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BY ELECTRONIC DELIVERY

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street S.W.
Washington D.C. 20554

Re: NCTA's Notice of Ex Parte, *Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as Amended by the Cable Television Consumer Protection and Competition Act of 1992*, MB Docket No. 05-311

Dear Ms. Dortch:

The State of Hawaii ("Hawaii"),[1] by and through its attorneys, hereby responds to the April 4, 2019 letter of NCTA addressing the appropriate method of valuation to be used for cable-related, in-kind contributions.[2]

For the reasons discussed in Hawaii's comments[3] and reply comments[4] to the Second Further Notice of Proposed Rulemaking ("*Second FNPRM*"), cable-related, nonmonetary franchise requirements authorized under the Communications Act of 1934 ("Communications Act" or "Act") should not count toward the five percent franchise fee cap. If the Commission were improperly to conclude otherwise, however, these franchise requirements should be valued at cost, not at some elusive fair market value.

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[1] This letter is being submitted on behalf of the State of Hawaii through its Department of Commerce and Consumer Affairs, which is the cable franchise authority for the State.

[2] *See* Letter from Rick Chessen, NCTA, to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket No. 05-311 (Apr. 4, 2019) ("*NCTA Letter*").

[3] *See* Comments of the State of Hawaii, MB Docket No. 05-311 (Nov. 14, 2018).

[4] *See* Reply Comments of the State of Hawaii, MB Docket No. 05-311 (Dec. 10, 2018).

The comments and reply comments filed in this proceeding overwhelmingly oppose the Commission's proposal[5] that cable-related, in-kind contributions be valued at their fair market value.[6] As a large coalition of cities aptly noted, "[t]he reasoning seems too obvious to state, but clearly Congress intended that cable operators be made whole by recovering their costs, not that they unfairly profit from the recovery on the backs of the public."[7]

The use of a cost-based recovery process would be consistent with numerous analogous provisions of the Communications Act and the Commission's past practices. For example, the Act directs that, in establishing rules for basic service tier cable rates, the Commission must take into account "the *direct costs* (if any) of obtaining, transmitting, and otherwise providing signals carried on the basic service tier."[8] The Act also directs the Commission to establish, "on the basis of actual cost," the price for installation and lease of equipment.[9] Furthermore, the Act permits common carriers to petition the Commission to "recover *costs expended* for making modifications to equipment, facilities, or services" for Law Enforcement Act compliance,[10] and directs the Attorney General to adopt rules that permit telecommunications carriers to recover their "*direct costs*" from the federal government.[11] Thus, as the same coalition of cities explained, "[t]here are

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[5] *See Second FNPRM*, ¶ 24.

[6] *See, e.g.*, Comments of the City of Philadelphia, *et al.*, MB Docket No. 05-311 at 37-38 (Nov. 14, 2018) ("*Philadelphia Comments*"); Comments of the Association of Washington Cities, *et al.*, MB Docket No. 05-311 at 14 (Nov. 14, 2018) ("*Washington Cities Comments*"); Comments of the Cable Act Preservation Alliance, MB Docket No. 05-311 at 14 (Nov. 14, 2018) ("*Alliance Comments*"); Reply Comments of MassAccess, MB Docket No. 05-311 at 10-11 (Dec. 14, 2018); Comments of BRIC, MB Docket No. 05-311 at 2-3 (Nov. 14, 2018); Comments of Clackamus County, Oregon, MB Docket No. 05-311 at 9-11 (Nov. 14, 2018); Comments of Charles County, Maryland, MB Docket No. 05-311 at 19-22 (Nov. 14, 2018); Comments of the City of Rochester, New York, MB Docket No. 05-311 at 18-20 (Nov. 14, 2018); Reply Comments of the City of Fort Collins, Colorado, MB Docket No. 05-311 at 2 (Dec. 13, 2018); Reply Comments of Boston Community Access and Programming Foundation, Inc., MB Docket No. 05-311 at 4 (Dec. 13, 2018); Reply Comments of the Board of Selectmen for the Town of Lexington, Massachusetts, MB Docket No. 05-311 at 3 (Dec. 11, 2018).

[7] *Philadelphia Comments* at 37-38.

[8] 47 U.S.C. § 543(b)(2) (*emphasis added*).

[9] 47 U.S.C. § 543(b)(3).

[10] 47 U.S.C. § 229(e) (*emphasis added*).

[11] 47 U.S.C. § 1008(e) (*emphasis added*).

no instances in which the Communications Act and the corresponding FCC's rules allow communications companies to recover the fair market value of their costs."[12]

The use of an actual cost valuation method would also provide the most accurate and easily verifiable means of valuing nonmonetary contributions. For example, actual costs of cable-related, in-kind contributions would include the actual costs of materials, permits, licenses, and inspection fees, as well as direct labor costs and amounts paid to external contractors. Other non-direct costs, like overhead including indirect labor costs, would not be included in the valuation of in-kind contributions. This is because all cable operators have overhead that they would incur with or without these in-kind franchise requirements, and thus an actual cost valuation method would not permit cable operators to pass on the cost of this overhead to franchising authorities. Similarly, most cable operators have excess network capacity that can be used for PEG distribution and institutional network ("INET") connections. The marginal cost of this additional capacity accordingly should not be included in the valuation of in-kind contributions because there is no lost opportunity cost to the cable operators to direct this capacity to franchising authorities.

