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SUPPLEMENTAL SUBMISSION

ON BEHALF OF DIRECTV & ECHOSTAR

BEFORE THE HOUSE JUDICIARY COMMITTEE, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

HEARING ON H.R. 3679, THE "STATE VIDEO TAX FAIRNESS ACT OF 2007"

SUBMITTED FEBRUARY 25, 2008

One question dominated the Subcommittee's hearing on H.R. 3679 last week:

Is a franchise fee a tax?

The battle lines were sharply drawn. Satellite TV providers and their supporters testified that franchise fees are rents for valuable rights of way, and nothing like a tax. Cable testified that "all franchise fees . . . levied on cable operators must be viewed as taxes." Testimony of Howard J. Symons at 6 (internal citations omitted). At every turn, cable's testimony referred to "taxes and fees" in the same breath as if they were equivalent. *See, e.g., id.* at 1, 2, 3, 8, 9, 10. And then, in its tally of the state and local taxes that cable pays, cable included franchise fees on almost every line. *See id*. at 3.

The dispute goes to the heart of H.R. 3679. The bill simply says: "No State shall impose a discriminatory tax on any means of providing multichannel video programming distribution services." It demands tax parity. Cable opposes the bill, protesting that it, too, is for "tax parity." The only way cable can support that claim, though, is by insisting that franchise fees *are* taxes. So, cable argues, if cable pays a franchise fee, it is only fair that satellite customers should pay an offsetting amount in taxes.

So which is it—a fee or a tax? Several authorities on the subject had this to say:

- "Franchise fees . . . are commonly understood to be consideration for the contractual award of a government benefit."
- "[F]ranchise fees [are] a form of 'rent.'"
- Cable's "largest asset[s]" are "cable franchise rights" purchased with franchise fees.
- In contrast, "[t]axes simply have no contractual element; they are a demand of sovereignty."

Are these the words of satellite TV partisans? No. These are the words of *cable companies*. In this supplemental submission we demonstrate: (I) that franchise fees are not taxes; (II) that cable consistently and emphatically tells everyone else that franchise fees are not taxes; and (III) that Congress and the courts consistently agree that franchise fees are not taxes.

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I. Franchise Fees Are Not Taxes

Franchise fees do not look anything like taxes. Consider the facts:

1. Local governments do not impose franchise fees the way they impose taxes. Cable companies voluntarily undertake to pay these fees as part of a negotiated contract.

2. Cable companies pay these franchise fees in return for a direct benefit—a property right—that the cable companies, alone, enjoy. Not just anyone can dig up a public street or hang wires from a public utility pole. Local governments own that property, and they charge rent for it.

3. The property rights that cable companies buy with franchise fees are highly valuable. Cable companies treat them as prized assets.

4. The franchise agreements that are negotiated at arms-length between cable and local governments look nothing like tax codes. They are intricate contracts that include all sorts of terms that one would never find in a tax code.

You don't call it a "tax" when a merchant pays rent for the right to set up a bodega on public property or a hot dog franchise at a public stadium. You don't call it a "tax" when an advertiser pays to post an ad on the side of a bus or on the Metro. And it is not a tax when cable negotiates an arms-length contract to purchase prized property rights necessary to sell its service.

II. The Two Faces of Cable

The simple truth is that cable doesn't call it a "tax" anywhere outside the confines of this debate over tax parity. Cable's current definition of a franchise fee is a transparent ploy to defeat a bill designed to level yet another unfair advantage that cable has managed to garner. We know this because in every other forum, to every other audience, cable tells a different story—from court filings to SEC filings to local government negotiations.

Cable tells courts: Franchise fees are NOT taxes

Cable routinely tells courts that franchise fees are *not* taxes. The question has been relevant, for example, in cases where cable has litigated over how much it will have to pay.[1] As one cable company successfully explained to a federal court:

> Municipal franchises have long been understood to be contracts. Franchise fees, in turn, are commonly understood to be consideration for the contractual award of a government benefit. Many cases have treated franchise fees as a form of "rent."

[1] *See, e.g.*, Opp. Br. to Def's Mot. for Summary Judgment at 14 in *Time Warner Ent't – Advance Newhouse P'ship v. City of Lincoln*, Case No. 8:04- CV-2049 (D. Neb. 2004) (attached at Exhibit A); *Texas & Kansas City Cable Partners, L.P v. City of West University Place*, Civ. Action No. 7-05-4177 (S.D. Tex. April 14, 2006), *available at* 2006 WL 1437647.

