CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

October 24, 2016

The Honorable City Council
Palo Alto, California

Policy and Services Committee Recommends the City Council Approve its Motions Regarding the Cable Franchise and Public, Education, and Government (PEG) Fees Audit

RECOMMENDATION

The Policy and Services Committee recommends that Council adopt three motions regarding the Cable Franchise and PEG Fees Audit: 1) that staff work with the Midpeninsula Media Center (Media Center) to develop options for the Council to consider for a plan going forward that complies with PEG funding restrictions while supporting the Media Center's public access function, 2) that the City Manager's Office move forward to demand payment of underpaid franchise and PEG fees, and 3) that staff return to the Committee with clearly defined roles and responsibilities for oversight of tracking funds and communications.

DISCUSSION

On May 10, 2016, the City Auditor presented the Cable Franchise and PEG Fees Audit to the Policy and Services Committee. The audit included three findings and related recommendations. The Policy and Services Committee minutes are included as Attachment B.

Committee discussion largely focused on the first audit finding and how to bring the City into compliance with federal law regarding the use of PEG fees. The City, on behalf of the Cable Joint Powers and under a written agreement with the Media Center, provides all of the cable subscriber PEG fees collected to the Media Center. The agreement requires the Media Center to use PEG funds in a manner consistent with federal law, which allows PEG fees to be used only for capital costs associated with PEG access facilities to the extent that the PEG fees exceed five percent of cable subscriber fees. The federal limits on the use of PEG fees apply to all of the PEG fees collected from subscribers in the Cable Joint Powers geographic area because subscribers pay the maximum of five percent in cable franchise fees. However, the Media Center had been using the PEG fees for operating expenses rather than capital expenses. Comments from members of the public in attendance at the meeting were primarily to support the Media Center and the value it provides to the community. As a result, Policy and Services moved that staff work with the Media Center and develop options for the Council to consider a plan going forward that complies with PEG funding restrictions while supporting the Media Center's public access function, such as:

a. A framework for meeting City communications and public access needs, and

b. Consider approaches used by other agencies, and
c. City purchase the Media Center's building, and
d. Upgrading City Hall broadcast technology.

The City Manager's Office is leading a team of staff that has been meeting with the Media Center to develop options for Council consideration that addresses the above direction. A proposed term sheet is nearing draft stage. Staff expects to return to Council in the next few months with options.

The upgrade of the audiovisual equipment and broadcasting room in Council Chambers is an in-progress project.

The second audit finding discussed Comcast's and AT&T's underpayment of franchise and PEG fees. Policy and Services moved to adopt the recommendations as stated in the audit report. Staff in Information Technology Department, Administrative Services Department and City Attorney's Office have been working to resolve the underpayment of franchise and PEG fees with Comcast and AT&T. Staff expects to provide an update on this matter as part of the report on options for the Media Center.

The third audit finding discussed the need to clarify roles and responsibilities regarding the City's cable communications program. Policy and Services moved to direct staff to return to the Committee with clearly defined roles and responsibilities for oversight of tracking funds and communications. This was a summary of the first recommendation in the finding. The second recommendation, regarding the need to update the Palo Alto Municipal Code, cannot be implemented until those roles and responsibilities are clarified.

Respectfully submitted,

Harriet Richardson

Harriet Richardson
City Auditor

ATTACHMENTS:

- Attachment A: Cable Franchise and Public, Education, and Government (PEG) Fee Audit (PDF)
- Attachment B: Policy and Services Committee Meeting Minutes Excerpt (May 10, 2016) (PDF)

Department Head: Harriet Richardson, City Auditor

CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

May 10, 2016

The Honorable City Council
Attention: Policy & Services Committee
Palo Alto, California

Cable Franchise and Public, Education, and Government (PEG) Fee Audit

In accordance with the Fiscal Year 2016 Annual Audit Work Plan, the Office of the City Auditor has completed the Cable Franchise and Public, Education, and Government (PEG) Fee Audit. The audit report presents three findings with a total of nine recommendations. The Office of the City Auditor recommends that the Policy and Services Committee review and recommend to the City Council acceptance of the Cable Franchise and PEG Fee Audit.

Respectfully submitted,

Harriet Richardson

Harriet Richardson
City Auditor

ATTACHMENTS:

- Attachment A: Cable Franchise and Public, Education, and Government (PEG) Fee Audit (PDF)

Department Head: Harriet Richardson, City Auditor

Attachment A

CITY OF PALO ALTO

CABLE FRANCHISE AND PUBLIC, EDUCATION, AND GOVERNMENT (PEG) FEE AUDIT

May 10, 2016

Office of the City Auditor

Harriet Richardson, City Auditor
Houman Boussina, Senior Performance Auditor
Lisa Wehara, Performance Auditor II

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OFFICE OF THE CITY AUDITOR

EXECUTIVE SUMMARY

Cable Franchise and PEG Fee Audit

May 10, 2016

PURPOSE OF THE AUDIT:

The audit objectives were to determine whether and to what degree, from July 1, 2010, through June 30, 2014:

- The City of Palo Alto accurately accounted for its receipt of franchise and public, education, and government (PEG) fees and met its oversight responsibilities regarding the Media Center's use of PEG access fees.
- Comcast and AT&T collected and promptly remitted the appropriate amount of franchise and PEG fees.
- The City established and sufficiently defined roles and responsibilities to administer its cable communications program and state franchises awarded to Comcast and AT&T.

REPORT HIGHLIGHTS

Finding 1: The Media Center did not restrict its use of $340,000 of annual PEG fees to capital expenditures as required by the federal Cable Act (Page 8)

The Media Center inappropriately used an annual average of $340,000 of public, education, and government (PEG) fees, or $1.4 million during the audit period, paid by cable television subscribers in the Cable Joint Powers areas, for operating expenses. Neither the City nor the Media Center enforced the federal law that restricts the use of PEG fees to capital expenses associated with PEG access facilities.

Key Recommendations to the City Manager's Office:

- Assess the need for the City to continue collecting PEG fees, adjust the fee, or discontinue collecting the fee based on the need for future capital expenses related to PEG access facilities.
- Coordinate with the other JPA jurisdictions regarding potential amendments to their municipal codes based on adjustments made to the PEG fee requirement.
- If the PEG fee is retained, establish criteria for how PEG fees may be used and require documentation and review of expenditures to ensure compliance with the federal Cable Act.
- Determine whether to allocate a portion of the unrestricted franchise fees or other funds to subsidize the Media Center's operations.

Finding 2: Comcast and AT&T did not remit the full amount of franchise and PEG fees due. (Page 14)

Comcast and AT&T did not always calculate the fees due in accordance with DIVCA and the municipal code of each of the Cable Joint Powers. As a result, Comcast underpaid about $141,000 in franchise and PEG fees from July 1, 2010, through June 30, 2014, and AT&T underpaid about $76,000 from July 1, 2011, through September 30, 2014.

AT&T's underpayments are estimated because it did not provide sufficient records for us to verify the accuracy of franchise and PEG fee payments. In addition, AT&T's underpayments are for all of Santa Clara and San Mateo Counties because it remitted fees collected from subscribers in the unincorporated county areas directly to the counties and could not provide the information needed to calculate the amounts due only to the Cable Joint Powers (see scope limitations section on page **5**).

Comcast and AT&T will owe interest, calculated at the highest prime lending rate during the delinquency period plus 1 percent, on underpaid fees, as required by DIVCA. DIVCA also requires that AT&T pay the City for its portion of the audit costs because AT&T's underpayment exceeds 5 percent of the amount that it should have paid.

Key Recommendations to the City Manager's Office:

- Send letters to AT&T and Comcast demanding payment of the underpaid franchise and PEG fees, interest due, and for AT&T, its portion of the audit costs.
- Work with AT&T and Comcast to develop methods to ensure accuracy of their address databases and the basis for determining the revenues on which franchise and PEG fees should be calculated.
- Review franchise and PEG fee payments to ensure they were calculated based on the established criteria and promptly follow up on discrepancies.

Finding 3: Roles and responsibilities for managing the City's cable communications program are not clearly defined or assigned (Page 21)

The City has not clearly assigned or defined roles and responsibilities for its cable communications program or effectively managed the program to ensure that funds are used appropriately and that program outcomes are consistent with the City's and residents' cable communications needs.

Key Recommendations to the City Manager's Office:

- Assign responsibility for the City's cable communications program and require the assigned department to provide appropriate program oversight.
- Submit a draft ordinance to the Palo Alto City Council recommending revisions to the Palo Alto Municipal Code based on the revised assignment of roles and responsibilities.

Comcast and AT&T Underpaid Franchise and PEG Fees by Revenue Category
July 1, 2010, through June 30, 2014

Revenue Category	Atherton	East Palo Alto	Menlo Park	Palo Alto	Santa Clara	San Mateo	Total
Comcast - July 1, 2010, through June 30, 2014							
Advertising Revenue	$3,797	$7,506	$18,455	$35,259	$3,937	$1,406	$70,360
Flat fees	$1,973	$6,499	$8,783	$17,145	$1,821	$428	$36,649
CPUC and FCC Fees	$1,139	$2,233	$5,329	$10,276	$931	$320	$20,228
Unreturned Equipment	$53	$75	$143	$315	$17		$603
Underpaid Franchise Fees	**$6,962**	**$16,313**	**$32,710**	**$62,995**	**$6,706**	**$2,154**	**$127,840**
Underpaid PEG Fees					**$8,548**	**$4,197**	**$12,745**
Total Due from Comcast	**$6,962**	**$16,313**	**$32,710**	**$62,995**	**$15,254**	**$6,351**	**$140,585**
AT&T - July 1, 2011, through September 30, 2014[1, 2]							
Santa Clara County Revenue & Adjustments	$542	$2,261	$2,837	$6,215	$4,455	$4,006	$20,316
Advertising	$126	$503	$814	$2,025	$1,212	$1,032	$5,712
Unreturned Equipment	$164	$4,231	$1,152	$2,197	$5,280	$5,280	$18,304
Other Revenues (Repair, Installation, etc.)	$108	$462	$444	$1,050	$1,017	$1,017	$4,098
Underpaid Franchise Fees	**$940**	**$7,457**	**$5,247**	**$11,487**	**$11,964**	**$11,335**	**$48,430**
Underpaid PEG Fees					**$2,126**	**$25,091**	**$27,217**
Total Due from AT&T	**$940**	**$7,457**	**$5,247**	**$11,487**	**$14,090**	**$36,426**	**$75,647**
Grand Total Due from Comcast and AT&T	**$7,902**	**$23,770**	**$37,957**	**$74,482**	**$29,344**	**$42,777**	**$216,232**

[1] The figures shown for Santa Clara and San Mateo Counties include AT&T underpayments for all county areas because AT&T did not provide sufficient information to calculate underpayments specific only to the Cable Joint Powers.

[2] Some AT&T underpayments are estimates because AT&T did not provide all requested records.

Source: Comcast and AT&T financial records

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ABBREVIATIONS

ASD	Administrative Services Department
DIVCA	Digital Infrastructure and Video Competition Act
FCC	Federal Communications Commission
FY	Fiscal Year
I-Net	Institutional Network
IT	Information Technology
JPA	Joint Powers Authority
PEG	Public, Education, and Government

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INTRODUCTION

Audit Objectives

The audit objectives were to determine whether and to what degree, from July 1, 2010, through June 30, 2014:

- The City of Palo Alto accurately accounted for its receipt of franchise and public, education, and government (PEG) fees and met its oversight responsibilities regarding the Media Center's use of public, education, and government PEG access fees.
- Comcast and AT&T collected and promptly remitted the appropriate amount of franchise and PEG fees.
- The City established and sufficiently defined roles and responsibilities to administer its cable communications program and state franchises awarded to Comcast and AT&T.

Background

Legal framework: franchise and PEG fees

The California Digital Infrastructure and Video Competition Act (DIVCA) of 2006 gives the California Public Utilities Commission sole authority to issue video and cable franchises to companies that provide such services within the state. DIVCA requires a franchise holder to pay a franchise fee of 5 percent of its gross revenues to each jurisdiction served, unless the jurisdiction adopts an ordinance that sets a lower fee, as rent or toll for using the public rights-of-way. DIVCA requires franchise holders to provide PEG access channels within each jurisdiction served, and jurisdictions may adopt an ordinance that establishes a fee to support PEG channel facilities. DIVCA limits the PEG fee to 1 percent of the franchise holder's gross revenues for entities that did not assess a PEG fee prior to December 31, 2006. The federal Cable Communications Policy Act of 1984 (Cable Act), 47 U.S.C. § 542, restricts the use of PEG fees to capital expenses associated with PEG access facilities when the fee is assessed in addition to a franchise fee, but allows paid advertising, underwriting, or sponsorships to fund PEG-related activities. Franchise holders may pass both the franchise and PEG fees on to their cable subscribers. DIVCA requires franchise holders to maintain records so the local entities can assess the accuracy of franchise and PEG fee payments.

Joint Exercise of Powers Agreement

The cities of Palo Alto, Menlo Park, and East Palo Alto; the Town of Atherton; and unincorporated portions of San Mateo and Santa Clara Counties created a Joint Powers Authority (JPA) in 1983 to obtain cable television service within these jurisdictions. The JPA members are known as the Cable Joint Powers. Two cable franchise holders, Comcast and AT&T, currently serve the Cable Joint Powers.

Palo Alto administers and enforces the state franchises on behalf of the Cable Joint Powers through an agreement among the members. A working group comprised of Cable Joint Powers members considers cable and video service-related issues related to state franchises.

JPA franchise and PEG fees

The Palo Alto Municipal Code (Municipal Code) requires each franchise holder to activate seven PEG access channels on its network. It sets the cable franchise fee at 5 percent of the franchise holder's gross revenues and the PEG support fee at 88 cents per month per subscriber. The other Cable Joint Powers members have similar requirements, except Santa Clara County requires a PEG support fee that is the higher of 1 percent of gross revenues or 88 cents per subscriber, limited to 3 percent of gross revenues, and San Mateo County requires a PEG support fee that is the higher of 1 percent of gross revenues or 88 cents per subscriber.

Roles and responsibilities

The Municipal Code defines roles and responsibilities for managing the City's cable communications program:

- The Office of the City Clerk is responsible for managing the City's cable communications program.
- The City Manager designates a cable coordinator to administer and provide oversight of state franchises in the City.
- The City may designate one or more entities, including itself, to control and manage the use of PEG access channels and any PEG facilities and equipment.

The City, through its Information Technology (IT) Department, contracts with an individual who serves as the City's cable coordinator to oversee and manage the cable communications program. This position was formerly managed in the Administrative Services Department (ASD) but was moved under the oversight of IT when IT became a separate department from ASD.

Use of funds and financial reporting

Palo Alto distributes the franchise fees to each of the Cable Joint Powers based on the percentage of fees derived from Comcast's and AT&T's subscribers within each jurisdiction, after:

- Reimbursing Palo Alto for its costs to administer the state franchises, including the fees paid to the cable coordinator.
- Paying the costs of regulatory and oversight functions.
- Paying for other cable- or video-related activities that benefit the area in which the revenue was generated.

In 2001, the Palo Alto City Council designated the Midpeninsula Community Media Center, Inc., (Media Center) as the community access organization to meet the Cable Joint Powers' existing and future PEG access needs. The City's 2011 contract with the Media Center requires Palo Alto to remit all of the PEG fees it receives from Comcast and AT&T on behalf of the Cable Joint Powers to the Media Center. The City separately contracts with the Media Center for cablecasting services, including broadcasting Palo Alto City council and committee meetings via cable television.

Palo Alto currently receives about 50 percent of the allocated franchise fee revenues. Exhibit 1 shows the distribution of franchise fees to the Cable Joint Powers, and Exhibit 2 shows the total PEG fees received and remitted to the Media Center from July 1, 2010, through June 30, 2014.

