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LEGAL MEMORANDUM

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DATE: February 16, 2007
RE: Tucson, Arizona Request for Proposal for Renewal Cable License (“RFRP”)
Adopted January 17, 2007; CoxCom, Inc. d/b/a Cox Communications Tucson

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I. Introduction

CoxCom, Inc. d/b/a Cox Communications Tucson (“Cox”) submits this Memorandum as part of its formal proposal (the “Cox Proposal”) for renewal of the Cable Communication License Agreement (the “License” or the “Franchise”) between Cox and the City of Tucson, Arizona (the “City”) pursuant to Section 626 of the federal Communications Act (the “Act”)¹ and Sections 9-505 and 9-506 of the Arizona Revised Statutes (the “Arizona Statute”).² Cox has provided state-of-the-art cable television services to the City and its citizens since 1998 and has been widely recognized for the high quality of its cable television, telephone, and high-speed Internet services in Arizona.³ As demonstrated in Cox’s responses to Parts II and III of the City’s Request for Proposal for Renewal Cable License (the “RFRP”) and the exhibits thereto, the Cox Proposal satisfies the City’s identified cable-related needs and interests to the maximum extent consistent with the requirements of the Arizona Statute and federal law. The City, therefore, is required to grant the Cox Proposal.

The Arizona Statute Limits the City’s Authority in This Proceeding.

The Arizona Statute became effective on September 21, 2006 and it explicitly applies to all cable television licenses that are “extended or renewed for a term that begins after June 30, 2007.”⁴ Because Cox’s License expires at 12:00 a.m. on September 1, 2007,⁵ the Arizona Statute indisputably governs the terms of Cox’s renewal License.

The Arizona Statute enacts into law the state legislature’s determination of certain specific cable-related needs and interests for all Arizona communities. It limits the authority of local Arizona governments to impose requirements on cable television operators with regard to license fees, Public, Educational, and Governmental (“PEG”) channel capacity, and PEG support. It specifically reduces the license fees and PEG support fees that Cox and its subscribers can be obligated to remit to the City, and reduces from the current nine (9) to a maximum of four (4) the number of PEG access channels that can be required under the License.⁶ Cox’s existing License reflects the City’s written agreement it would be subject to federal, state, and local laws and regulations, including “laws now in effect, as the same may be amended from time to time, and new laws.”⁷ Now, however, when those laws explicitly limit the City’s authority, it has refused to comply. The City’s refusal violates federal and state law, the City’s obligations under the License, and the best interests of Tucson citizens.

The Arizona Statute’s primary goal is to reduce burdens on cable television subscribers by limiting local government authority to require excessive fees, PEG access channels, and PEG access financial support, the costs of which are borne by cable operators and their customers. Despite the governing provisions of the Arizona statute, the City has demanded that Cox pay license fees and provide PEG access channels and support far beyond what Arizona law now permits. The City bases its demands on a subjective ascertainment of community needs and

¹ Communications Act of 1934, ch 652, 48 Stat. 1064 (1934), *as amended* (the “Act”); 47 U.S.C. § 546 (2000).

² A.R.S. §§ 9-505, 9-506 (2006).

³ In 2006 alone, Cox Arizona won three J.D. Powers and Associates’ awards.

⁴ *Id.* § 9-506(H).

⁵ License, § 2(a).

⁶ *See* A.R.S. § 9-506(D)(1).

⁷ License § 1; *see also, id.* at §§ 2.g., 3.a., and 3.b.

interests. As demonstrated in the attached Ascertainment Analysis,⁸ however, the City's ascertainment is unreliable and is inconsistent with an independently conducted survey of the Tucson community. In any event, the City's demands cannot override the governing dictates of state law and the state legislature's sound policy decisions. The City's demands not only violate state law, but would substantially increase costs to Cox's subscribers.⁹

Moreover, the City never challenged the Arizona Statute by bringing an action claiming it violated the Arizona Constitution, any provision of Arizona law, or otherwise. The City also never sought a ruling that the Arizona Statute was preempted by federal law, although the City made that claim while discussing a renewal cable license agreement with Cox in August 2006. Instead, both the Ascertainment and the RFRP simply ignore the governing provisions of the Arizona Statute with which the City must comply. The City, in effect, is attempting an end-run around the Arizona Statute rather than raising its objections, if any, in a proper forum.¹⁰

The City has not Reasonably Conducted the License Renewal Proceeding.