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> Cable franchises are enforceable as contracts, even though they are traditionally awarded by ordinance. . .. The contractual nature of cable franchise fees removed them far from "taxes." Taxes simply have no contractual element; they are a demand of sovereignty. The consent of the taxpayer is not necessary to their enforcement.

Exhibit A at 15 (internal quotations and citations omitted). We could not say it any better ourselves.

Cable tells shareholders and the SEC: Franchise fees are payments for valuable property rights

Cable tells the same story to its shareholders and to the SEC. It admits that the rights it obtains from local governments in exchange for "franchise fees" are valuable assets. According to cable companies, franchise fees buy local rights of way worth *billions of dollars*—assets that are *more valuable than all their other assets combined.* Here's what cable executives say:

- "*Our largest asset, our cable franchise rights*, results from agreements we have with state and local governments that allow us to construct and operate a cable business within a specified geographic area."[2]
- "As of December 31, 2006, [Time Warner Cable] had approximately $41.0 billion of unamortized intangible assets, including . . . franchises of $38.1 billion on its balance sheet. At December 31, 2006, *these intangible assets represented approximately 74% of TWC's total assets*."[3]
- "Cox believes that the franchises, although contractually non-exclusive, *provide economic exclusivity* for broadband video services to an incumbent cable operator." In other words, Cox tells its investors and the SEC that it is using franchise fees to buy itself a monopoly.[4]

Scan the SEC filings of any cable company for any year, and you will see similar statements.[5] When you pay money to governmental entities as a quid pro quo for property that represents

[2] Comcast Corp. Annual Report (Form 10-K for 2007) at 32 (Feb. 20, 2008) ("Comcast 2007 Annual Report") (emphasis added).

[3] Time Warner Cable, Inc. Annual Report (Form 10-K for 2006) ("TWC 2006 Annual Report") at 38 (Feb. 23, 2007) (emphasis added).

[4] Cox Communications, Inc. Annual Report (Form 10-K for 2005) at 71 (Mar. 29, 2006).

[5] *See, e.g.,* Time Warner Cable Inc. Quarterly Report (Form 10-Q for Q3 2007) at 27 (Nov. 7, 2007) (franchise rights valued at $38.1 billion); Charter Communications Holdings, LLC, Quarterly Report (Form 10-Q for Q3 2007) at 4, 10 (Nov. 13, 2007) (franchise rights valued at $9.1 billion); Comcast Corp. Quarterly Report (Form 10-Q for Q3 2007) at 2 (Oct. 26, 2007) (franchise rights valued at $58 billion); CSC Holdings Inc. Quarterly Report (Form 10-Q

(Footnote continued)

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three-quarters of your company's total value, it is ludicrous to characterize the money you pay as a tax.

In those same SEC filings, cable companies also depict franchise fees as a cost of doing business—not as a tax. Cable treats franchise fees the way they treat any other business expense, such as payments to purchase TV programs and salaries they negotiate with employees. Once again, here are cable's own words from a representative SEC filing:

- "Costs of revenue include: video programming costs . . . high speed data connectivity costs; Digital Phone network costs[;] maintenance of the Company's delivery systems; *franchise fees*, and other related expenses." TWC 2006 Annual Report at 66-67 (emphasis added).

The franchise agreements speak for themselves

Perhaps the best evidence of what cable thinks franchise fees are—and what they pay for—can be drawn from the franchise agreements themselves. Teams of cable lawyers pore over these documents. Cable companies own every word that appears in these documents.

The first characteristic that is evident from scanning any one of these franchise agreements is that they are, well, agreements. They waddle, smell, and quack like contracts. They do not look anything like tax ordinances. For example, Monterey, California's franchise agreement with Cablevision is 51 pages. It is rife with terms that you would never find in any tax code, provisions about: acceptance; the rights reserved by the city; waivers; construction standards; the method and timing of fee payments; termination, revocation and forfeiture; liquidated damages and other remedies; maintenance and inspection of books and records; time of the essence; and force majeure. *See* http://www.monterey.org/cable/final.pdf.