Exhibit 1: Franchise Fee Payments to Each Jurisdiction

Jurisdiction	FY 2011		FY 2012		FY 2013		FY 2014	
	Comcast	AT&T*	Comcast	AT&T*	Comcast	AT&T*	Comcast	AT&T*
Palo Alto	$688,735	$96,631	$678,092	$131,907	$716,504	$137,738	$735,326	$135,902
Menlo Park	$384,301	$34,815	$380,990	$49,218	$399,290	$55,996	$412,231	$64,065
East Palo Alto	$130,772	$21,645	$130,560	$28,915	$135,299	$34,505	$137,082	$39,495
Atherton	$105,734	$5,981	$105,191	$8,955	$111,060	$10,524	$116,765	$10,735
Santa Clara County	$82,831	-	$84,322	-	$92,266	-	$100,399	-
San Mateo County	$32,917	-	$33,084	-	$33,869	-	$34,019	-
Total	**$1,425,289**	**$159,072**	**$1,412,239**	**$218,995**	**$1,488,289**	**$238,763**	**$1,535,822**	**$250,198**

*No revenue is shown from AT&T for Santa Clara and San Mateo Counties because AT&T remitted all of its franchise fee payments for Santa Clara and San Mateo Counties directly to the counties.

Source: City of Palo Alto financial records

Exhibit 2: PEG Fees Remitted to the Media Center

Jurisdiction	FY 2011		FY 2012		FY 2013		FY 2014	
	Comcast	AT&T[2]	Comcast[1]	AT&T[2]	Comcast[1]	AT&T[2]	Comcast[1]	AT&T[2]
Palo Alto	$156,306	$19,573	$251,013	$25,440	$297,289	$26,978	$294,613	$28,062
Menlo Park	$79,199	$6,693	$25,811	$8,990	-	$10,620	-	$12,305
East Palo Alto	$33,495	$4,117	$10,849	$5,279	-	$6,643	-	$7,958
Atherton	$15,736	$1,072	$5,157	$1,479	-	$1,774	-	$1,918
Santa Clara County	$15,368	-	$5,120	-	-	-	-	-
San Mateo County	$5,944	-	$1,975	-	-	-	-	-
Total	**$306,047**	**$31,455**	**$299,925**	**$41,188**	**$297,289**	**$46,016**	**$294,613**	**$50,243**

[1] Starting in November 2011, Comcast stopped providing a detailed breakdown by jurisdiction; total PEG fees are shown under Palo Alto.
[2] No revenue is shown from AT&T for Santa Clara and San Mateo Counties because AT&T remitted all of its PEG fee payments for Santa Clara and San Mateo Counties directly to the counties.

Source: City of Palo Alto financial records

Palo Alto established the Cable Fund as a restricted-use fund for nonrecurring cable-related revenue, such as settlements and grants. The fund is used to carry out specific actions required by the policy. The fund's balance was $759,000, including about $4,000 in interest receivable, as of June 30, 2014. In FY 2015, the City began using the Cable Fund to record franchise and PEG fee remittances from the cable companies and to allocate the fees to the Cable Joint Powers and the Media Center, respectively.

Exhibit 3 summarizes the main components of the cable communications program, which generates $2.1 million in revenues and incurs $436,000 in expenditures annually for the Cable Joint Powers.

Exhibit 3: Summary of Estimated Annual Cable Communications Program FY 2014 Revenues and Expenditures

Program Revenues Collected from Comcast and AT&T	
Franchise fees	$1.8 million - distributed to the Cable Joint Powers, after deducting the City's expenses, based on the percentage of fees generated within each area
PEG fees	$345,000 - all remitted to the Media Center (see program expenditures below)
Total	**$2.1 million**
Program Expenditures	
Management and oversight	$48,000 - consultant (cable coordinator) costs, allocated to the Cable Joint Powers $14,000 - other costs (cable program oversight, accounting, procurement, financial statement preparation, legal, audit, etc.), allocated to the Cable Joint Powers
Media Center*	$345,000 in pass-through PEG fees to the Media Center
Institutional Network (I-Net) operation and management	$29,000 - Comcast contract costs for use of I-Net fiber, allocated to the Cable Joint Powers through the Cable Fund
Total	**$436,000***
Estimated Net Annual Program Revenues*	**$1.7 million - net unrestricted Cable Joint Powers revenues**

* An additional $125,000 for cablecasting services (i.e., broadcasting via cable television), including Palo Alto City Council and committee meetings, is associated with the City's contract with the Media Center and is not allocated to the Cable Joint Powers or included in the estimated net annual program revenues shown above.

Source: Estimates based on City of Palo Alto financial records, staff reports, and contracts

Audit Scope

We assessed the City's oversight of its cable communications program and the use of franchise and PEG fee payments that Comcast and AT&T collected from cable subscribers in the Cable

Joint Powers areas and remitted to Palo Alto from July 1, 2010, through June 30, 2014. We also reviewed Cable Fund activity from its inception in 2000. We did not review changes that the City made after the audit period for how it accounts for franchise and PEG fees and use of the Cable Fund.

Scope Limitations

Despite repeated requests, AT&T did not provide all information needed to perform a complete review of the accuracy and completeness of the franchise and PEG fees it remitted to Palo Alto. As a result, The Buske Group sometimes estimated AT&T's underpayment of franchise and PEG fees based on common industry practices.

We intended our audit to cover four years, based on DIVCA's data retention provision, but AT&T only provided three years of data based on the DIVCA provision that requires claims for refunds or other corrections to be made within three years and 45 days of the end of the quarter for which compensation was remitted, or three years from the date of remittance, whichever is later. However, AT&T provided information for July through September 2014, which was not originally included in the audit period.

AT&T remitted fees collected from subscribers in unincorporated Santa Clara and San Mateo Counties directly to the counties and could not provide the information needed to calculate the amounts due for the unincorporated areas specific to the Cable Joint Powers. As a result, the audit report includes estimates of AT&T's franchise and PEG fee underpayments for all of Santa Clara and San Mateo Counties, including areas that are not in the Cable Joint Powers.

Audit Methodology

To conduct this audit, we:

- Reviewed federal, state, and local regulations regarding collection and use of franchise and PEG fees.
- Assessed the City's process to calculate and remit franchise and PEG fees to the Cable Joint Powers and the Media Center, respectively.
- Reviewed the City's and the Media Center's financial records to determine whether franchise and PEG fees were used appropriately.
- Interviewed the cable coordinator and staff in the Office of the City Clerk, ASD, IT Department, and Media Center to assess operation and oversight of the state franchises and the City's cable communications program.

- Consulted with the City Attorney for legal advice regarding the federal Cable Act and DIVCA.
- Contracted with The Buske Group, a subject-matter expert, to obtain and review Comcast and AT&T records on our behalf to determine if they collected and promptly remitted the appropriate amount of franchise and PEG fees to the City.

Data Reliability

We assessed the reliability of the Comcast and AT&T data by interviewing our hired subject matter expert, who was knowledgeable about the data, and by comparing Comcast and AT&T address and fee allocation data with Cable Joint Powers members' address data to identify any miscoding that could result in payment misallocation. Except as noted in the Scope Limitations section above, we determined that the data were sufficiently reliable for the purposes of this report.

Compliance with government auditing standards and independence impairment

We conducted this performance audit of cable franchise and PEG fees in accordance with our FY 2014 and FY 2015 Annual Audit Work Plans and generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Except as noted in the Scope Limitations section above, we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The government auditing standards require auditors to be free from external interference or influence that could compromise an auditor's professional judgment or create the appearance that the auditor's professional judgment may be compromised. Subsequent to our providing the Media Center with a copy of the draft audit report and discussing our finding regarding the Media Center's use of PEG fees, the Media Center commissioned Sue Buske, president of The Buske Group, to write a paper supporting the appropriateness of the Media Center's use of PEG fees for what we identified as operating expenses. When Ms. Buske wrote the opinion, which conflicts with our conclusions, she was under contract with our office to perform work for a separate audit objective unrelated to the use of PEG fees, although we had informed her of the nature of our work regarding the use of PEG fees. Prior to beginning her work for the Office of the City Auditor, Ms. Buske had signed an "independence statement" to confirm that she was not biased (i.e., political, ideological, social, or other convictions that might impair her independence related to the subject matter of the audit) and that she would immediately notify the City Auditor regarding any new threats to independence that occurred during the course of the audit or after the report is issued.

Ms. Buske did not notify the City Auditor as required by the independence statement. When we became aware of this situation and asked Ms. Buske about the opinion document, she referred us back to the Media Center. The Media Center indicated that they would rely on Ms. Buske's opinion when responding to our audit finding. Although Ms. Buske's work on the audit was limited to determining whether Comcast and AT&T had collected and promptly remitted the appropriate amount of franchise and PEG fees, we believe that Ms. Buske's opinion document and lack of notification to the City Auditor creates the appearance that the auditor's professional judgment may be compromised. To avoid an independence impairment, we relied on the research and legal advice that we had obtained during the audit and not on Ms. Buske's opinion document.

Finding 1

The Media Center did not restrict its use of $340,000 of annual PEG fees to capital expenditures as required by the federal Cable Act

The Media Center inappropriately used an annual average of $340,000 of public, education, and government (PEG) fees, or $1.4 million during the audit period, paid by cable television subscribers in the Cable Joint Powers areas, for operating expenses.[1] Neither the City nor the Media Center enforced the federal law that restricts the use of PEG fees to capital expenses associated with PEG access facilities.[2]

$1.4 million of PEG fees used for operating expenses did not comply with federal law

From July 1, 2010, through June 30, 2014, Comcast and AT&T collected $1.4 million in PEG fees from cable television subscribers in the Cable Joint Powers areas. They remitted the fees to the City of Palo Alto, which gave them to the Media Center, as required by the written agreement with the Media Center. To the extent that the Media Center used the fees for operating expenses, the expenditures did not comply with the federal law that restricts the use of PEG fees to capital expenditures for PEG access facilities. Federal law does not restrict the use of franchise fees, but does restrict the use of PEG fees to capital expenses for PEG access facilities. Because the Cable Joint Powers impose a PEG support fee, the PEG fee must be used only for capital expenses associated with PEG access facilities.

Media Center's records support that PEG fees were allocated to operating expenses

Media Center staff provided detailed financial records showing that it allocated PEG fees to operating expenses, including salaries and benefits, professional services, janitorial services, maintenance, outreach, and insurance:

- In calendar year 2013, $340,000 in PEG funds comprised more than 40 percent of the Media Center's operating revenue.

[1] Because the Media Center's fiscal years run from January 1 through December 31, we were able to review its financial records only through December 31, 2013, although our audit period ran through June 30, 2014. The differences in timing do not affect the issues cited in our findings, although the dollar amounts may differ.

[2] The Media Center's accounting policies in use during the audit period say that it capitalizes the aggregate cost of assets over $1,500 and expenses maintenance and repair costs as incurred. A 2008 federal appellate court decision ruled that Congress intended "capital costs associated with the construction of PEG access facilities" to refer to channel capacity designated for PEG use, as well as for facilities and equipment, including vans, studios, cameras, or other equipment, related to the use of PEG channel capacity.

- From calendar year 2010 through 2013, the Media Center had only $161,563 in capital expenditures associated with its PEG program, including website redesign, a cablecasting system, computers, software, and camcorders. Although the Media Center received $1.4 million in PEG fees during this period and had only $161,563 in capital expenditures,[3] it requested, and the City paid, an additional $52,708 from the Cable Fund for a portion of the cost of a cablecasting system that the Media Center purchased.

Media Center's capital plan does not show capital needs related to PEG access facilities

The Media Center's August 2014 capital plan did not show planned capital expenditures through 2018 or plans to construct or expand PEG access facilities, but Media Center staff said that the Media Center Board had recently approved spending $579,000 from the Media Center's "investment account" to provide high-definition broadcasting in its studios. The studio update is a potentially qualifying capital expense for use of PEG fees, but the Media Center did not identify it as such. Media Center staff provided financial records in April 2015 showing that it had over $427,000 in capital expenditures in calendar year 2014 and an equal amount budgeted for calendar year 2015 for its studio upgrade project. Although these may have qualified as an appropriate use of PEG fees under the federal Cable Act, the Media Center used its investment fund for these expenditures and used the PEG fees for operating expenses.

Agreement with the Media Center requires compliance with DIVCA and the federal Cable Act

The agreement between the City of Palo Alto and the Media Center requires the Media Center to use PEG funds in a manner consistent with DIVCA and federal law. It specifically states that PEG fees shall not be construed to be a franchise fee within the meaning of the Cable Act, which allows the PEG fees to be used only for capital costs associated with PEG access facilities. The agreement requires the Media Center to provide the City with an annual plan and budget that lists the activities and programs for which it plans to use funds received from the City during the following fiscal year. Although the Media Center provided its annual plan and budget as required, the City's cable coordinator reviewed the plan based on the Media Center's incorrect definition of capital expenditures, which did not ensure that the Media Center used the PEG fees in compliance with the Cable Act.

[3] We did not assess whether these capital expenditures were actually for items that were specific to PEG access facilities.

The agreement also states that equipment or facilities purchased with PEG fees or City funds belong to the City upon termination of the agreement or dissolution of the Media Center. To the extent that the Media Center used the PEG fees for operating expenses instead of tangible capital expenses, there is less equipment or facilities in the Media Center's possession for potential transfer to the City upon termination of the agreement.

Some thought the Media Center was "grandfathered in" to use PEG fees for operating expenses

A 2011 Congressional Research Service report said that more than 100 PEG access centers nationwide have closed due to restrictions on the use of PEG fees and the lack of other funding to support operating expenses. Despite the Media Center's acknowledgment of those closings, its executive director and the City's cable coordinator said they believed that the Media Center was "grandfathered in" under DIVCA to use the funds as they had under the City's prior local franchise agreements. However, neither DIVCA nor the City's agreement with the Media Center allow the PEG fees to be used in a manner other than as prescribed in the federal Cable Act, and DIVCA specifically requires that PEG fees only be used "as authorized under federal law."

Franchise fees, Cable Fund, or Media Center's investment account could have paid for Media Center operations

Instead of providing all of the PEG fees collected to the Media Center without knowing if there was a specific capital-expense need for the fees, the Cable Joint Powers could have used some of the franchise fees collected to support the Media Center's ongoing operations. It was not within the scope of our audit to review how the Cable Joint Powers members used their allocation of franchise fees, but the Media Center's financial statements do not show that it received franchise fees from any Cable Joint Power members.

The Cable Fund was another option for supporting the Media Center's operating costs related to PEG channels. The JPA's Cable Fund policy prioritizes support to the Media Center to operate the PEG channels, but the Cable Joint Powers did not allocate Cable Fund revenues to the Media Center for operating expenses. Doing so would have allowed the Media Center to reserve the PEG fees received for capital expenses associated with PEG access facilities and be compliant with the federal Cable Act.

A third option would have been for the Media Center to use its investment account for its operating expenses. The Media Center already uses this account to offset the portion of its annual operating expenses that exceed its revenues from PEG fees and other sources. The investment account, established through a charitable contribution received when the former Cable Co-op sold its principal assets to AT&T, had a balance of $6.4 million as of December 31, 2014.

Customer usage and satisfaction data for PEG channels not tracked

Neither the City nor the Media Center collect customer usage and satisfaction data, such as frequency and duration of resident access to Media Center PEG channels, ease of access to PEG channels, and users' overall satisfaction with PEG channel programming and transmission quality. The Media Center provided us with a 2004 telephone survey, which showed that about one-third of all subscriber respondents had watched at least one Media Center channel and 70 percent of those viewers, or 23 percent of those surveyed, had watched a City Council or other public meeting - a lower than anticipated viewership. Consistent with these results, Palo Alto's National Citizen Survey™ show a declining trend in PEG channel viewership. In 2006, 31% of respondents reported that they had watched a meeting of local elected officials or other public meeting on cable television, the internet, or other media during the previous year compared to 16% in 2014.

Concerns about ongoing usefulness of PEG channels

The above issues may raise questions about the ongoing need for PEG access channels, particularly because there have been significant changes in technology since the Cable Act and DIVCA were enacted, and other options are now available for residents to obtain local information and programming. A November 2008 Mackinac Center Policy Brief provided insights on the evolving state of PEG channels:[4]

- Only a small portion of cable subscribers actually watch the programming on PEG channels.
- PEG channels do offer some benefits today, including broadcasts of local government meetings, school concerts, sporting events, graduation ceremonies, and training opportunities for aspiring filmmakers.
- The idea that PEG channels offer unique choices to viewers is outdated. Much of the programming and local information is available on the internet through websites such as YouTube and through e-mail groups, rendering PEG channels increasingly redundant.