On November 1, 2004, Cox requested that the City commence a proceeding under Section 626(a) of the Act for the purpose, among other things, of identifying future cable-related community needs and interests (the "Ascertainment") in connection with the renewal of Cox's License.¹¹ Despite the nearly three-year period provided under the Act for franchise renewal negotiations and proceedings, the City failed to begin its Ascertainment process seriously for at least eighteen (18) months.¹² The City did not publicly release its proposed Ascertainment findings until December 12, 2006, and did not publicly release its final Ascertainment report or its RFRP until January 17, 2007.¹³ The RFRP required that Cox submit for the City's

⁸ The Ascertainment Analysis is attached to Cox's RFRP response as Exhibit A.

⁹ Cox estimates the costs of only those portions of the City's demands that patently violate governing federal or state law at \$76,585,278 over the ten-year term of Cox's renewal License (*i.e.*, a \$6.05 monthly assessment on each of Cox's 105,488 customers for 120 months).

¹⁰ This failure leads Cox to question whether the City actually believes its stated objections to the Arizona Statute are even legally cognizable.

¹¹ See Letter, dated November 1, 2004, from Anne Doris (Cox Tucson Vice President and System Manager) to Ms. Liz Wallendorf (Tucson Information Technology Project Manager).

¹² The City failed even to acknowledge Cox's November 1, 2004 letter requesting the commencement of proceedings pursuant to Section 626 of the Act for eleven (11) months (*see* letter, dated October 5, 2005, from Ann Strine (Director, Tucson Information Technology Department) to Anne Doris (Cox Tucson Vice President and System Manager)) and failed to begin its "community assessment" until May 21, 2006 (*see* letter, dated May 16, 2006, from Ann Strine to Michael DiMaria (Cox Tucson Director of Government Relations)).

¹³ See Tucson City Council Resolution No. 20562. The Council Resolution incorporated a variety of supplemental documents. Those documents included, among others: a Supplemental Staff Report on Cable-Related Needs and Interests; a Cable Television License Fee and PEG Analysis prepared by Ashpaugh & Sculco, P.L.C. (the "License Fee Audit"); a Technical Evaluation of the Cox Cable System Serving Tucson, Arizona prepared by Columbia Telecommunications Corporation (the "Technical Audit"); a Cox Communications Subscribership Satisfaction and Local Community Programming Viewership Study prepared by FMR Associates, Inc. (the "FMR Study"); a PEG Community Needs Assessment Report prepared by Holly Hansen Consulting (the "PEG Report"); and the transcripts of several local "Town Hall" meetings conducted in September 2006. For purposes of this Memorandum, references to the RFRP include without limitation Council Resolution 20562 and all the incorporated documents identified above.

consideration a formal renewal proposal conforming to the RFRP within thirty (30) days; *i.e.*, by February 16, 2007.¹⁴

Beginning in 2006, Cox worked diligently to conclude a timely and mutually beneficial renewal agreement with the City under the informal renewal procedure set forth in Section 626(h) of the Act.¹⁵ Cox proposed several informal renewal proposals, all of which attempted to address, within the bounds of the law and the best interests of Cox's subscribers, the City's objections to the Arizona Statute. The City, however, simply rejected each of Cox's informal renewal proposals.

Certain findings in the RFRP, along with certain requirements of the formal proposal solicited in the RFRP, however, conflict with the standards and policies set forth in the Act and the Arizona Statute. For example, the RFRP contains proposed requirements for (i) subscriber equipment and transmission technologies in violation of Section 624(e) of the Act,¹⁶ (ii) the provision of an Institutional Network in violation of Section 611(b),¹⁷ (iii) the regulation of rates in violation of Section 623(a)(2),¹⁸ and (iv) the provision of telecommunications and other non-cable related services in violation of Section 621(b)(3)(D).¹⁹