As important as the contractual nature of these agreements is how they describe the deal. Invariably, they describe these deals as payments for valuable rights of way, not as taxes for the general public welfare. They almost always have clauses that read something like this one (drawn from Comcast's 151-page contract with Fairfax, Virginia):

> *Grant of Authority*. . . . [T]he County hereby grants the Grantee *the right to own, install,* [and] . . . operate, a Cable System *along . . . the Public Rights-of-Way or public land* within the Franchise Area.

http://www.fairfaxcounty.gov/cable/regulation/franchise/comcast/comcast_franchise_2005.pdf (emphasis in original). Translation: Cable is paying money to rent public land.

The same features appear in most any franchise agreement one might randomly choose.

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for Q3 2007) at 3, 13 (Nov. 8, 2007) (franchise rights valued at $731.8 million); Mediacom Broadband LLC, Annual Report (Form 10-K for 2006) at 27 (Mar. 27, 2007) (franchise rights valued at $1.26 billion).

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In short, cable has two stories about franchise fees. One story is what cable is telling this Subcommittee. The other story is what cable tells everyone else: courts, its owners and investors, the SEC, and its contracting partners. The two stories are irreconcilable—but the truth is clear: Franchise fees are simply not taxes.

III. Congress, the Courts, and the FCC Agree that Franchise Fees are Not Taxes

Congress, the courts, and the FCC consistently agree that cable's franchise fees are not taxes, but are a cost of cable's business. And they often do so at *cable's* prodding. Here are some examples:

- Congress defined the term "tax" in the Internet Tax Freedom Act of 1998—a bill cable vocally supported. In the definition, Congress declared that "such term does not include any franchise fee or similar fee imposed by a State or local franchising authority." Pub. L. No. 105-277, § 1105(8), 112 Stat. 2681-719 (codified as amended at 47 U.S.C. § 151 note).

- Just last year, the FCC confirmed that "[o]ne of the primary justifications for cable franchising is the [local government's] need to regulate and receive compensation for the use of public rights-of-way."[6]

- Federal courts have distinguished between proceeds collected to pay franchise fees and those collected to pay taxes, invoking the same reasoning that cable itself propounds in its filings: "*Franchise fees are* not a tax . . . but essentially a form of rent [i.e.,] *the price paid to rent use of public right-of-ways.*" *City of Dallas v. FCC*, 118 F.3d 393, 397-98 (5th Cir. 1997) (citations omitted; emphasis added).[7]

- Counties and municipalities agree. They frequently try to persuade state courts that franchise fees are costs, not taxes, when defending the imposition of those fees without following procedural requirements for tax increases. *See Bruce v. Colorado Springs*, 131 P.3d 1187 (Colo. App. 2005); *Kowalski v. Livonia*, 705 N.W. 2d 161, 162 (Mich. App. 2005).

- The courts routinely side with these authorities. As a Michigan appellate court recently held: "Plaintiffs [i.e., cable subscribers] accurately and unreservedly admit

[6] *In re 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*, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd. 5101, ¶ 23 (Mar. 5, 2007).

[7] *See, e.g.*, *Time Warner Ent't – Advance/Newhouse Partnership v. City of Lincoln*, 360 F. Supp. 2d 1012, 1017 (D. Neb. 2004); *cf. Qwest Comm. Corp. v. City of Berkeley*, 146 F. Supp. 2d 1081, 1092 (N.D. Cal. 2001) (franchise fee described as "annual rent compensation").

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> that the cable 'franchise fees' are voluntary. This is true whether viewed from the perspective of the subscriber or the supplier, because each pays the charge in exchange for a service: the provider pays the city for its valuable franchise and the subscriber, in turn, pays the supplier for the privilege of receiving cable programming. Therefore, the 'franchise fee' is a voluntary payment and consideration in exchange for a commodity." *Kowalski*, 705 N.W. 2d at 162.

Conclusion

A vote for H.R. 3679 is a vote for "tax parity." Cable is just plain wrong when it asserts that it is protecting "tax parity" by advocating against the bill. Its position is based on the assumption that franchise fees are taxes, and that they, too, must be equalized. Cable is wrong. Franchise fees are not taxes. Congress has said it. Courts, the FCC, and local governments say it. Cable says it, too—but only when it serves its purposes. Congress should not be fooled by cable's contrary position here.

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