[4] Theodore Bolema, Ph.D., J.D., *An Evaluation of Legislative Proposals for Higher Cable Fees to Finance Public, Education and Government Access Channels* (Mackinac Center Policy Brief, November 10, 2008), available at https://www.mackinac.org/archives/2008/2008-11REGfeesWEB.pdf.

- There is no real evidence that cable subscribers want more PEG channels or that PEG cable channel viewing will significantly increase following the proposed increase in funding.[5]

Recommendations

We recommend that the City Manager's Office:

1.1 Consult with ASD, IT, the City Attorney's Office, and Cable Joint Powers members to assess the need to continue collecting PEG fees and adjust the fee based on a demonstrated need for future capital expenses related to PEG access facilities or discontinue collecting the fee.

   a. If it is determined that the PEG fee should be adjusted or discontinued, submit a staff report to the City Council with a recommendation to amend the Municipal Code to reflect the revised fee or to eliminate the requirement and recommend to the other Cable Joint Powers members that they do the same.

   b. If it is determined that the PEG fee should continue to be collected:

      - Amend the agreement with the Media Center to remove the requirement for the City to remit all PEG fees collected to the Media Center.
      - Coordinate with ASD, the City Attorney's Office, and the Cable Joint Powers to develop and implement criteria for the use of PEG fees to ensure compliance with the federal Cable Act, and that the fees are set at a level appropriate for anticipated and necessary capital expenses.
      - Place the PEG fees in a restricted account and distribute them based on City-approved capital expenditures that meet federal Cable Act requirements.
      - Require that semi-annual documentation of expenditures be provided and adopt procedures to review the documentation to ensure that PEG fees are spent only as allowed by the federal Cable Act and take immediate corrective action as necessary.

[5] This was in reference to proposed amendments to Michigan state law that would have removed several legal limitations on the amount of PEG fees that local governments could charge cable companies to finance local PEG channels.

1.2 Consult with ASD, IT, the City Attorney's Office, and the Cable Joint Powers on whether to allocate a portion of the unrestricted franchise fees or other funds, instead of restricted-use PEG fees, to subsidize the Media Center's operations or to discontinue subsidizing the Media Center's operations. Based on the resulting recommendation, the City Manager's Office should make recommendations to the Council regarding appropriate future funding, if any, for the Media Center.

Finding 2

Comcast and AT&T did not remit the full amount of franchise and PEG fees due

Comcast and AT&T did not always calculate the fees due in accordance with DIVCA and the municipal code of each of the Cable Joint Powers. As a result, Comcast underpaid about $141,000 in franchise and PEG fees from July 1, 2010, through June 30, 2014, and AT&T underpaid about $76,000 from July 1, 2011, through September 30, 2014.[6]

AT&T's underpayments are estimated because it did not provide sufficient records for us to verify the accuracy of franchise and PEG fee payments. In addition, AT&T's underpayments are for all of Santa Clara and San Mateo Counties because it remitted fees collected from subscribers in the unincorporated county areas directly to the counties and could not provide the information needed to calculate the amounts due only to the Cable Joint Powers (see scope limitations section on page 5).

Comcast and AT&T will owe interest, calculated at the highest prime lending rate during the delinquency period plus 1 percent, on underpaid fees, as required by DIVCA. DIVCA also requires that AT&T pay the City for its portion of the audit costs because AT&T's underpayment exceeds 5 percent of the amount that it should have paid.

Comcast and AT&T underpaid $216,000 in franchise and PEG fees

Comcast underpaid the Cable Joint Powers about $128,000 in franchise fees and $13,000 in PEG fees, and AT&T underpaid about $48,000 in franchise fees and $27,000 in PEG fees.[7]

Comcast and AT&T underpaid franchise and PEG fees because they did not always comply with provisions of DIVCA and the Cable Joint Powers' municipal codes that require:

- Payment of a 5 percent franchise fee based on gross revenues for all charges billed to subscribers for cable or video service provided by the franchise holders and their affiliates, including

[6] AT&T provided data for July 1, 2011, through September 30, 2014, based on the DIVCA requirement for local entities to make claims for underpayments within three years and 45 days of the end of the quarter for which compensation was remitted or three years from the remittance date, whichever is later.

[7] AT&T's estimated underpayments shown in this report include all of Santa Clara and San Mateo Counties because AT&T does not maintain its records in a manner that would allow us to calculate underpayments only for the unincorporated county areas that are within the Cable Joint Powers geographical area.

revenue related to programming provided to the subscriber, equipment rentals, late fees, and insufficient fund fees.

- Payment of an $0.88 PEG fee per subscriber, except for Santa Clara and San Mateo Counties, which require the fee to be the higher of $0.88 per subscriber or 1 percent of gross revenue.

Exhibit 4 summarizes the amount of underpaid franchise and PEG fees for each of the Cable Joint Powers members.

Exhibit 4: Comcast and AT&T Underpaid Franchise and PEG Fees by Revenue Category

Revenue Category	Atherton	East Palo Alto	Menlo Park	Palo Alto	Santa Clara	San Mateo	Total
Comcast - July 1, 2010, through June 30, 2014							
Advertising Revenue	$3,797	$7,506	$18,455	$35,259	$3,937	$1,406	$70,360
Flat fees	$1,973	$6,499	$8,783	$17,145	$1,821	$428	$36,649
CPUC and FCC Fees	$1,139	$2,233	$5,329	$10,276	$931	$320	$20,228
Unreturned Equipment	$53	$75	$143	$315	$17	-	$603
Underpaid Franchise Fees	**$6,962**	**$16,313**	**$32,710**	**$62,995**	**$6,706**	**$2,154**	**$127,840**
Underpaid PEG Fees	**-**	**-**	**-**	**-**	**$8,548**	**$4,197**	**$12,745**
Total Due from Comcast	**$6,962**	**$16,313**	**$32,710**	**$62,995**	**$15,254**	**$6,351**	**$140,585**
AT&T - July 1, 2011, through September 30, 2014[1, 2]							
Revenue Adjustments	$542	$2,261	$2,837	$6,215	$4,455	$4,006	$20,316
Advertising	$126	$503	$814	$2,025	$1,212	$1,032	$5,712
Unreturned Equipment	$164	$4,231	$1,152	$2,197	$5,280	$5,280	$18,304
Other Revenues (Repair, Installation, etc.)	$108	$462	$444	$1,050	$1,017	$1,017	$4,098
Underpaid Franchise Fees	**$940**	**$7,457**	**$5,247**	**$11,487**	**$11,964**	**$11,335**	**$48,430**
Underpaid PEG Fees	**-**	**-**	**-**	**-**	**$2,126**	**$25,091**	**$27,217**
Total Due from AT&T	**$940**	**$7,457**	**$5,247**	**$11,487**	**$14,090**	**$36,426**	**$75,647**
Grand Total Due from Comcast and AT&T	**$7,902**	**$23,770**	**$37,957**	**$74,482**	**$29,344**	**$42,777**	**$216,232**

[1] Only portions of unincorporated county areas are included in the Cable Joint Powers geographical area. However, the figures shown for Santa Clara and San Mateo Counties include AT&T underpayments for all county areas because AT&T did not provide sufficient information to calculate underpayments specific only to the Cable Joint Powers.

[2] Some AT&T underpayments are estimates because AT&T did not provide all requested records.

Source: Comcast and AT&T financial records

Comcast and AT&T did not pay franchise fees on all advertising revenue

Comcast underpaid about $70,000 in franchise fees because it excluded from its gross revenue the commissions paid by its advertising affiliate, Spotlight, to third-party advertising agencies and their representatives and because it did not include revenue that Spotlight earned from assisting other cable operators in the Cable Joint Powers areas. DIVCA requires an affiliate's revenue to be treated as the franchise holder's revenue, and specifically states that not doing so has the effect of evading the payment of fees that would otherwise be paid to the local entity.

AT&T underpaid franchise fees by about $6,000, based on a standard 15 percent commission charged by advertising agencies to assist in selling advertising time to businesses. The Buske Group estimated this amount because AT&T did not provide sufficient information to verify advertising revenue.

Comcast did not pay franchise fees on all flat fees charged to subscribers

Comcast underpaid about $37,000 in franchise fees because it did not include in its gross revenues all flat fees collected from its subscribers. Flat fees include late, nonsufficient fund, convenience, wire maintenance, early termination, and collection fees. Instead, Comcast allocated to its gross revenues only the flat fee charges that represented subscribers' video revenue as a percentage of its total revenue, which could include other services, such as internet and telephone. Because flat fees are not based on a subscriber's service level, the only amounts that should be excluded from gross revenues are those for subscribers who did not have video service. Comcast also excluded from its revenues its expenses for collecting past-due payments. The Buske Group estimated this underpayment because Comcast only provided records of net collection fees.

AT&T remitted fees collected from subscribers in unincorporated Santa Clara and San Mateo County areas directly to the counties

The Cable Joint Powers agreement requires Palo Alto to remit to the JPA members the franchise and PEG fees that Comcast and AT&T collect from subscribers, based on the percentage of total fees collected in each member's jurisdiction and after deducting the City's administrative costs. The JPA area includes unincorporated areas of Santa Clara and San Mateo Counties that border the Cable Joint Powers cities. However, AT&T remitted the franchise and PEG fees collected from subscribers in all of Santa Clara and San Mateo Counties directly to the counties and could not provide information needed to calculate the amounts due only to the Cable Joint Powers. An AT&T representative told us that the City would have to provide the addresses for the county areas in the JPA for AT&T to appropriately allocate fees to the Cable Joint Powers. Because Palo Alto was unaware of these direct payments, the cable coordinator did not allocate to the counties the City's administrative costs for this portion of the revenues. This caused the counties to underpay and the other Cable Joint Powers members to overpay their respective shares of administrative costs.

The counties did not remit the PEG fees paid directly to them for the unincorporated areas to the Media Center, as required by the contract with the Media Center, and it was beyond the scope of this audit to determine if the counties used the PEG fees only for capital expenditures related to PEG access facilities, as required under the federal Cable Act (see related discussion in Finding 1). However, regardless of whether the counties used the PEG fees in accordance with the Cable Act, AT&T's payments directly to the counties resulted in subscribers other than those who paid the fees to receive the benefit of those payments.

AT&T excluded customer refunds and credits from gross revenues

AT&T excluded adjustments, such as customer refunds and credits that it made for noncable service revenues that are subject to franchise fees, from its revenues. This caused AT&T to underpay Santa Clara County about $20,000 in franchise fees.

Comcast excluded FCC and CPUC fees from gross revenues

Comcast underpaid about $20,000 in franchise fees because it did not include fees assessed by the California Public Utilities Commission (CPUC) and the Federal Communications Commission (FCC) in gross revenues. Although DIVCA clearly defines franchise fees as those paid to the local entity, Comcast excludes the CPUC and FCC fees because it claims that these are franchise fees and that including them would cause it to pay more than DIVCA's 5 percent cap on franchise fees. Comcast includes these fees in subscribers' monthly service charges and should have included them in gross revenues.

Comcast and AT&T did not pay franchise fees on unreturned equipment charges

Comcast underpaid about $600 and AT&T underpaid about $18,000 in franchise fees because they excluded unreturned equipment revenue from their calculation of gross revenue that is subject to franchise fees. Comcast's underpayment may be understated because it changed the mapping for unreturned equipment revenue, which made it difficult to determine if it fully reported this revenue. AT&T began calculating and paying franchise fees on unreturned equipment revenue in April 2014 but inappropriately excluded amounts written off from its gross revenues.

Comcast and AT&T miscalculated and underpaid some PEG fees

Comcast underpaid about $13,000 in PEG fees due to Santa Clara and San Mateo Counties and AT&T underpaid about $4,000 because they billed $0.88 per subscriber instead of 1 percent, which would have generated more revenue. AT&T underpaid an additional $23,000 in PEG fees because, although it billed $0.88 per subscriber, it remitted payment based on $0.55 per subscriber in San Mateo County instead of 1 percent. The municipal codes for Palo Alto, Menlo Park, East Palo Alto, and Atherton require a PEG fee of $0.88 per subscriber, but Santa Clara and San Mateo Counties require the fee to be the higher of $0.88 per subscriber or 1 percent of gross revenue. AT&T's representative told us that its systems can only calculate the fee based on a single rate for a geographical area, not an "either/or" formula.

AT&T did not pay franchise fees on all gross revenues

AT&T underpaid about $4,100 in franchise fees because it did not include all revenues, including convenience fees, installation labor, additional outlets, and repair labor, in gross revenues that are subject to franchise fees. The Buske Group estimated the underpayment because AT&T did not provide all requested records needed to calculate the amount due.

Comcast and AT&T owe interest on underpaid franchise and PEG fees

Comcast and AT&T owe interest on the underpaid franchise and PEG fees. DIVCA requires that interest be calculated at an annual rate equal to the highest prime lending rate during the period of delinquency, plus 1 percent. The interest owed should be calculated when the City finalizes the underpayment amounts on which it will pursue collection.

AT&T owes the City for the costs of the audit

AT&T's estimated underpayment of $48,400 in franchise fee payments equals 6 percent of total franchise fees due during the audit period, which means that AT&T owes the City for the costs related to AT&T's portion of this audit. DIVCA requires a franchise holder to pay the audit costs if it underpaid franchise fees by more than 5 percent. Whether AT&T has to pay the audit costs will also depend on whether it provides additional information that would allow us to recalculate the underpayments based on revenue that is only for the unincorporated areas of San Mateo and Santa Clara Counties, rather than all areas of those counties.

Inaccuracies and omissions in Comcast and AT&T address databases can cause payment errors

Comcast uses an address database, commonly referred to in the industry as a "homes-passed" list, to associate subscriber revenues with the jurisdiction that should receive the franchise and PEG fees. However, the database is not complete or fully reliable, which likely caused errors in franchise and PEG fee payments to the Cable Joint Powers members:

- 524 out of 36,930 residential address records for Palo Alto are associated with the East Palo Alto billing code, which means that some Palo Alto revenues and their related franchise fees were misallocated to East Palo Alto.
- About 1,400 residential address records in the Cable Joint Powers area are not in the database, and 246 Comcast database

records are not in the Cable Joint Powers members' residential address records.

Although DIVCA requires franchise holders to maintain records that would allow a local entity to ensure that the franchise holder accurately compensated the local entity, AT&T does not have a homes-passed list or other database to show how each residential address is associated with jurisdictions in the Cable Joint Powers area. AT&T uses a third-party vendor to determine how to allocate revenue when an account is established for a residential address and can only provide addresses that are being billed within a jurisdiction for the point in time when the list is produced. The lack of a comprehensive address list for the areas served limits the ability to assess AT&T's address database to gain assurance that past fees were and that future fees will be appropriately allocated to Cable Joint Powers members. However, the account database that AT&T provided for a point in time during the audit included residential addresses that were associated with incorrect jurisdictions, which would cause inappropriate allocation of franchise and PEG fees.

The City does not effectively monitor the accuracy and completeness of franchise and PEG fee payments

The City's cable coordinator reviews Comcast and AT&T franchise and PEG fee payments and follows up with them regarding large variances and late payments. However, the cable coordinator does not obtain and review documents, such as customer count and address billing records and documents that show how Comcast and AT&T calculated gross revenue that is subject to franchise fees, to verify the accuracy of fee payments. Recognized internal control frameworks require organizations to implement monitoring processes that allow timely identification of deficiencies, but the City has relied on the Office of the City Auditor and an external consultant to periodically assess the accuracy of franchise and PEG fee payments.[8] The Office of the City Auditor conducted the last assessment, which included only Comcast, in 2006. Because of the cost of conducting periodic audits and DIVCA limits on the amount of time entities have to submit claims to recover underpayments, ongoing reviews would help ensure the accuracy of fee payments on a routine basis.

