provision, is subject to both sides agreeing to alternative dispute resolution. The Qwest franchise provisions are reasonably commensurate with the requirements in Sections 24.2 and 24.3 of the Comcast franchise in East Portland. Differences between the franchise provisions are not material.

18. Guarantor.

Source: Comcast II

Brief Restatement of Issue: Comcast argues that the guarantor provisions differ between Comcast's franchise and Qwest's proposed franchise.

Staff Analysis & Response: See staff Analysis and Response to Issue #12 (above).

19. Undergrounding.

Source: Hillsdale citizens

Brief Restatement of Issue: Hillsdale citizens (Wes Risher, past president of the Hillsdale Neighborhood Association) and Rick Seifert (past president of the Hillsdale Business and Professional Association) urge that the MHCRC modify the franchise to include required utility

undergrounding provisions within all Metro-designated Town Centers and Main Streets within the franchise area, and in addition require 1% of annual Gross Revenues be set aside to fund the capital costs of undergrounding utilities.

Staff Analysis & Response: These recommendations, among others, were the subject of the City of Portland's Utility Undergrounding Citizen Advisory Committee (UUCAC) which was created by the Portland City Council on August 12, 1998, and whose final report (containing both a majority recommendation and minority opinion) was presented to the Council on March 29, 2000. Both Mr. Risher and Mr. Seifert served on the UUCAC. Setaside of a percent of gross revenues to fund undergrounding in this franchise or any other is a Portland City Council budget decision. It is not necessarily a matter that needs to be negotiated with Qwest or any other franchisee. If the franchise imposed an additional 1% gross revenue fee, above and beyond the cable franchise fee, this would implicate federal law limiting cable franchise fees to a maximum of 5% of gross revenues (except for PEG capital expenditures). Any amount above the federal ceiling could be offset by Qwest. This would simply return the question to the Portland City Council to consider as a budgetary matter along with other general fund needs. In conclusion, while not taking exception to the recommendations contained in the 2000 UUCAC Report to the Portland City Council, the Qwest franchise for cable services does not represent an appropriate or sufficiently robust opportunity to implement the recommendations of that study.

BACKGROUND

In December, 2006, Qwest representatives notified MHCRC staff that Qwest was interested in discussing and obtaining a competitive cable services franchise in the City of Portland portion of Qwest's telephone service area. Among other things, Qwest representatives advised MHCRC staff that Qwest would be prepared to meet commensurate public benefit requirements (including PEG access and franchise fee commitments) in parity with requirements applicable to the incumbent cable operator. MHCRC staff duly notified the MHCRC of Qwest's application, and began informal discussions with Qwest in January, 2007. The MHCRC designated a Portland-appointed MHCRC member (Commissioner Sue Dicile) as liaison to the MHCRC staff-Qwest negotiations and discussions proceeded in earnest at a staff level through winter and spring of 2007. On May 21, 2007, Qwest made a formal public presentation to the MHCRC regarding Qwest's competitive cable franchise application, including an overview of Qwest's system technical design and extension plans, and proposed channel capacity and public service commitments. Qwest also responded to questions and comments from the MHCRC. Negotiations between Qwest and MHCRC staff continued through early July 2007, at which point the negotiators announced mutual agreement in connection with most significant key issues in a proposed competitive cable franchise between the City of Portland and Qwest. Based on this agreement, the MHCRC released the proposed franchise for public review (dated July 13, 2007). At a July 30 public hearing, the MHCRC received comments from many interested organizations and parties (including the incumbent cable operator Comcast) as well as a number of interested citizens. The MHCRC established a closing date of August 13, 2007 for additional public comment.

ATTACHMENTS

Exhibit A - PDX-MHCRC-Qwest Cable Services Franchise, dated Sept. 7, 2007

Exhibit B – Summary of Public Comments – Proposed Qwest Franchise (July 13, 2007 draft)

Exhibit C – Memorandum, Ben Walters to David Olson (August 14, 2007)
Exhibit D – Memorandum, Ben Walters to David Olson (August 20, 2007)