In contrast to the objectivity provided by an actual cost valuation approach, the definition of "fair market value" is subject to multiple interpretations, and any attempt to determine the fair market value of in-kind contributions is likely to result in endless disputes between cable operators and franchising authorities.[13] Unlike an actual cost valuation method, which relies on verifiable documentation, a fair market valuation method lacks any governing standards or guidelines. Cable operators could thus vary their assessments of the fair market value of any given in-kind contribution by changing which data elements they incorporate into their valuation model. Furthermore, "[a] valuation of fair market value may vary by cable operator, placing LFAs with multiple cable franchises in the untenable position of determining which value is accurate and ensuring that the franchises are competitively equitable."[14] The use of fair market value would therefore inevitably result in disputes between cable operators and franchising authorities, increasing the cost and time spent on franchise negotiations and ultimately harming American consumers.[15]

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[12] *Philadelphia Comments* at 37 n.201.

[13] *Contra NCTA Letter* at 3 ("Because marketplace alternatives exist for virtually all cable-related in-kind contributions, there should be few material disputes over their fair market value.").

[14] *Washington Cities Comments* at 14.

[15] *See id.* ("Using a fair market value standard places LFAs in a clear disadvantage, will prolong franchise negotiations, and will increase costs to all parties involved. . . .").

Using a fair market valuation method would also incentivize cable operators to assign in-kind contributions the highest possible market value in order to decrease the remainder of the franchise fees they agreed to and are contractually and statutorily required to pay. For example, assume that the five percent statutory cap of a cable operator's gross revenue is $200,000. Further assume that the cable operator incurs actual costs for in-kind contributions in the amount of $20,000, but by using the malleable fair market valuation method, the cable operator "determines" that those in-kind contributions should be valued at $50,000. This approach would allow the cable operator to collect $200,000 from subscribers to satisfy the five percent franchise fee, pay the remaining $150,000 to beneficiaries, and retain a profit of $30,000. In other words, this cable operator would appear to satisfy its $200,000 franchise fee obligation, while actually incurring only $170,000 in out-of-pocket costs. As this example shows, if the Commission were to allow cable operators to use a fair market valuation method to manipulate the value of in-kind contributions, cable operators would necessarily receive a windfall in the form of a reduced cost burden at the expense of American consumers.

Contrary to NCTA's bizarre assertion, the use of an actual cost valuation method creates no similar irrational incentives for cable franchising authorities. The NCTA argues that using a fair market valuation method "ensures that a franchising authority will not consume more resources simply because they are available at an artificially reduced price."[16] In actual practice, however, an actual cost recovery process already provides more than adequate incentive for franchising authorities to limit their requests for new connections. Hawaii, for example, has long procured many of its new INET connections from its cable franchisees on an actual cost recovery basis. The actual cost of new construction is not insignificant and local and state governments such as Hawaii are under enormous pressure from taxpayers to minimize their expenditures. Therefore, NCTA's suggestion that an actual cost recovery approach might prompt franchising authorities to procure more in-kind contributions then they actually require does not align with reality.

Finally, the *Second FNPRM*'s policy justification for subjecting cable-related, in-kind contributions to the franchise fee cap also counsels in favor of using an actual cost, not fair market value, approach. The *Second FNPRM* proposes that cable-related, nonmonetary franchise requirements should be subject to the franchise fee cap in order to encourage cable operators to invest in new services and facilities.[17] Hawaii reiterates that cable-related, in-kind contributions

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[16] *See* Reply Comments of NCTA – The Internet & Television Association, MB Docket No. 05-311 at 19 (Dec. 14, 2018).

[17] *See Second FNPRM*, ¶ 1 (stating that the proposed rule will "ensure that local franchising requirements do not discourage cable operators from investing in new facilities and services"); *see also id.* ¶¶ 15, 23.

should not be subject to the franchise fee cap. But, "[t]o the extent that cable-related, nonmonetary franchise requirements deter additional investment, it is because those requirements cost the operator an amount of money that otherwise could be used elsewhere."[18] That is, if cable operators were not subject to cable-related, in-kind contribution requirements, the amount that those cable operators would otherwise invest in infrastructure is the actual cost of the cable-related, in-kind contributions, not some amorphous fair market value of those contributions. Therefore, the Commission's policy goals also support the use of an actual cost valuation method to determine the value of cable-related, in-kind contributions.

For all of these reasons, if the Commission improperly concludes that cable-related, in-kind contributions are franchise fees subject to the five percent statutory cap, the in-kind contribution valuation should be limited to the actual, direct costs incurred by cable operators. Direct costs should include only the actual costs incurred by cable operators for providing in-kind contributions. Direct costs should exclude indirect or overhead costs that cable operators would incur regardless of whether they were providing the in-kind contributions. The in-kind contribution valuation should rely only on verifiable documentation, in order to ensure the most neutral valuation of these nonmonetary franchise requirements.[19] Otherwise, "cable operators and their shareholders would receive a windfall, at the public's expense, if they were able to offset their franchise fee payments by amounts greater than their actual costs of complying with nonmonetary franchise requirements."[20] Such a result would directly undermine the Commission's stated policy goals of increasing cable operators' investment in infrastructure and ensuring access to voice, video, and broadband Internet for American consumers.[21]

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[18] *Alliance Comments* at 15.

[19] Under an actual cost model, franchising authorities could verify the value of in-kind contributions by requiring cable operators to provide adequate documentation of costs incurred, including: invoices for materials; a description of all materials used for the in-kind contribution; permits, licenses, and inspection fees for the specific in-kind location; timesheets for employees that include documentation of specific in-kind projects, paystubs, and personnel files with pay rates and salaries; and invoices from external contractors that include documentation of the specific in-kind project. This documentation would ensure transparency and accuracy in calculating the value of in-kind contributions.

[20] *Alliance Comments* at 14.

[21] *See, e.g.*, *Second FNPRM*, ¶ 15 ("[W]e view the proposals discussed below as part of the Commission's larger, ongoing effort to reduce regulatory barriers to infrastructure investment.").

Please contact the undersigned if you have any questions about this matter.

Sincerely,

Bruce A. Olcott
Counsel to The State of Hawaii