[8] U.S. Government Accountability Office, "Standards for Internal Control in the Federal Government," Washington, D.C., 2014, available at **http://www.gao.gov/products/GAO-14-704G**.

Committee of Sponsoring Organizations of the Treadway Commission, "Internal Control – Integrated Framework," 2013, available at: **http://www.coso.org/IC.htm**.

Recommendations

We recommend that the City Manager's Office, in coordination with ASD, IT, and the City Attorney's Office:

2.1 Send a letter to AT&T and Comcast describing the results of the audit and demanding payment of the underpaid franchise and PEG fees shown in Exhibit 4, plus interest calculated in accordance with DIVCA requirements.

2.2 Include in AT&T's letter a demand for payment of the audit costs that are attributable to AT&T.

2.3 Work with Comcast and AT&T to develop methods to ensure:

- Their address databases accurately reflect all potential service addresses within the Cable Joint Powers geographic areas.
- They have a separate billing code for each member jurisdiction and accurately report and remit payments to the City of Palo Alto based on those billing codes.

2.4 Develop criteria for assessing the accuracy of future Comcast and AT&T franchise and PEG fee payments on an ongoing basis and:

- Communicate the criteria to Comcast and AT&T and that it will be used to review the accuracy of future payments.
- Require Comcast and AT&T to report the breakdown of their fees in more detail, including identifying what is and is not included in the gross revenues used to calculate the fees and the reason for any exclusions.
- Review the franchise and PEG fee payments to ensure that they were calculated on all revenues that are subject to franchise and PEG fees and promptly follow up with Comcast and AT&T regarding any discrepancies.

2.5 Request that San Mateo and Santa Clara Counties revise their municipal codes to reflect only a single adopted rate to accommodate the cable companies' billing system capabilities, if the PEG fee continues to be collected (see Recommendation 1.1).

Finding 3

Roles and responsibilities for managing the City's cable communications program are not clearly defined or assigned

The City has not clearly assigned or defined roles and responsibilities for its cable communications program or effectively managed the program to ensure that funds are used appropriately and that program outcomes are consistent with the City's and residents' cable communications needs.

Municipal Code assigns the Office of the City Clerk responsibility for managing cable communications

Municipal Code Section 2.08.110, Office and Duties of the City Clerk, was adopted in 1995 and designates the Office of the City Clerk as responsible for administering the city's cable communications program. However, the City Clerk's Office does not in fact administer the program and administering it does not align well with the City Clerk's other key responsibilities.

Other sections of Municipal Code updated responsibility for program administration and oversight

Municipal Code Chapter 2.10, adopted in 2000 and no longer operative after 2008, described cable television franchise awards and identified the cable coordinator as "the individual or individuals designated by the city to administer a cable communications system franchise." This chapter was superseded by Chapter 2.11, which Council adopted in 2007 to implement DIVCA. It states that the cable coordinator is "the city manager or the individual or individuals designated by the city manager to administer oversight of state franchisees in the city." The term, "cable communications program," is not defined in the Code and is not referenced anywhere in the Code other than where the Code assigns responsibility for the program to the Office of City Clerk.

The IT Department performs limited activities related to the cable program

The IT Department administers a contract and approves payments for the City's cable coordinator but does not otherwise actively manage or provide oversight of the cable communications program. ASD administered the cable coordinator contract prior to IT becoming a separate department. When the Municipal Code was updated, the provision in Chapter 2.08 that assigns responsibility to the Office of the City Clerk was not updated to reflect changes in how cable activities were to be administered in the City.

No program performance measures

There are no established goals and objectives to address program activities or performance measures to monitor and assess program inputs, outputs, and outcomes. Having measures would help the department responsible for oversight to ensure that the program meets its goals and objectives and aligns with the City's mission, business needs, and responsibilities.

Recommendations

We recommend that the City Clerk and City Manager's Office:

3.1 Confer and develop a recommendation for the City Council to assign responsibility for the City's cable communications program and require the assigned department to provide appropriate program oversight to ensure that:

a. The City's cable communications program objectives are aligned with the City's goals and objectives.

b. The assigned department develops performance measures to demonstrate that the program is effective and is meeting the City's goals and objectives.

c. There is effective oversight and management of the cable coordinator's contract and activities.

3.2 Submit a draft ordinance to the Palo Alto City Council recommending revisions to the Palo Alto Municipal Code based on the revised assignment of roles and responsibilities.

APPENDIX 1 – City Manager's Response

CITY OF PALO ALTO

CITY OF PALO ALTO
MEMORANDUM

TO: Harriet Richardson, City Auditor

FROM: James Keene, City Manager

DATE: April 22, 2016

SUBJECT: Cable Audit Response

The staff appreciates the work of the City Auditor in assessing the cable communications program and associated fees and agrees with the findings and recommendations of the audit. The City typically conducts cable franchise and public, education, and government (PEG) fee audits every three to five years. However, this is the first audit that the City has undertaken following the passage of the California Digital Infrastructure and Video Competition Act (DIVCA) of 2006. This law changed the franchising and regulatory structure for the provision of cable services in California. Most cable franchises in California (including our Comcast and AT&T franchises) have moved from local to state franchises since DIVCA was enacted.

The audit brings to the forefront a significant impact related to the shift from a locally negotiated franchise. DIVCA eliminated the means through which localities, like the Joint Powers Authority (JPA), could protect PEG fees from the federal Cable Act's capital cost limitation. Under the JPA's state-issued franchises, the use of PEG money is now restricted to capital costs. Staff agrees to develop and implement criteria for the use of PEG fees to ensure compliance with the federal Cable Act, and to set fees at a level that is consistent with future capital needs.

The audit also raises an important policy question about the ongoing value of PEG channels in our community and the desire to invest in and maintain the current model for the provision of local community media. This is primarily a policy consideration for the Council to consider. Staff will assist Council as requested, in particular with respect to potential operating cost subsidies.

My office has reviewed the audit, provided the responses and will work with the other JPA members to address the audit findings. Staff will report progress on implementation six months after the Council accepts the audit report, and every six months thereafter until all recommendations have been addressed.

JAMES KEENE
City Manager

The City Manager has agreed to take the following actions in response to the audit recommendations in this report. The City Manager will report progress on implementation six months after the Council accepts the audit report, and every six months thereafter until all recommendations have been implemented.

Recommendation	Responsible Department(s)	Agree, Partially Agree, or Do Not Agree and Target Date and Corrective Action Plan	Status
Finding 1: The Media Center did not restrict its use of $340,000 of annual PEG fees to capital expenditures as required by the federal Cable Act.			
We recommend that the City Manager's Office:			
1.1 Consult with ASD, IT, the City Attorney's Office, and Cable Joint Powers members to assess the need to continue collecting PEG fees and adjust the fee based on a demonstrated need for future capital expenses related to PEG access facilities or discontinue collecting the fee. a. If it is determined that the PEG fee should be adjusted or discontinued, submit a staff report to the City Council with a recommendation to amend the Municipal Code to reflect the revised fee or to eliminate the requirement and recommend to the other Cable Joint Powers members that they do the same. b. If it is determined that the PEG fee should continue to be collected: • Amend the agreement with the Media Center to remove the requirement for the City to remit all PEG fees collected to the Media Center. • Coordinate with ASD, the City Attorney's Office, and the Cable Joint Powers to develop and implement criteria for the use of PEG fees to ensure compliance with the federal Cable Act, and that the fees are set at a level appropriate for anticipated and necessary capital expenses. • Place the PEG fees in a restricted account and distribute them based on City-approved capital expenditures that meet federal Cable Act requirements. • Require that semi-annual documentation	City Manager's Office, ASD, IT, City Attorney's Office	**Concurrence: Agree** **Target Date: 2017** Action Plan: Staff agrees that it should confirm the ongoing need for the PEG fee and ensure it is set at a level that is consistent with future capital needs. Staff will work with the City Attorney's Office to develop a "capital cost" definition that eliminates any cost categories that could be construed as operating costs and will restrict the use of PEG fees to expenditures that meet this definition. Staff will also develop and adopt procedures that define the PEG fee distribution and reporting process. Staff will propose the appropriate revisions to the Municipal Code if it is determined that the PEG fee should be modified in any way.	

Recommendation	Responsible Department(s)	Agree, Partially Agree, or Do Not Agree and Target Date and Corrective Action Plan	Status
of expenditures be provided and adopt procedures to review the documentation to ensure that PEG fees are spent only as allowed by the federal Cable Act and take immediate corrective action as necessary.			
1.2 Consult with ASD, IT, the City Attorney's Office, and the Cable Joint Powers on whether to allocate a portion of the unrestricted franchise fees or other funds, instead of restricted-use PEG fees, to subsidize the Media Center's operations or to discontinue subsidizing the Media Center's operations. Based on the resulting recommendation, the City Manager's Office should make recommendations to the Council regarding appropriate future funding, if any, for the Media Center.	City Manager's Office, ASD, IT, City Attorney's Office	**Concurrence: Agree** **Target Date: 2017** Action Plan: Staff will consult with the Cable Joint Powers to determine if there is any interest in subsidizing the Media Center's operations. Staff will propose recommendations to the City Council if needed.	
Finding 2: Comcast and AT&T did not remit the full amount of franchise and PEG fees due.			
We recommend that the City Manager's Office, in coordination with ASD, IT, and the City Attorney's Office:			
2.1 Send a letter to AT&T and Comcast describing the results of the audit and demanding payment of the underpaid franchise and PEG fees shown in Exhibit 4, plus interest calculated in accordance with DIVCA requirements.	City Manager, ASD, IT, City Attorney's Office	**Concurrence: Agree** **Target Date: 4Q 2016** Action Plan: Staff will draft a letter to Comcast/AT&T demanding payment of the underpaid franchise and PEG fees, plus interest (and audit costs in the case of AT&T). Staff will work with Comcast/AT&T to correct their address databases so that future payments are properly remitted and will develop criteria to assess the accuracy of future payments. Staff will work with San Mateo and Santa Clara Counties to adjust their PEG fee rates as needed.	
2.2 Include in AT&T's letter a demand for payment of the audit costs that are attributable to AT&T.			
2.3 Work with Comcast and AT&T to develop methods to ensure:			

Recommendation	Responsible Department(s)	Agree, Partially Agree, or Do Not Agree and Target Date and Corrective Action Plan	Status
• Their address databases accurately reflect all potential service addresses within the Cable Joint Powers geographic areas. • They have a separate billing code for each member jurisdiction and accurately report and remit payments to the City of Palo Alto based on those billing codes.			
2.4 Develop criteria for assessing the accuracy of future Comcast and AT&T franchise and PEG fee payments on an ongoing basis and: • Communicate the criteria to Comcast and AT&T and that it will be used to review the accuracy of future payments. • Require Comcast and AT&T to report the breakdown of their fees in more detail, including identifying what is and is not included in the gross revenues used to calculate the fees and the reason for any exclusions. • Review the franchise and PEG fee payments to ensure that they were calculated on all revenues that are subject to franchise and PEG fees and promptly follow up with Comcast and AT&T regarding any discrepancies.			
2.5 Request that San Mateo and Santa Clara Counties revise their municipal codes to reflect only a single adopted rate to accommodate the cable companies' billing system capabilities, if the PEG fee continues to be collected (see Recommendation 1.1).			
Finding 3: Roles and responsibilities for managing the City's cable communications program are not clearly defined or assigned.			
We recommend that the City Clerk and City Manager's Office:			
3.1. Confer and develop a recommendation for the City Council to assign responsibility for the City's cable communications program and require the	City Manager's Office, City Clerk	**Concurrence: Agree** **Target Date: 4Q 2016**	

Recommendation	Responsible Department(s)	Agree, Partially Agree, or Do Not Agree and Target Date and Corrective Action Plan	Status
assigned department to provide appropriate program oversight to ensure that: a. The City's cable communications program objectives are aligned with the City's goals and objectives. b. The assigned department develops performance measures to demonstrate that the program is effective and is meeting the City's goals and objectives. c. There is effective oversight and management of the cable coordinator's contract and activities.		Action Plan: Staff will determine where to assign responsibility for the City's cable communications program/activities and propose the appropriate revisions to the Municipal Code. The responsible department will establish performance measures to ensure proper program administration and oversight.	
3.2. Submit a draft ordinance to the Palo Alto City Council recommending revisions to the Palo Alto Municipal Code based on the revised assignment of roles and responsibilities.			

APPENDIX 2 – Media Center's Response

Midpen Media Center

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Date: 3/24/16

To: Office of the City Auditor

RE: Response to City of Palo Alto Cable Franchise and PEG Fee Audit

A. Overview of Comments

The Midpeninsula Community Media Center (Media Center) believes that the audit report, at least as it relates to the use of the PEG fees paid by cable operators as annually reviewed by the Joint Powers Authority, does not accurately reflect what has occurred in the past or correctly describe applicable law. It misrepresents the accounting system actually used by the Media Center, and misinterprets documents provided to the auditor, as explained in Appendix A to these comments. Worse, it implies motivations on the part of Media Center, or negligence on the part of the members of the JPA, even though there is no indication the auditor did the sort of review of internal documentation required to support those implications. Indeed, the report seems to depart from the objectivity required of an auditor by selectively using information supportive of conclusions the report draws and ignoring readily-available contrary data. For example, the report relies primarily on a study by a far-right Michigan think tank funded by the Koch brothers and their allies to make recommendations as to how the City should proceed with respect to PEG (a) without providing information regarding other studies that call the report cited into substantial question, indicating the auditor did not undertake any reasonable investigation before drawing conclusions from the think tank study; and (b) apparently without utilizing the expertise of The Buske Group, or some other PEG expert to review the audit report's conclusions or to provide information relevant to them.[1] As a result, the report unfortunately reads as an attack on public access masquerading as a financial document.

[1] The Buske Group was retained by the City in connection with the audit and is well-recognized as expert in the field of PEG access. While the report contains a disclaimer regarding The Buske Group's role in the audit discussed below, the disclaimer *(footnote continued)*

Our central disagreements are as follows:

B. Use of PEG Funds

We object to Finding 1: "The Media Center did not restrict its use of $340,000 of annual PEG fees to capital expenditures as required by the federal Cable Act." The Media Center did not restrict use of PEG fees to purchases of capital facilities and equipment. However, the Cable Act does not restrict use of PEG fees to capital expenditures, as evidenced by (a) FCC decisions indicating that funds may be used for operating support, *e.g.*, at least with operator consent; and (b) the fact that the City itself entered into a franchise agreement, reviewed by the then City Attorney, that allowed PEG fees to be used for operating support (we understand that the franchise was negotiated by The Buske Group, which could have been asked for information about that negotiation, but apparently was not). While that franchise expired in 2010, the law the audit report refers to was identical at the time it was negotiated; if federal law absolutely prohibited use of PEG fees for operating support, that contract could not have been approved, and it is unlikely that the cable operator would have agreed to the condition. More detail regarding the use of the fee is addressed in the memorandum provided by the law firm of Best Best & Krieger (Appendix B).

We likewise object to the finding that the use of the PEG fees was "inappropriate." This finding seems to assume (incorrectly) that the particular uses by the Center were somehow violative of the Cable Act or of California law. In addition, however, the actual obligation of the access center with respect to use of the funds, from Section 15 of the agreement with the Joint Powers Authority is: "Media Center shall use the funds generated from the PEG Fee only in a manner consistent with DIVCA and the Cable Act, such that the PEG Fee shall not be construed to be a "franchise fee" within the meaning of the Cable Act, 47 U.S.C. § 542(g)." Not one penny of the amount paid to the Media Center has been treated as a franchise fee. Under California law, if there is a dispute as to PEG fees, "[a] court of competent jurisdiction shall have exclusive jurisdiction to enforce any requirement under this section or resolve any dispute regarding the requirements…" DIVCA, Section 5870(p). No court has "construed" the PEG payments to be franchise fees and no court has been asked to make that determination.