The RFRP similarly violates various provisions of the Arizona Statute. For example, the Arizona Statute limits the categories of gross revenues that may be subject to license fees²⁰ and prohibits the City from levying any "tax, rent, fee or charge, however denominated, on a cable operator" other than the license fee and the transaction privilege tax²¹ (which together may not exceed five percent of gross revenues as defined in the Statute).²² The Arizona Statute also requires that any PEG channel capacity mandated under the license "shall be limited to not more than two channels of public, educational or governmental access programming in the basic service tier . . . and not more than two channels of noncommercial governmental programming, at least one of which may be programmed by the federal government, in the digital programming tier."²³

¹⁴ Given the four-month period provided for the City's review of Cox's License renewal proposal under Section 626(c)(1) of the Act, the potential administrative proceeding that will follow if the City reaches a preliminary assessment that Cox's License not be renewed, and the City's self-imposed but arbitrary June 12, 2007 deadline to complete the entire process, the City's failure to timely conduct its renewal proceeding may irreparably harm Cox, and the City's unreasonably truncated proceeding likely will deny Cox the due process to which it is entitled.

¹⁵ 47 U.S.C. § 546(h).

¹⁶ *Id.* § 544(e).

¹⁷ *Id.* § 531(b).

¹⁸ *Id.* § 543(a)(2). As the City knows, the Federal Communications Commission determined that Cox's Tucson cable system is subject to effective competition under the Act and the City consequently is without authority to regulate Cox's rates. *See Brighthouse Networks, LLC, Charter Communications, CoxCom, Inc. d/b/a Cox Communications Tucson et al.*, 20 FCC Rcd 15229 (Med. Bur. 2005).

¹⁹ 47 U.S.C. § 541(b)(3)(D).

²⁰ A.R.S. § 9-505(6).

²¹ *Id.* § 9-506(C).

²² *Id.* § 9-506(C)(3). The only exception relates to the three-year phase-in of license fee reductions for licenses with terms that begin before January 1, 2008. *Id.* § 9-506(H).

²³ *Id.* § 9-506(D)(1).

Despite the Arizona Statute's requirements, however, the City's RFRP (among a variety of findings and requirements at odds with state and federal law): (1) fails to acknowledge or comply with the Statute's mandated reduction in permitted license fees, and instead asserts that "[a] reduction in the fee would adversely affect the general fund, and funds available for PEG support";²⁴ (2) contradicts the statute's express limitation on permitted PEG fees, and instead purports to require a variety of substantial PEG fees and charges in addition to license fees and transaction privilege taxes;²⁵ (3) violates the Arizona Statute's limitation of two analog and two digital PEG channels, and instead purports to find "a significant need and interest in having Cox provide at least eight PEG channels initially . . . as part of basic service";²⁶ and (4) illegally purports to require that Cox deploy subscriber equipment and transmission technologies "that will allow PEG users to provide access programming 'on demand.'"²⁷

The City's Ascertainment notwithstanding, Cox cannot be required to address or satisfy purported "needs and interests" that governing state and federal law expressly prohibit. Moreover, the City's Ascertainment cannot be accepted as a credible reflection of "future cable-related community needs and interests."²⁸ As demonstrated in the attached Ascertainment Analysis,²⁹ the City designed its Ascertainment to support a variety of requirements that it knew were prohibited by governing law. The Ascertainment, instead of determining *bona fide* community needs, primarily reflects the self-interested views of PEG access administrators and producers who may lose funding and power due to the limitations of the Arizona Statute. This is confirmed by an independent study of Tucson citizens and the City's Ascertainment process,³⁰ as well as by the state legislature's governing determination of community needs and interests.

The City's assertion that "Cox has failed to pay the full license fee owed, and is failing to pay the full fees for PEG owed,"³¹ similarly cannot be accepted. Contrary to the City's License Fee Audit, the City in fact has collected license fees from Cox substantially exceeding the maximum five percent (5%) of gross revenues permitted under Section 622(b) of the Act.³² Even if the City's assertions were accurate, which the attached License Fee Audit Analysis³³ demonstrates they are not, the City must credit actual license fee overpayments against purported underpayments claimed in the City's License Fee Audit and may be required to refund any overpayments to Cox and its customers. The City's License Fee Audit claims that Cox owes the City \$1,651,541 (including interest charges and audit costs) based primarily on a purported

²⁴ RFRP at 17, § B.4.

²⁵ *Id.* § B.3.a.-e.

²⁶ *Id.* at 15-16, § B.2.a, B.2.b.