The finding also seems to assume, incorrectly, that the JPA and the City were unaware or unconcerned with how PEG funds were being used, and that the Media Center used the PEG fees for operations in order to maintain control of capital facilities to its advantage. As explained in Appendix A, this is not a factually supportable conclusion, and it is not even clear that the auditor examined the relevant documents before drawing these erroneous conclusions. The Media Center's two largest sources of funding are an investment fund that was created in connection with the transfer of the cable system from a cable cooperative to a private operator (now Comcast); and PEG fees paid pursuant to DIVCA. The investment fund could have been used for operating expenses and the PEG fees for capital expenses, but as shown by the materials attached in Appendix A, the City preferred the reverse. Consistent with that direction (which necessarily reflected City views as to permissible uses of PEG fees), the Media Center has used much (though not all) of the PEG fees received for operations and the investment fund for capital purposes. The budget for the Media Center has been presented to the JPA and the City each year; while the City and operators have therefore been familiar with the uses, no objection has been raised to that use.

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does not explain why The Buske Group was not used in connection with the reliance on the think tank's report, or why other expertise was not sought out.

Finally, when the auditor writes of a violation of the Cable Act, what the auditor means is that the City's franchise fee is capped at an amount equal to 5% of operator gross revenues as defined in *federal law.* While a PEG fee that is used for capital purposes would not count against the cap, the auditor assumes that non-capital uses would count against the franchise fee, and would take the City over the 5% cap. But this also means that, even under the auditor's view of the law, if the City is collecting less than the 5% federal maximum, the PEG fees can be used for operating support without violating the law.

There are two cable operators that were audited – Comcast and AT&T. The audit of franchise fees did not examine how much either of the operators would have owed under the federal franchise fee definition – the audit only looked at fees owed under DIVCA. To know what would have been owed under federal law, the auditor would have had to examine, among other things how the companies treated revenues from bundled services, which may be treated differently under state and federal gross revenues definitions. Likewise, the audit report would have had to examine the treatment of revenues collected and used to pay PEG fees. That does not appear to have been examined. The auditor would have needed to examine credits taken against franchise fees by AT&T during the audit period for refunds to customers and for other promotional purposes. It does not appear that this was done. Without fully examining what could have been owed under federal law, conclusions as to the fund usage – even if otherwise correct – are simply incomplete.

The Media Center has in fact expended significant capital funds in recent years from the investment fund – enough in the last three years, for example, to equal or exceed amounts spent on operating funds. Setting aside the other flaws in the report, in many respects the conclusions are not a matter of propriety or impropriety, but of accounting for those items through the two funds in a manner with which the City and JPA would be comfortable. The Media Center has already adopted a change in its treatment of funds that would address this issue, based on its understandings of the City's concerns. While the City cannot directly control the Media Center except in a manner consistent with its 501(c)(3) status, it is fair for the City and JPA to review the policies to determine whether they are consistent with accepted accounting principles. We believe that they are, although that need not be decided now.

Media Center therefore believes that more accurate conclusions to which it would not object would be as follows:

- *There remains a significant legal question as to how PEG fees may be used in California.*
- *Without drawing any conclusions as to past practices, or dismissing any rights the City could assert if use of PEG funds was contested, a prudent course from the City's perspective is to dedicate the PEG fees to capital uses, absent a change in law, or some other agreement that City and JPA find acceptable.*

An appropriate recommendation would be to direct the City Manager to work with the Media Center through the JPA to comment upon and review the implementation of the Media Center's new PEG policies restricting PEG fee use to capital expenses.

C. Recommendations Regarding PEG Funding

The auditor's report recommends that the City "[a]ssess the need for the City to continue collecting PEG fees, adjust the fee, or discontinue collecting the fee based on the need for future capital expenses related to PEG access facilities."

This recommendation is based on at least two deeply flawed assumptions and factual errors.

The first is the assumption that there is a substantial question as to whether PEG is needed in the current digital environment, and that the "need" is properly assessed by examining viewership. The auditor, who claims no expertise in this area, relies primarily on a 2008 report by the Michigan-based Mackinac Center, which is funded by the Koch brothers, the Bradley and Scaife foundations and other hard-right supporters of what some claim is an agenda to undermine public education, destroy unions, suppress minority voting and deny public access to communication media. Information on the Center and its activities is easily discovered through a simple web search,[2] and it is rather striking that the City was not advised of the potential cloud surrounding the key study cited by the auditor, and which the City has now been asked to endorse.

A central premise the auditor appears to accept is that sources of online digital content, such as YouTube, are equivalent to, and a substitute for, PEG channels. They are not: they are complementary. In the JPA area, for example, the existence of a PEG channel and PEG equipment allows producers to create programming that can be distributed via cable, but then also distributed via other digital media, including public access center websites and YouTube. The PEG funding thus provides resources that allow citizens who would otherwise be unable to produce quality programming to develop free speech content that is then available across platforms – and allows those who rely on television as the main source of information to obtain community specific information through that medium.

Indeed, a more recent study by researchers at the University of Texas in Austin, also readily available on the Internet,[3] concluded that PEG channels retain their importance, and are of particular importance to minorities and to segments of a community with lower income. What the report implicitly finds is that the value of PEG is measured not just by viewership, but by participation in the process of creating the programming, and its contribution to creation of social capital and civic engagement.[4] The absence of any mention of contrary reports, as well as the failure of the auditor to test the report by speaking with an acknowledged PEG expert such as The Buske Group is troubling, not just because it affects whether an analysis of PEG funding is required, but also because it fails to come to grips with factors that would need to be considered in conducting that analysis.

Separately, the auditor did not have or seek information regarding the future capital needs for PEG, nor did the auditor take into account the existing assets that, based on the auditor's own report, ought to be somehow transferred to the control of the JPA. That is an issue the Media Center has been seeking to address through various proposals to obtain credit for its past expenditures of its own investment funds on its facilities and equipment, and would affect long-term capital requirements for the PEG fee. Finally, the auditor assumed that there could never be an arrangement under which PEG fees could be used for

[2] For a discussion of the Mackinac Center (admittedly from an opposition point of view), see the following:
http://meamatters.com/2016/01/13/how-the-kochs-use-the-mackinac-center/
http://www.progressmichigan.org/2013/11/mackinac-center-exposed-whos-running-michigan/
http://www.motherjones.com/politics/2011/12/michigan-privatize-public-education. The audit report also relies on a City survey that contained two questions on viewership of public meetings of just Palo Alto, not the whole JPA area, and a Congressional study showing many access centers have closed for lack of funding. Neither is sufficient to support the recommendations made in the audit report.

[3] A summary of the conclusions can be found at:
http://www.academia.edu/4489694/_2013_Still_Relevant_An_Audience_Analysis_of_Public_and_Government_Access_Channels.

[4] https://www.americanpressinstitute.org/publications/reports/survey-research/how-americans-get-news/

operations, an assumption that is incorrect, but that could be an appropriate matter for the City to consider.

The Media Center wholeheartedly favors periodic review of the value PEG brings to the community, but any such analysis needs to look to factors other than viewership alone. Absent an assessment of PEG value, it is premature to decide whether or not PEG funding should be adjusted.

Likewise, the amount of funding required for the future can only be determined after the accounting issues raised by Media Center's new policies have been reviewed. Other recommendations should await that review.

Other comments are italicized and in blue in the annotated copy of the report, which follows.

Annotated Draft Audit Report dated April 12, 2016.

PURPOSE OF THE AUDIT:

The audit objectives were to determine whether and to what degree, from July 1, 2010, through June 30, 2014:

- The City of Palo Alto accurately accounted for its receipt of franchise and public, education, and government (PEG) fees and met its oversight responsibilities regarding the Media Center's use of PEG access fees.
- Comcast and AT&T collected and promptly remitted the appropriate amount of franchise and PEG fees.
- The City established and sufficiently defined roles and responsibilities to administer its cable communications program and state franchises awarded to Comcast and AT&T.

Recommendations with respect to assessing the future need for PEG, or the value of PEG are beyond the defined scope of the audit.

REPORT HIGHLIGHTS

Finding 1: The Media Center did not restrict its use of $340,000 of annual PEG fees to capital expenditures as required by the federal Cable Act (Page 8)

The Media Center inappropriately used an annual average of $340,000 of public, education, and government (PEG) fees, or $1.4 million during the audit period, paid by cable television subscribers in the Cable Joint Powers areas, for operating expenses. Neither the City nor the Media Center enforced the federal law that restricts the use of PEG fees to capital expenses associated with PEG access facilities.

See Overview above and BB&K legal analysis (Appendix B). In addition, the report is unclear as to what is meant when it is said that the City or Media Center has responsibility for "enforcing" the federal law. Neither the "Media Center" nor "City" is responsible for enforcing federal law restrictions, or given the authority to unilaterally determine what the law means in a particular instance. Under DIVCA, claims that funds have been misused should be brought in a court of competent jurisdiction. The FCC or a court would likewise be the entity responsible for determining how the restrictions on PEG apply in particular cases.

Key Recommendations to the City Manager's Office:

- Assess the need for the City to continue collecting PEG fees, adjust the fee, or discontinue collecting the fee based on the need for future capital expenses related to PEG access facilities.

  See Overview above - premature.

- Coordinate with the other JPA jurisdictions regarding potential amendments to their municipal codes based on adjustments made to the PEG fee requirement.

  See Overview above - premature.

- If the PEG fee is retained, establish criteria for how PEG fees may be used and require documentation and review of expenditures to ensure compliance with the federal Cable Act.

  Report fails to consider costs associated with this recommendation, if its intention is to require documentation in addition to that already existing. Further, it fails to consider the impact of an approval process on the Media Center given the delay that the approval process would introduce between the time funds are expended and the time that the Media Center would receive reimbursement for them. If a capital repair is required to the building, for example, delay could lead to significant operational issues. Given the capital expenditure policies adopted by the Media Center, it is not clear why this is necessary.

  But in any case, this recommendation is unsupported by objective analysis. Auditor did not examine existing documentation in detail (because auditor did not request, and affirmatively chose not to examine, the Media Center's actual accounting for capital expenditures). See Appendix A.

- Determine whether to allocate a portion of the unrestricted franchise fees or other funds to subsidize the Media Center's operations.
  See Overview above – premature.

Finding 2: Comcast and AT&T did not remit the full amount of franchise and PEG fees due. (Page 14)

Comcast and AT&T did not always calculate the fees due in accordance with DIVCA and the municipal code of each of the Cable Joint Powers. As a result, Comcast underpaid about $141,000 in franchise and PEG fees from July 1, 2010, through June 30, 2014, and AT&T underpaid about $76,000 from July 1, 2011, through September 30, 2014.

AT&T's underpayments are estimated because it did not provide sufficient records for us to verify the accuracy of franchise and PEG fee payments. In addition, AT&T's underpayments are for all of Santa Clara and San Mateo Counties because it remitted fees collected from subscribers in the unincorporated county areas directly to the counties and could not provide the information needed to calculate the amounts due only to the Cable Joint Powers (see scope limitations section on page 5).

Comcast and AT&T will owe interest, calculated at the highest prime lending rate during the delinquency period plus 1 percent, on underpaid fees, as required by DIVCA. DIVCA also requires that AT&T pay the City for its portion of the audit costs because AT&T's underpayment exceeds 5 percent of the amount that it should have paid.

Key Recommendations to the City Manager's Office:

- Send letters to AT&T and Comcast demanding payment of the underpaid franchise and PEG fees, interest due, and for AT&T, its portion of the audit costs.

- Work with AT&T and Comcast to develop methods to ensure accuracy of their address databases and the basis for determining the revenues on which franchise and PEG fees should be calculated.
- Review franchise and PEG fee payments to ensure they were calculated based on the established criteria and promptly follow up on discrepancies.

Auditor did not examine amount that would have been owed had City collected full amount it could have collected if the federal franchise fee definition (as opposed to DIVCA definition) applied; in the absence of that analysis, any calculation of use of PEG fees is defective, even assuming auditor correctly analyzed the law.

Finding 3: Roles and responsibilities for managing the City's cable communications program are not clearly defined or assigned (Page 21)

The City has not clearly assigned or defined roles and responsibilities for its cable communications program or effectively managed the program to ensure that funds are used appropriately and that program outcomes are consistent with the City's and residents' cable communications needs.

Key Recommendations to the City Manager's Office:

- Assign responsibility for the City's cable communications program and require the assigned department to provide appropriate program oversight.
- Submit a draft ordinance to the Palo Alto City Council recommending revisions to the Palo Alto Municipal Code based on the revised assignment of roles and responsibilities.

The Media Center has no comments on these recommendations.

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Cable Franchise and PEG Fee Audit *1*

INTRODUCTION

Audit Objectives

The audit objectives were to determine whether and to what degree, from July 1, 2010, through June 30, 2014:

- The City of Palo Alto accurately accounted for its receipt of franchise and public, education, and government (PEG) fees and met its oversight responsibilities regarding the Media Center's use of public, education, and government PEG access fees.
- Comcast and AT&T collected and promptly remitted the appropriate amount of franchise and PEG fees.
- The City established and sufficiently defined roles and responsibilities to administer its cable communications program and state franchises awarded to Comcast and AT&T.

The recommendations regarding PEG funding for the future appear to exceed the scope of the audit.

Background

Legal framework: franchise and PEG fees

The California Digital Infrastructure and Video Competition Act (DIVCA) of 2006 gives the California Public Utilities Commission sole authority to issue video and cable franchises to companies that provide such services within the state. DIVCA requires a franchise holder to pay a franchise fee of 5 percent of its gross revenues to each jurisdiction served, unless the jurisdiction adopts an ordinance that sets a lower fee, as rent or toll for using the public rights-of-way. DIVCA requires franchise holders to provide PEG access channels within each jurisdiction served, and jurisdictions may adopt an ordinance that establishes a fee to support PEG channel facilities. DIVCA limits the PEG fee to 1 percent of the franchise holder's gross revenues for entities that did not assess a PEG fee prior to December 31, 2006.

For a fuller discussion of DIVCA, see the BB&K analysis. In Palo Alto, a fee was being assessed prior to December 13, 2006, and so the fee in Palo Alto is not limited to 1% of a holder's gross revenues. Per Section 2.11 of the Palo Alto Administrative Code, the fee is set at $0.88 per subscriber/month. The audit report should more clearly describe the rights of the communities to charge more than 1%.

The federal Cable Communications Policy Act of 1984 (Cable Act), 47 U.S.C. § 542, restricts the use of PEG fees to capital expenses associated with PEG access facilities when the fee is assessed in addition to a franchise fee, but allows paid advertising, underwriting, or sponsorships to fund PEG-related activities. Franchise holders may pass both the franchise and PEG fees on to their cable subscribers.

As the BB&K analysis indicates, this is not correct and the City's own past practices are to the contrary. Even if one assumes that PEG fees were limited to capital, and the maximum 5% franchise fee as defined under federal law were being charged, the audit report does not examine whether the maximum fee permitted under federal law is being assessed. Typically, operators in California do pay less under DIVCA than could be paid if the maximum fee permitted under the Cable Act was being charged. See Appendix C, Letter from Ashpaugh & Sculco, CPAs, PLC.

As the BB&K report explains, the FCC has recently said that its rulings with respect to PEG operating funds do not apply in California or in other state franchising states, although the FCC did not make it clear what rule would apply. However, there is reason to believe the State could authorize fees that might not be permissible under a simple cable franchise, because DIVCA purports to grant rights that an operator would not have if the franchise were limited to the right to install a cable system to provide cable services, as would be the case with a Cable Act franchise.

DIVCA requires franchise holders to maintain records so the local entities can assess the accuracy of franchise and PEG fee payments.

We agree.

Joint Exercise of Powers Agreement

The cities of Palo Alto, Menlo Park, and East Palo Alto; the Town of Atherton; and unincorporated portions of San Mateo and Santa Clara Counties created a Joint Powers Authority (JPA) in 1983 to obtain cable television service within these jurisdictions. The JPA members are known as the Cable Joint Powers. Two cable franchise holders, Comcast and AT&T, currently serve the Cable Joint Powers. Palo Alto administers and enforces the state franchises on behalf of the Cable Joint Powers through an agreement among the members. A working group comprised of Cable Joint Powers members considers cable and video service-related issues related to state franchises.

As explained in the BB&K report, the use of the term "enforce" could be misleading in the audit report.

JPA franchise and PEG fees

The Palo Alto Municipal Code (Municipal Code) requires each franchise holder to activate seven PEG access channels on its network. It sets the cable franchise fee at 5 percent of the franchise holder's gross revenues and the PEG support fee at 88 cents per month per subscriber. The other Cable Joint Powers members have similar requirements, except Santa Clara County requires a PEG support fee that is the higher of 1 percent of gross revenues or 88 cents per subscriber, limited to 3 percent of gross revenues, and San Mateo County requires a PEG support fee that is the higher of 1 percent of gross revenues or 88 cents per subscriber.

No comment.

Roles and responsibilities

The Municipal Code defines roles and responsibilities for managing the City's cable communications program:

- The Office of the City Clerk is responsible for managing the City's cable communications program.
- The City Manager designates a cable coordinator to administer and provide oversight of state franchises in the City.
- The City may designate one or more entities, including itself, to control and manage the use of PEG access channels and any PEG facilities and equipment.

The City, through its Information Technology (IT) Department, contracts with an individual who serves as the City's cable coordinator to oversee and manage the cable communications program. This position was formerly managed in the Administrative Services Department (ASD) but was moved under the oversight of IT when IT became a separate department from ASD.

No comment.

Use of funds and financial reporting

Palo Alto distributes the franchise fees to each of the Cable Joint Powers based on the percentage of fees derived from Comcast's and AT&T's subscribers within each jurisdiction, after:

- Reimbursing Palo Alto for its costs to administer the state franchises, including the fees paid to the cable coordinator.
- Paying the costs of regulatory and oversight functions.
- Paying for other cable- or video-related activities that benefit the area in which the revenue was generated.

No comment.

In 2001, the Palo Alto City Council designated the Midpeninsula Community Media Center, Inc., (Media Center) as the community access organization to meet the Cable Joint Powers' existing and future PEG access needs. The City's 2011 contract with the Media Center requires Palo Alto to remit all of the PEG fees it receives from Comcast and AT&T on behalf of the Cable Joint Powers to the Media Center. The City separately contracts with the Media Center for cablecasting services, including broadcasting Palo Alto City council and committee meetings via cable television.

The Midpeninsula Access Corp. was established as an independent 501(c)(3) in 1985 and designated as the entity responsible for PEG in 1986. As part of the transaction that resulted in the transfer of the cable system from the Cable Co-op to TCI, and ultimately to Comcast, the Access Corp merged with Silicon Valley Community Communications Inc. (SVCC) and became the Media Center. The Media Center was redesignated as the entity responsible for managing PEG in 2001, and had two primary sources of funding: an investment fund that it received as part of the system sale and merger with SVCC; and the PEG funding provided under its contract with the JPA. As the BB&K report explains, the transfer to TCI was contingent on PEG funding being provided by the company that could be used for operating support.

Palo Alto currently receives about 50 percent of the allocated franchise fee revenues. Exhibit 1 shows the distribution of franchise fees to the Cable Joint Powers, and Exhibit 2 shows the total PEG fees received and remitted to the Media Center from July 1, 2010, through June 30, 2014.

No comment; table omitted.

Palo Alto established the Cable Fund as a restricted-use fund for nonrecurring cable-related revenue, such as settlements and grants. The fund is used to carry out specific actions required by the policy. The fund's balance was $759,000, including about $4,000 in interest receivable, as of June 30, 2014. In FY 2015, the City began using the Cable Fund to record franchise and PEG fee remittances from the cable companies and to allocate the fees to the Cable Joint Powers and the Media Center, respectively.

No comment.

Exhibit 3 summarizes the main components of the cable communications program, which generates $2.1 million in revenues and incurs $436,000 in expenditures annually for the Cable Joint Powers.

Our records show a small difference in PEG fee remittances [about $2-3000 per year]. However, we do not believe that this discrepancy *is significant to the audit report. Table omitted.*

Audit Scope

We assessed the City's oversight of its cable communications program and the use of franchise and PEG fee payments that Comcast and AT&T collected from cable subscribers in the Cable Joint Powers areas and remitted to Palo Alto from July 1, 2010, through June 30, 2014. We also reviewed Cable Fund activity from its inception in 2000. We did not review changes that the City made after the audit period for how it accounts for franchise and PEG fees and use of the Cable Fund.

To be clear: the audit did not review capital expenditures made by the Media Center, or plans for capital expenditures. Rather, it reviewed how the Media Center accounted for the $0.88 per sub per month it received from the JPA through the City. The Media Center provided information for the audit report regarding the capital expenditures for 2014, but was not requested to provide other information on capital expenditures.

Scope Limitations

Despite repeated requests, AT&T did not provide all information needed to perform a complete review of the accuracy and completeness of the franchise and PEG fees it remitted to Palo Alto. As a result, The Buske Group sometimes estimated AT&T's underpayment of franchise and PEG fees based on common industry practices.

We intended our audit to cover four years, based on DIVCA's data retention provision, but AT&T only provided three years of data based on the DIVCA provision that requires claims for refunds or other corrections to be made within three years and 45 days of the end of the quarter for which compensation was remitted, or three years from the date of remittance, whichever is later. However, AT&T provided information for July through September 2014, which was not originally included in the audit period.

AT&T remitted fees collected from subscribers in unincorporated Santa Clara and San Mateo Counties directly to the counties and could not provide the information needed to calculate the amounts due for the unincorporated areas specific to the Cable Joint Powers. As a result, the audit report includes estimates of AT&T's franchise and PEG fee underpayments for all of Santa Clara and San Mateo Counties, including areas that are not in the Cable Joint Powers.

No comment.

Cable Franchise and PEG Fee Audit 6

Audit Methodology

To conduct this audit, we:

- Reviewed federal, state, and local regulations regarding collection and use of franchise and PEG fees.

  The audit is not clear as to what was actually reviewed, and as the BB&K report suggests, the report appears to omit significant information bearing on fee use.

- Assessed the City's process to calculate and remit franchise and PEG fees to the Cable Joint Powers and the Media Center, respectively.
- Reviewed the City's and the Media Center's financial records to determine whether franchise and PEG fees were used appropriately.

  The auditor did not conduct a complete review of the Media Center's financial records, including records for capital expenditures for relevant periods under DIVCA, although those records were offered. During those periods, capital expenditures have generally exceeded the amount collected through the $0.88 PEG fee but was accounted for through the investment fund.

- Interviewed the cable coordinator and staff in the Office of the City Clerk, ASD, IT Department, and Media Center to assess operation and oversight of the state franchises and the City's cable communications program.
- Consulted with the City Attorney for legal advice regarding the federal Cable Act and DIVCA.
- Contracted with The Buske Group, a subject-matter expert, to obtain and review Comcast and AT&T records on our behalf to determine if they collected and promptly remitted the appropriate amount of franchise and PEG fees to the City.

  While The Buske Group is acknowledged as a subject matter expert, and may have been involved in the development of the current franchise and DIVCA fee ordinance, it does not appear that The Buske Group was consulted in developing recommendations regarding PEG fees, or with respect to the use of the PEG fees, or that other PEG experts were consulted with respect to the PEG recommendations. In that sense, as we discuss below, we believe that the audit report fails to satisfy the standards for government auditing. *See Appendix C.*

Data Reliability

We assessed the reliability of the Comcast and AT&T data by interviewing our hired subject matter expert, who was knowledgeable about the data, and by comparing Comcast and AT&T address and fee allocation data with Cable Joint Powers members' address data to identify any miscoding that could result in payment misallocation. Except as noted in the Scope Limitations section above, we determined that the data were sufficiently reliable for the purposes of this report.

No comment.

Compliance with government auditing standards and independence impairment

We conducted this performance audit of cable franchise and PEG fees in accordance with our FY 2014 and FY 2015 Annual Audit Work Plans and generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Except as noted in the Scope Limitations section above, we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We disagree that the audit was conducted in compliance with generally accepted government auditing standards (GAGAS). GAGAS requires independence on the part of the auditor, including adherence to the principle of objectivity. See Appendix C.

> *.01 Objectivity and independence principle. A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.*
>
> *.02 Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest, independence precludes relationships that may impair a member's objectivity in rendering attestation services.*
>
> *Source: Code of Professional Conduct codified, 0.300.050, Objectivity and Independence. Copyright (c) 2015, American Institute of Certified Public Accountants, Inc. All Rights Reserved.*

We believe that the audit report failed to examine relevant historical data and financial data. The auditor, apparently without the necessary expertise in PEG issues that would be required by

GAGAS, relied on a report by a right-wing think tank to develop PEG recommendations. The audit report does not show that in evaluating PEG information, or making recommendations about PEG, professionals in the field who actually possessed relevant information were consulted.

The government auditing standards require auditors to be free from external interference or influence that could compromise an auditor's professional judgment or create the appearance that the auditor's professional judgment may be compromised. Subsequent to our providing the Media Center with a copy of the draft audit report and discussing our finding regarding the Media Center's use of PEG fees, the Media Center commissioned Sue Buske, president of The Buske Group, to write a paper supporting the appropriateness of the Media Center's use of PEG fees for what we identified as operating expenses. When Ms. Buske wrote the opinion, which conflicts with our conclusions, she was under contract with our office to perform work for a separate audit objective unrelated to the use of PEG fees, although we had informed her of the nature of our work regarding the use of PEG fees. Prior to beginning her work for the Office of the City Auditor, Ms. Buske had signed an "independence statement" to confirm that she was not biased (i.e., political, ideological, social, or other convictions that might impair her independence related to the subject matter of the audit) and that she would immediately notify the City Auditor regarding any new threats to independence that occurred during the course of the audit or after the report is issued.

Ms. Buske did not notify the City Auditor as required by the independence statement. When we became aware of this situation and asked Ms. Buske about the opinion document, she referred us back to the Media Center. The Media Center indicated that they would rely on Ms. Buske's opinion when responding to our audit finding. Although Ms. Buske's work on the audit was limited to determining whether Comcast and AT&T had collected and promptly remitted the appropriate amount of franchise and PEG fees, we believe that Ms. Buske's opinion document and lack of notification to the City Auditor creates the appearance that the auditor's professional judgment may be compromised. To avoid an independence impairment, we relied on the research and legal advice that we had obtained during the audit and not on Ms. Buske's opinion document.

The last sentence implies that the audit report had taken advantage *of Ms. Buske's expertise until it was discovered she had prepared a paper regarding what may and what may not be treated as a capital expense under DIVCA. That is not the case. Based on our own earlier discussions with the auditor, the recommendations in the report with respect to the access center were largely fixed prior to the time the auditor became aware that the report mentioned had been prepared by The Buske Group. As far as we are aware, Ms. Buske was not consulted on that issue, and even more importantly, on the PEG recommendations before the audit report's conclusions were drawn.*

In any case, the disclaimer appears to misunderstand the respects in which we believe Ms. Buske may have information relevant to an objective audit, or to drawing conclusions as to use of PEG funding. First, Ms. Buske was involved in the negotiation of the franchise that resulted in the transfer of the cable system to TCI and ultimately Comcast. She may have been able to shed light on the agreements under which PEG fees were permitted to be used for operating support; that history may affect, among other things, the continuing rights of the City to use the PEG fees for operating support. Likewise, Ms. Buske was involved in the efforts to amend DIVCA to allow PEG fees in California to be used to support PEG. Factually, that discussion may have been relevant in assessing the rights of the City. Finally, Ms. Buske is in a position to shed light on the practices of other communities, which may be useful in assessing whether (as the report suggests) there is only one way to interpret the federal law requirements. If the auditor felt that Ms. Buske was not an appropriate source for this information, the information could have been sought from other sources. The audit report's failure to seek out this factual information may itself require a disclaimer. The Media Center obviously does not rely on Ms. Buske for legal conclusions. In fact, the Media Center did not adopt the recommendations of Ms. Buske with respect to the classification of capital expenses, and is not relying on her report to the Media Center for purposes of this response.

In addition, the audit report goes on to discuss the capital requirements for PEG and the value of PEG. In this area, Ms. Buske is an acknowledged expert, and as far as we can determine, the auditor has no similar experience or expertise. Yet the audit report appears to have been prepared without the benefit of Ms. Buske's expertise (or the expertise of an alternative PEG expert), and without any discussion of either (a) limitations on the auditor's *experience in the field; or (b) any indication that an analysis of literature was conducted sufficient to draw any conclusions (although at the beginning of the report, the report mentions the importance of examining relevant information). The reliance on the Mackinac Center report, the failure to even mention readily available contrary information cited in the overview, and the failure to seek out necessary expertise calls into question the objectivity of the report under applicable government accounting guidelines, some of which are cited in Appendices B and C.*

Finding 1

The Media Center did not restrict its use of $340,000 of annual PEG fees to capital expenditures as required by the federal Cable Act.

The Media Center inappropriately used an annual average of $340,000 of public, education, and government (PEG) fees, or $1.4 million during the audit period, paid by cable television subscribers in the Cable Joint Powers areas, for operating expenses.[5] Neither the City nor the Media Center enforced the federal law that restricts the use of PEG fees to capital expenses associated with PEG access facilities.[6]

See BB&K analysis. This conclusion is not correct. It is not clear what the audit report means by the statement that neither the City nor the Media Center "enforced the federal law." Neither is in a position to decide definitively what the federal law means, neither is required to seek a determination, and both had a significant basis

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[5] Because the Media Center's fiscal years run from January 1 through December 31, we were able to review its financial records only through December 31, 2013, although our audit period ran through June 30, 2014. The differences in timing do not affect the issues cited in our findings, although the dollar amounts may differ. *This conclusion is misleading. First, the conclusions with respect to 2010-2013 fail to take into account who may bring claims that PEG fees have been overpaid, and when those claims must be brought; timing is important to the conclusion of the report. Under DIVCA, only a video service provider has authority to bring a claim that it has overpaid franchise fees, and the claim must be made within 3 years and 45 days of remittance, or three years from the date payment was due, whichever is later. In this case, it has been more than 3 years and 45 days since the payment of the franchise fees and PEG fees due through December 31, 2013. The audit report does not state that there has been any claim that, as a result of the use of PEG fees, the video service providers overpaid franchise fees for the relevant period. There should therefore be no basis on which the companies could now "construe" the PEG fees to be a franchise fees, and therefore, no basis for concluding that the use of the fees was inappropriate for the period examined. Second, for later periods, there have been significant capital expenditures.*

[6] The Media Center's accounting policies in use during the audit period say that it capitalizes the aggregate cost of assets over $1,500 and expenses maintenance and repair costs as incurred. A 2008 federal appellate court decision ruled that Congress intended "capital costs associated with the construction of PEG access facilities" to refer to channel capacity designated for PEG use, as well as for facilities and equipment, including vans, studios, cameras, or other equipment, related to the use of PEG channel capacity. *This is not correct. The Media Center has capitalized the aggregate costs of individual assets over $1,500, and capitalizes certain repairs costing more than $1,500 that qualify as capital expenditures under standard accounting procedures.*

for concluding that the use of the Comcast fees, which was consistent with uses approved by the City and consented to by Comcast or its predecessors, was proper. Because AT&T contends it is not a cable operator, neither the City or the Media Center is in a position to decide what AT&T's rights are with respect to franchise fees without a determination as to AT&T's status. Neither has an obligation to enforce the federal law by seeking a determination of the status.

As a correction, the average PEG fee was actually $342,000 per annum for the audit period.

$1.4 million of PEG fees used for operating expenses did not comply with federal law

From July 1, 2010, through June 30, 2014, Comcast and AT&T collected $1.4 million in PEG fees from cable television subscribers in the Cable Joint Powers areas.

It is not clear from the facts stated that this is the amount collected, versus the amount remitted. Comcast as a matter of course collects fee amounts through the bills that are not necessarily identical to (and may vary substantially from) the amounts paid to the City. The same is true for AT&T. In many California cities (we know of no exceptions), AT&T made adjustments to PEG fees to reflect credits and discounts provided to customers to bundled services that could have affected the accuracy of this statement with respect to collections.