²⁷ As explained in greater detail below, any such requirement would violate governing federal law, which specifically provides that "[n]o State or franchising authority may prohibit, condition, or restrict a cable system's use of any type of subscriber equipment or any transmission technology." 47 U.S.C. § 544(e). Thus, although Cox may voluntarily deploy equipment and technologies that would permit the "on demand" delivery of PEG or other programming, the City is prohibited from requiring it.

²⁸ 47 U.S.C. § 546(a)(1).

²⁹ See Cox RFRP response at Exhibit A.

³⁰ The Summary of Research Findings prepared by Marketing Intelligence and Zimmerman & Associates, Inc. (the "Cox Survey") is attached to the Cox RFRP response as Exhibit B.

³¹ RFRP at 19, § C.2.

³² 47 U.S.C. § 542(b).

³³ The License Fee Audit Analysis is attached to Cox's RFRP response as Exhibit C.

failure to pay all required fees on advertising revenue and launch expense reimbursements. Before the City publicly released its audit findings on December 12, 2006 in connection with its preliminary Ascertainment, however, the City never previously objected to Cox's license fee payments, and Cox denies that it owes additional fees. Cox has paid the City license fees on all advertising revenue it has received, and the launch expense reimbursements that Cox has received from various programmers are not gross revenues under the License or Generally Accepted Accounting Principles ("GAAP").

Even if the City's License Fee Audit were correct regarding advertising revenues and launch expense reimbursements, Cox has overpaid the City at least \$3,098,869 in license fees over the audit period (October 1, 2000 through September 30, 2005).³⁴ Because Cox's payments under Section 15(g)(2) of the License constitute franchise fees under federal law, the City has collected fees exceeding the maximum five percent (5%) fee permitted under federal law and Section 5(a) of the License.³⁵ In addition, the Arizona Statute specifically excludes advertising revenue and launch fees from the calculation of gross revenues under any renewal or extension of the License,³⁶ and the City itself acknowledged during its Ascertainment proceeding that Cox had satisfied all its financial obligations under the License.³⁷

The City's assertion in the Ascertainment that "Cox has not provided an adequate level of service to subscribers [because] [i]ts cable system should have been upgraded before now"³⁸ is simply ludicrous. It also contradicts a verifiable factual record of Cox's superior performance. Cox Communications Arizona has won numerous J.D. Power and Associates' awards, including three such awards in 2006 alone. Cox Communications Arizona won the 2006 Residential Cable/Satellite TV Customer Satisfaction Award in the Western Region, as well as top honors for telephone customer service (West Region) and data/high-speed Internet (small medium business). Cox completed its most recent system upgrade only a few years ago, which brought the system from 550 MHz to 750 MHz pursuant to the City's Transfer Agreement.³⁹ Cox, moreover, currently is in the process of upgrading the system to an 860 MHz capacity at an estimated raw cost (materials and labor, excluding return on investment) of \$36,337,557 even

³⁴ See Exhibit C (License Fee Audit Analysis).

³⁵ Cox paid the City \$4,750,409.82 in fees under Section 15(g)(2) of the License during the audit period. Therefore, even if the City were correct regarding its recently discovered "underpayments," Cox overpaid license fees by \$3,098,868.82 (\$4,750,409.82 - \$1,651,541 = \$3,098,868.82).

³⁶ A.R.S. § 9-505(6) ("Gross revenues do not include revenues from commercial advertising on the cable system . . . , reimbursements paid by programmers for launch fees or marketing expense, license fees, taxes or other fees or charges that the cable operator collects and pays to any governmental authority . . .").

³⁷ See transcript of September 28, 2006 Ward 3 Town Hall Meeting at 8 (statement of Ann Strine: "I do think it is important that I make it very clear that Cox has met the terms of their agreement in terms of paying the city what they are obligated to pay us They have met their obligation in terms of what the license requires them to collect for the franchise fee and the PEG fees. So I appreciate your concern about funding for Access Tucson but I want to make sure it's not directed at Cox because they have done what the license requires them to do.").

³⁸ RFRP at 19, § C.3.

³⁹ The Transfer Agreement, dated June 15, 1998, approved the transfer of the License from Robin Cable Systems of Tucson ("TCI") to Cox.