They remitted the fees to the City of Palo Alto, which gave them to the Media Center, as required by the written agreement with the Media Center. To the extent that the Media Center used the fees for operating expenses, the expenditures did not comply with the federal law that restricts the use of PEG fees to capital expenditures for PEG access facilities. Federal law does not restrict the use of franchise fees, but does restrict the use of PEG fees to capital expenses for PEG access facilities. Because the Cable Joint Powers impose a PEG support fee, the PEG fee must be used only for capital expenses associated with PEG access facilities.

We disagree with this conclusion, which, if accurate, would have applied to the 2001 franchise agreement approved by the City Attorney. See BB&K analysis.

Media Center's records support that PEG fees were allocated to operating expenses

Media Center staff provided detailed financial records showing that it allocated PEG fees to operating expenses, including salaries and benefits, professional services, janitorial services, maintenance, outreach, and insurance:

- In calendar year 2013, $340,000 in PEG funds comprised more than 40 percent of the Media Center's operating revenue.
- From calendar year 2010 through 2013, the Media Center had only $161,563 in capital expenditures associated with its PEG program, including website redesign, a cablecasting system, computers, software, and camcorders. Although the Media Center received $1.4 million in PEG fees during this period and had only $161,563 in capital expenditures,[7] it requested, and the City paid, an additional $52,708 from the Cable Fund for a portion of the cost of a cablecasting system that the Media Center purchased.

The second bullet is not accurate. The audit report is based solely on a line from the Fixed Asset register that includes "additions to program equipment." It does not include all capital expenditures, or capital expenditures under federal law that are not classified as such by the Media Center under its "small equipment" purchases. Thus, for example, the audit report does not include facilities investments of $68,047, or other capital expenditures. For the audit period, through December, 2013, the audit report fails to apply what the audit report considers to be the federal definition of capital to the full books of the Media Center. For 2014, all budgeted capital expenditures are reported (except for small equipment expenditures) and the total for that year is approximately $427,000, and the same amount was budgeted for 2015.

The $52,708 paid for a portion of the cablecasting system purchased by the Media Center and covers the allocated cost of the equipment required for the government channels. The reimbursement was consistent with the agreement of the parties. The implication from the use of the word "although" is that the Center should have covered that expense without compensation and that implication is not supported by the audit report, or any other citation. The allocation was consistent with the practices of the parties. This is one of several subtle statements that suggest a bias in the report or a basic misunderstanding of the relationship with the City that are inconsistent with sound accounting practices.

Finally, the audit report recognizes that capital expenses vary dramatically year to year, and the audit report does not reflect

[7] We did not assess whether these capital expenditures were actually for items that were specific to PEG access facilities.

or examine the capital expenditures over the life of the JPA.

Media Center's capital plan does not show capital needs related to PEG access facilities

The Media Center's August 2014 capital plan did not show planned capital expenditures through 2018 or plans to construct or expand PEG access facilities, but Media Center staff said that the Media Center Board had recently approved spending $579,000 from the Media Center's "investment account" to provide high-definition broadcasting in its studios.

The statement is misleading. The spreadsheet that the Media Center gave the auditors was captioned a "capital plan" because it listed the center's fixed assets to date and was a template for budgeting future expenses. It was an internal document that used placeholders – "0.00"s in boxes rather than actual numbers – to mark the years when capital spending was anticipated. The auditor was informed of the nature of the document, but in the text has chosen to confuse this document with a capital plan. A description of how the Media Center accounts for, and obtains approval for, capital expenditures is contained in Appendix A.

The studio update is a potentially qualifying capital expense for use of PEG fees, but the Media Center did not identify it as such.

It is not clear why a studio update should be identified as "potentially qualifying" on the documents that the auditor chose to review. The expenses would have been identified as capital expenses in the relevant materials presented to the Media Center Board, as described in Appendix A.

Media Center staff provided financial records in April 2015 showing that it had over $427,000 in capital expenditures in calendar year 2014 and an equal amount budgeted for calendar year 2015 for its studio upgrade project. Although these may have qualified as an appropriate use of PEG fees under the federal Cable Act, the Media Center used its investment fund for these expenditures and used the PEG fees for operating expenses.

It is correct that the 2014 expenditures were allocated to the investment fund. This was consistent with the direction of the JPA, which since 2001 has indicated a preference for capital funding to first come from the investment fund, and the PEG fees to be used for operational funds. Copies of documents showing this preference are attached as part of Appendix A. These documents were not requested by the auditor, and a proffer of them was rejected by the auditor. This practice has been reflected in the budgets provided to *the JPA for their review; the financial reports of the Media Center are public, and the usage has also been available to the franchise holders.*

Agreement with the Media Center requires compliance with DIVCA and the federal Cable Act

The agreement between the City of Palo Alto and the Media Center requires the Media Center to use PEG funds in a manner consistent with DIVCA and federal law. It specifically states that PEG fees shall not be construed to be a franchise fee within the meaning of the Cable Act, which allows the PEG fees to be used only for capital costs associated with PEG access facilities.

This combines a conclusion that is incorrect – that the fees may only be used for capital purposes – with the actual requirement in the agreement with the City, quoted in the BB&K report and paraphrased in a misleading way in the audit report. As the BB&K report indicates, we are unaware that any of the PEG fees have ever been "construed" to be a franchise fee, and the audit report does not actually examine that issue, even though, as explained in fn. 4, the time has passed for construing the PEG fees to be franchise fees.

The agreement requires the Media Center to provide the City with an annual plan and budget that lists the activities and programs for which it plans to use funds received from the City during the following fiscal year. Although the Media Center provided its annual plan and budget as required, the City's cable coordinator reviewed the plan based on the Media Center's incorrect definition of capital expenditures, which did not ensure that the Media Center used the PEG fees in compliance with the Cable Act.

The basis for this claim is not explained. It implies that the Media Center was classifying or claiming as capital expenses in its budget line items, items that were in fact operating expenses. This is not the case, as explained in Appendix A. In addition, the audit report clearly stated that no analysis was made of capital expenditures of the Media Center since that was not in the scope of the audit.

The agreement also states that equipment or facilities purchased with PEG fees or City funds belong to the City upon termination of the agreement or dissolution of the Media Center. To the extent that the Media Center used the PEG fees for operating expenses instead of tangible capital expenses, there is less equipment or facilities in the Media Center's possession for potential transfer to the City upon termination of the agreement.

The current arrangement with respect to which fund capital expenditures are attributed reflects a policy preference of the City *of Palo Alto reflected in the documents attached in Appendix A. It is an odd inclusion given the scope of the audit, and appears designed to suggest a sort of impropriety or scheme in the choice of funding sources used by the Media Center. However, members of the Media Center, although clearly familiar with the reason for the use of the funds, were never interviewed about that use, and the auditor appears to have written the statement without interviewing all relevant people, or seeking to review all relevant documents (the Media Center was not asked to produce documents related to the choice of funds, for example).*

In any case, the choice had the effect of significantly reducing the investment fund available to the Media Center. The Media Center has been more than willing to effect a transfer of the assets to the City, which could be appropriately done by using PEG fees to pay for the assets; the payment would then restore the investment fund. This has already been proposed by the Media Center.

Some thought the Media Center was "grandfathered in" to use PEG fees for operating expenses

A 2011 Congressional Research Service report said that more than 100 PEG access centers nationwide have closed due to restrictions on the use of PEG fees and the lack of other funding to support operating expenses. Despite the Media Center's acknowledgment of those closings, its executive director and the City's cable coordinator said they believed that the Media Center was "grandfathered in" under DIVCA to use the funds as they had under the City's prior local franchise agreements. However, neither DIVCA nor the City's agreement with the Media Center allow the PEG fees to be used in a manner other than as prescribed in the federal Cable Act, and DIVCA specifically requires that PEG fees only be used "as authorized under federal law."

We disagree for reasons stated in the BB&K analysis attached as Appendix B. As it explains, there are good reasons to believe that the City may be "grandfathered" by among other things, the voluntary agreements (reflected in documents and by practice) to allow use of PEG funds for operations. In addition, the last sentence of the paragraph above is not from the correct section of DIVCA. The City should be advised that the quoted language "as authorized..." is from Pub. Util. Code Section 5870(m), which addresses the allocation of "unsatisfied cash payments for the ongoing capital costs of PEG channel facilities" among incumbents and new operators between the time a new entrant's franchise is issued to the time the obligations of then-existing local franchises end. It is the next section, 5870 (n), which addresses the use of PEG *fees required by the local ordinance. It is those fees that are the subject to the report. It is unclear why the report quotes the wrong section. As discussed in the BB&K analysis, the language of Section 5870(n) is different.*

Franchise fees, Cable Fund, or Media Center's investment account could have paid for Media Center operations

Instead of providing all of the PEG fees collected to the Media Center without knowing if there was a specific capital-expense need for the fees, the Cable Joint Powers could have used some of the franchise fees collected to support the Media Center's ongoing operations. It was not within the scope of our audit to review how the Cable Joint Powers members used their allocation of franchise fees, but the Media Center's financial statements do not show that it received franchise fees from any Cable Joint Power members.

No franchise fees were received by the Media Center.

The Cable Fund was another option for supporting the Media Center's operating costs related to PEG channels. The JPA's Cable Fund policy prioritizes support to the Media Center to operate the PEG channels, but the Cable Joint Powers did not allocate Cable Fund revenues to the Media Center for operating expenses. Doing so would have allowed the Media Center to reserve the PEG fees received for capital expenses associated with PEG access facilities and be compliant with the federal Cable Act.

Setting aside the reference to compliance with the Cable Act, which is a restatement of the incorrect conclusion about use of PEG fees, getting funding from the Cable Fund would not be a long-term solution. It is a limited fund with prior commitments.

A third option would have been for the Media Center to use its investment account for its operating expenses. The Media Center already uses this account to offset the portion of its annual operating expenses that exceed its revenues from PEG fees and other sources. The investment account, established through a charitable contribution received when the former Cable Co-op sold its principal assets to AT&T, had a balance of $6.4 million as of December 31, 2014.

We agree this is a potential option, although the current JPA Agreement reflects a preference for use of the investment fund for facilities and equipment. This option is consistent with our comments above, and inconsistent with some of the conclusions above, which suggest that the operating/capital use was somehow done to advantage the Media Center, or without the knowledge of *the members of the JPA.*

Customer usage and satisfaction data for PEG channels not tracked

Neither the City nor the Media Center collect customer usage and satisfaction data, such as frequency and duration of resident access to Media Center PEG channels, ease of access to PEG channels, and users' overall satisfaction with PEG channel programming and transmission quality. The Media Center provided us with a 2004 telephone survey, which showed that about one-third of all subscriber respondents had watched at least one Media Center channel and 70 percent of those viewers, or 23 percent of those surveyed, had watched a City Council or other public meeting - a lower than anticipated viewership. Consistent with these results, Palo Alto's National Citizen Survey™ show a declining trend in PEG channel viewership. In 2006, 31% of respondents reported that they had watched a meeting of local elected officials or other public meeting on cable television, the internet, or other media during the previous year compared to 16% in 2014.

This data is cited as a lead in to the next point, that this data may raise questions about the ongoing need for PEG channels. But to go from this point to that conclusion, the person interpreting the data would need to have some knowledge of overall television viewership patterns, as well as patterns with respect to public participation in meetings. The report does not claim to have the expertise to analyze the data and does not state that experts were consulted, even though expertise was readily available through The Buske Group, or other experts on PEG and viewership.

As it happens, there are many reasons to believe that viewership of the Media Center survey is comparable to viewership of other access centers like Austin, which suggests added significant social capital to the community. That study is cited in the Overview. An objective report would at least include readily accessible information comparing access viewership to viewership of commercial channels.[8] Those studies also suggest the Media Center fares quite well. The Media Center's 2004 survey of the whole JPA area, not just Palo Alto, showed that:

- *About 40% of all subscriber respondents are aware of the Media Center.*
- *About one-third of all subscriber respondents are "viewers"*

[8] http://www.wisconsincommunitymedia.com/assets/docs/Library/viewership%20and%20peg%20access%20channels.pdf

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having watched programming on at least one of the Media Center channels. Almost 70% of these viewers have watched City Council or other public meetings.

- *When viewers were asked to grade how well each of five statements described the services provided by the Media Center, the statements "programming that deals with local issues" and "provides a valuable community service" were both given grades of "A" or "B" by well over half of all viewers.*
- *Current viewers of Media Center channels appear to be "very interested" in watching public meetings and information on local community services, while non-viewers appear to be "very interested" in watching "educational programs" and "art & cultural programs."*

The audit report points to declines in viewership based on the City's own surveys, but fails to note that general attendance at meetings is also down, and that viewership continues to exceed attendance: meaning that more people participate via the government channel than in person.

Concerns about ongoing usefulness of PEG channels

The above issues may raise questions about the ongoing need for PEG access channels, particularly because there have been significant changes in technology since the Cable Act and DIVCA were enacted, and other options are now available for residents to obtain local information and programming. A November 2008 Mackinac Center Policy Brief provided insights on the evolving state of PEG channels:[9]

The auditor does not appear to have the expertise to make such an evaluation absent reliance on outside expertise. As previously stated, the auditor had expertise of The Buske Group available but chose not to seek their advice. Aside from pointing to a report indicating access centers are closing, the outside "expertise" relied on is that of the Mackinac Center. (See the Overview for a discussion of the Mackinac Center.) The auditor describes no effort to check the reliability of the conclusions of a report from such a biased source. The distinction between the auditor's treatment of this report and the long discussion of Ms. Buske suggests either a bias or a lack of care that is inconsistent with GAGAS.

For a discussion of the continuing value of PEG channels in the

[9] Theodore Bolema, Ph.D., J.D., *An Evaluation of Legislative Proposals for Higher Cable Fees to Finance Public, Education and Government Access Channels* (Mackinac Center Policy Brief, November 10, 2008), available at https://www.mackinac.org/archives/2008/2008-11REGfeesWEB.pdf

pending appeal of the FCC's Reconsideration Order, see "Brief Amicus Curiae Of The Alliance For Community Media And The Alliance For Communications Democracy" filed March 4, 2016 in Montgomery County, Md. V. FCC, No. 08-3023 (6th Cir.), pp. 5-8. Excerpts from the brief are attached as Appendix D. The reports cited in the brief could have been sought out easily for the audit report. See also, the University of Texas study cited in the Overview.

- Only a small portion of cable subscribers actually watch the programming on PEG channels.

  This observation requires the drafter (and anyone evaluating the drafter's statement) to have some understanding of what is a "small portion" of subscribers of cable channels in light of overall viewership patterns. Evaluation of the assertion likewise requires some understanding as to the significance of viewership for a hyper-local medium like access. The audit report simply recites the Mackinac Center's assertion without the critical analysis required before conclusions may be drawn from the assertion.

- PEG channels do offer some benefits today, including broadcasts of local government meetings, school concerts, sporting events, graduation ceremonies, and training opportunities for aspiring filmmakers.

  See the University of Texas study cited in the Overview for an analysis of the benefits of PEG in Austin.

- The idea that PEG channels offer unique choices to viewers is outdated. Much of the programming and local information is available on the internet through websites such as YouTube and through e-mail groups, rendering PEG channels increasingly redundant.

  Persons with experience in PEG recognize that the same arguments have been made for years. E-mail groups – one of the purported substitutes for PEG – have been available for almost 30 years (the 1984 Cable Act's legislative history notes the developing information landscape) – yet the information is repeated in the audit report as if it were reliable. As the Overview notes, PEG and online video streaming are complementary – and PEG facilities are actually used in the City to produce programming which is then cablecast via multiple platforms, much as most modern media communicate via multiple platforms. As noted in the Overview, television still remains the main source of public information, and studies from the University of Texas suggest the PEG platform remains *relevant. The problem with the audit report is not that it raises questions about PEG – it is that it purports to have a neutral basis for raising them, and to present well-considered recommendations for moving forward. The contrary is true. This is not a fair or objective analysis.*

- There is no real evidence that cable subscribers want more PEG channels or that PEG cable channel viewing will significantly increase following the proposed increase in funding.[10]
  We doubt this conclusion is accurate, but it is irrelevant to the recommendations made, as we are not proposing to add PEG channels, and merely proposing to maintain funding. It is unclear why this is included.

Recommendations

We recommend that the City Manager's Office:

1.1 Consult with ASD, IT, the City Attorney's Office, and Cable Joint Powers members to assess the need to continue collecting PEG fees and adjust the fee based on a demonstrated need for future capital expenses related to PEG access facilities or discontinue collecting the fee.

a. If it is determined that the PEG fee should be adjusted or discontinued, submit a staff report to the City Council with a recommendation to amend the Municipal Code to reflect the revised fee or to eliminate the requirement and recommend to the other Cable Joint Powers members that they do the same.

b. If it is determined that the PEG fee should continue to be collected:

- Amend the agreement with the Media Center to remove the requirement for the City to remit all PEG fees collected to the Media Center.
- Coordinate with ASD, the City Attorney's Office, and the Cable Joint Powers to develop and implement criteria for the use of PEG fees to ensure compliance with the federal Cable Act, and that the fees are set at a level appropriate for anticipated and necessary capital expenses.

[10] This was in reference to proposed amendments to Michigan state law that would have removed several legal limitations on the amount of PEG fees that local governments could charge cable companies to finance local PEG channels. *We note that this should have suggested that the report might be political in nature, and would have led a cautious reviewer to examine the sources of funding for the report.*

- Place the PEG fees in a restricted account and distribute them based on City-approved capital expenditures that meet federal Cable Act requirements.
- Require that semi-annual documentation of expenditures be provided and adopt procedures to review the documentation to ensure that PEG fees are spent only as allowed by the federal Cable Act and take immediate corrective action as necessary.

As a general matter, these recommendations are based on a faulty legal conclusion, backed up by a Mackinac Center report. The recommendations should be flatly rejected, and replaced with the recommendations contained in the Overview.

1.2 Consult with ASD, IT, the City Attorney's Office, and the Cable Joint Powers on whether to allocate a portion of the unrestricted franchise fees or other funds, instead of restricted-use PEG fees, to subsidize the Media Center's operations or to discontinue subsidizing the Media Center's operations. Based on the resulting recommendation, the City Manager's Office should make recommendations to the Council regarding appropriate future funding, if any, for the Media Center.

See above.

Finding 2

Comcast and AT&T did not remit the full amount of franchise and PEG fees due.

Comcast and AT&T did not always calculate the fees due in accordance with DIVCA and the municipal code of each of the Cable Joint Powers. As a result, Comcast underpaid about $141,000 in franchise and PEG fees from July 1, 2010, through June 30, 2014, and AT&T underpaid about $76,000 from July 1, 2011, through September 30, 2014.[11]

AT&T's underpayments are estimated because it did not provide sufficient records for us to verify the accuracy of franchise and PEG fee payments. In addition, AT&T's underpayments are for all of Santa Clara and San Mateo Counties because it remitted fees collected from subscribers in the unincorporated county areas directly to the counties and could not provide the information needed to calculate the amounts due only to the Cable Joint Powers (see scope limitations section on page 5).

Comcast and AT&T will owe interest, calculated at the highest prime lending rate during the delinquency period plus 1 percent, on underpaid fees, as required by DIVCA. DIVCA also requires that AT&T pay the City for its portion of the audit costs because AT&T's underpayment exceeds 5 percent of the amount that it should have paid.

As noted in the Overview, in order to determine whether the PEG fees plus the franchise fee exceeded 5%, the City would need to closely examine the fee that would have been paid applying the maximum fee permissible under the Cable Act, and the fee actually paid under DIVCA, as adjusted by the auditor report. For example, based on experience:

- *The allocation of bundled revenues under DIVCA often fails to recognize funds that could be treated as revenues under the Cable Act.*

- *The treatment of PEG fees tends to exclude the amounts collected from subscribers to pay those fees from revenues, although those are gross revenues under federal law.*

[11] AT&T provided data for July 1, 2011, through September 30, 2014, based on the DIVCA requirement for local entities to make claims for underpayments within three years and 45 days of the end of the quarter for which compensation was remitted or three years from the remittance date, whichever is later.

- *Launch fees (fees paid to cable operators to place programming on the system or at particular channel locations) are often not recognized as gross revenues under DIVCA, and can be substantial.*

Without that analysis, it is difficult to draw any conclusions with respect to PEG fee/franchise fee issues.

We have no comments on the remainder of the report.

Appendix A
Prepared by Annie Folger

Media Center Funding Process

The attached excerpts from the August 2001 *Agreement of Merger* and the October 1999 *Vision for a New Community Media Center* are parts of several documents that show that the City, along with the Cities of Atherton, East Palo Alto and Menlo Park and unincorporated parts of San Mateo and Santa Clara Counties, desired what is now the "investment fund" to be used for purchasing new facilities and equipment first, and for operations secondarily. Should the issue remain in doubt, there are other documents that could be reviewed including the *Compromise and Settlement between the City and Cable Co-op*, and the *City/SVCC Agreement*.

Because of this direction the Media Center was given in the above documents, PEG fees have always been primarily assigned for accounting purposes as if they came from the operational fund, although the actual expenditures of capital and operations over time would have effectively allowed those funds to be expended for capital under the definition of capital we have traditionally used for our books. There have been some expenses that could have been classified as capital but which have not been because of the Media Center's policy of expensing expenditures under $1,500.

Each year, we provide our annual operating budget to the JPA for their review and comment, and to the Media Center Board for their approval. We submit a separate capital budget for known capital expenditures and, as in 2014, include that in the budget package. As in 2014, if we know that a significant capital expenditure may be made in the year, but the amount is not known (because we go through RFP processes for such purchases) we advise the JPA and the Board of that fact. This is also reflected in the attached documents. The Board must be later asked to approve any capital expenditures that are unanticipated, or that are based on RFP responses. In fact, in 2014, a substantial capital expenditure that was allocated to the investment fund was approved and made, as shown in the attached document.

As can be seen from the 2014 budget documents, the sum of the then-known capital expenditures and any net operating loss represents the total dollar amount requested from our Board through the normal budgeting process. See attached examples: 2014 Board Budget Presentation, Proposed 2014 Budget, and Media Center Studio Upgrade 2014-2015. All of the Media Center's annual financial statements are available on our website.

Contrary to the statement of the auditor, the materials that have been presented to the JPA (and to the City) as part of the annual operating budget have shown the total income resources, and total expenditures, and then included a line item showing the amount that would need to come from the investment fund (if any) to make up the difference. That is, it was very clear in every budget that the choice that was made at the outset for budgeting purposes – that capital would first come from the investment fund and operations first from the PEG fees and other revenue sources – was still continuing. This was known to the City, and would have been known to the franchised operators.

Documentation Provided to Auditor: *Use of PEG Fees* (attached)

We performed an exercise by taking the Media Center expenditures and overlaying them into the accounting structure of other Bay Area media centers to determine the following: If we were to use our PEG fees, rather than our investment fund, solely for "qualifying capital-related expenses" (as defined by other Bay Area media centers), would the total of those capital-related expenses equal or exceed PEG fees received?

This exercise revealed that there were more than enough qualifying capital-related expenses as defined by the other Bay Area media centers to equal or exceed the amount of PEG fees received (allowing for year-to-year fluctuations). This is not surprising since the definitions used in other communities classify some items as capital that we do not.

This was just an exercise, based on the definition of "capital" used by other communities in this area. We did not adopt that classification system for our own use. Our own definition of capital that we use is more conservative. In response to a request made in connection with the preparation of the audit report, we made this example available to the auditor. It was explained that this was not a document that was part of our budget approval process or a normal document used by the Media Center, but as stated, merely an exercise in applying the methodology used by other media centers. The audit report appears to misuse this document as our presentation of capital expenses and a reflection of our accounting system– something it was never intended to reflect. As far as we can tell, the audit report does not actually examine our accounting system in any detail.

Capital Policy

Since the merger of SVCC and MPAC and acquisition of the investment fund, it has been our policy to capitalize the aggregate total costs of individual assets of $1,500 or more, and certain repairs costing more than $1,500 that qualify as capital expenditures under standard accounting procedures (e.g. the total replacement of the lower roof in 2013). The threshold was lowered to $100 effective January 2016.

AGREEMENT OF MERGER

THIS AGREEMENT OF MERGER is made as of August 20, 2001, by and between **SILICON VALLEY COMMUNITY COMMUNICATIONS, INC.**, a California nonprofit public benefit corporation ("*SVCC*"), and **MID-PENINSULA ACCESS CORPORATION**, a California nonprofit mutual benefit corporation ("*MPAC*").

RECITALS

A. MPAC is a California nonprofit corporation organization exempt from income tax under Section 501(c)(3) of the United States Internal Revenue Code, as amended (the "*Code*"). MPAC's business is comprised of (a) promoting and facilitating open, nondiscriminatory community access to, and administering and managing the public access channels designated under the Cable Television Franchise Agreement effective as of July 24, 2000 between the City of Palo Alto on behalf of the Joint Powers (the "*Joint Powers*") and TCI Cablevision of California, Inc (as the same may form time to time be amended, modified, renewed, extended or replaced, the "*Franchise Agreement*") granted by the City of Palo Alto on behalf of the Joint Powers comprising the Cities of Palo Alto, East Palo Alto, Menlo Park, the Town of Atherton, and certain unincorporated parts of San Mateo and Santa Clara Counties as described in the Franchise Agreement (the "*Service Area*"), (b) administering and managing the institutional channels designated under the Franchise Agreement and (c) performing the functions of the Community Access Organization ("*CAO*") as so designated under and pursuant to the Franchise Agreement.

B. SVCC is a California nonprofit corporation exempt from income tax under Section 501(c)(3) of the Code. SVCC's business is comprised of originating and producing local television programming focused on news, sports, people and events in the San Francisco Bay midpeninsula area centered on the Service Area (the "*Midpeninsula Region*"), including programming distributed over the access channels administered and managed by MPC.

C. The parties wish to combine their resources into a single organization committed to expanding upon SVCC's and MPAC's current operations and to the establishment, development and promotion of a new community media center capitalizing on the convergence of community, media and technology in furtherance of and as envisioned and contemplated by the Vision for a Mid-Peninsula Community Media Center adopted and endorsed by the Boards of Directors of both SVCC and MPAC (the "*Vision Statement*"), a copy of which is attached as **EXHIBIT A**, by effecting the merger of SVCC with and into MPAC in accordance with this Agreement, the California General Corporation Law as it relates to mergers of non-profit corporations (including, without limitation, Section 6010 *et seq.* of the California Corporations Code) and the parties' respective organizational documents (the "*Merger*"), with MPAC being the surviving corporation and MPAC being the disappearing corporation.

D. Immediately upon the Closing, MPAC shall be renamed Midpeninsula Community Media Center, Inc.

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VISION FOR A NEW COMMUNITY MEDIA CENTER

Representatives of Cable Co-op and the Mid-Peninsula Access Corporation, contingent upon review of the available funding, have endorsed the creation of a new community media center, which would eventually replace MPAC and Cable Co-op as they are currently structured.

A new non-profit corporation would serve those who live or work in Atherton, East Palo Alto, Palo Alto, Menlo Park, Stanford, and unincorporated parts of San Mateo county. The Center will be housed in a new facility and will provide a variety of services to address the following goals:

1. Create and maintain a facility available to all members of the community at which people have access to resources that enable and enhance communication and expression.

2. Generate and maintain a public forum that promotes civic engagement, diversity awareness, a venue for arts and a forum for many voices, adhering to the guarantees of the First Amendment.

3. Produce quality programming of particular local interest, some of which will be produced by center staff and some by individuals and groups assisted by center staff.

4. Enhance access to government and the political process for all members of the community and enhance dialogue between government and members of the public.

5. Provide accessible and affordable training for community members in media production including but not limited to video, radio and website content.

6. Collaborate with schools, local government, non-profits, and local arts organizations to produce and disseminate community communications.

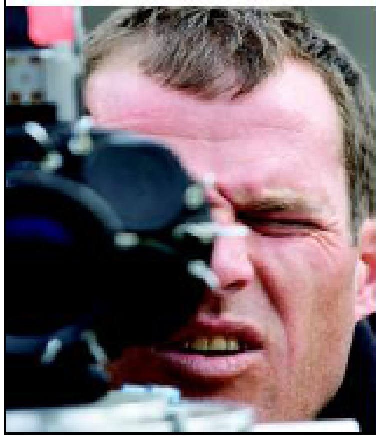
7. Use any number of media, as resources allow, to accomplish the above goals.

The board governing the new nonprofit corporation would include representatives from each Mid-peninsula community to ensure that all perspectives are represented and that the center remains a truly community institution. The Board could also include additional elected members.

This statement was formally ratified by the Boards of Directors of both Cable Co-op and the Mid-Peninsula Access Corporation in October 1999.

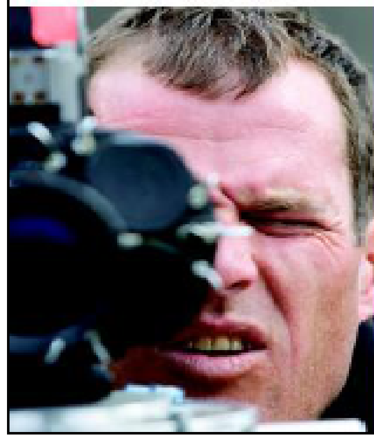
Media Center
2014 Board Budget Presentation

Media Center
Lights! Camera! Community Action!



2014 Proposed Budget

Media Center
Lights! Camera! Community Action!



Presented to
Board of Directors
12/02/13

2014 Budget Assumptions Income

- Continuation of programmatic activities
- Continuation of Gov contracts at current rate
- Conservative estimate for professional services
- New grants: $45.6K
  - Greenlight Sponsors: $2.3K
  - Sports: $10K
  - Elections LWV: $3.5K
  - Menlo Park: $9.8K
  - TBD: $20K
- Continuing grants from 2013: $26.3K
  - Microsoft: $3.8K
  - Made Into America: $22.5K
- In-kind contributions: $40K Legal

Media Center
Lights! Camera! Community Action!

2014 Budget Assumptions Expenses

- Salaries
  - No cost of living increase
  - Small health cost increase
  - 6 full time employees
- No Review
  - Review was performed in 2013 for 2012
- Expenses
  - No funds for January 2015 youth event
  - Decrease of $25.5K from 2013 budget
  - Salaries and salary costs down by $9.5K
  - Non-capital equipment $6.5K, $15.4K less than 2013 budget
  - Operating Supplies increase - props and sets budget $3.5K

Media Center
Lights! Camera! Community Action!

Media Center
2014 Board Budget Presentation

Funding Sources (variance from 2013 forecast)

- PEG fees: $340K ($0K)
- Government contracts: $186.1K ($4.2K)
- Misc. media services: $67K ($6.1K)
- Members/donors/grants: $79.4K (-$8.7K)
- In-kind contributions: $40K ($0K)
- Classes & facility use: $78.9K ($3.9K)
- Checking int/misc. sales: $1.6K ($0K)
- Total: $793K ($5.5K)

MEDIA CENTER

Expenses (variance from 2013 forecast)

- Salaries: $567.2K ($3.4K)
- Salary costs/benefits: $103.8K ($6.1K)
- Prof. services/in-kind legal: $166.6K ($12.2K)
- Facility: $49.5K (-$2.3K)
- Operating: $23.5K (-$4.5K)
- Equipment: $13.5K (-$15.5K)
- Advertising/outreach: $5.5K ($1.2K)
- Insurance/vehicle: $23.3K ($2.2K)
- Conferences/training/hosp: $10.9K ($1.1K)
- Total: $963.8K ($3.9K)

MEDIA CENTER

Proposed Budget vs 2013

	2014 Proposed Budget	2013 Budget	2013 Yearend Forecast	2014 Bud/ 2013 Bud Variance	2014 Bud/ YE Forecast Variance
Income	793.0	817.2	787.6	-24.2	5.4
Expenses	963.8	989.3	960.0	-25.5	3.8
Net Op Inc/-Loss	-170.8	-172.1	-172.4	1.3	1.6
Investment Distribution	170.8	172.1	172.4	-1.3	-1.6
Net Inc/-Loss	0.0	0.0	0.0	0.0	0.0

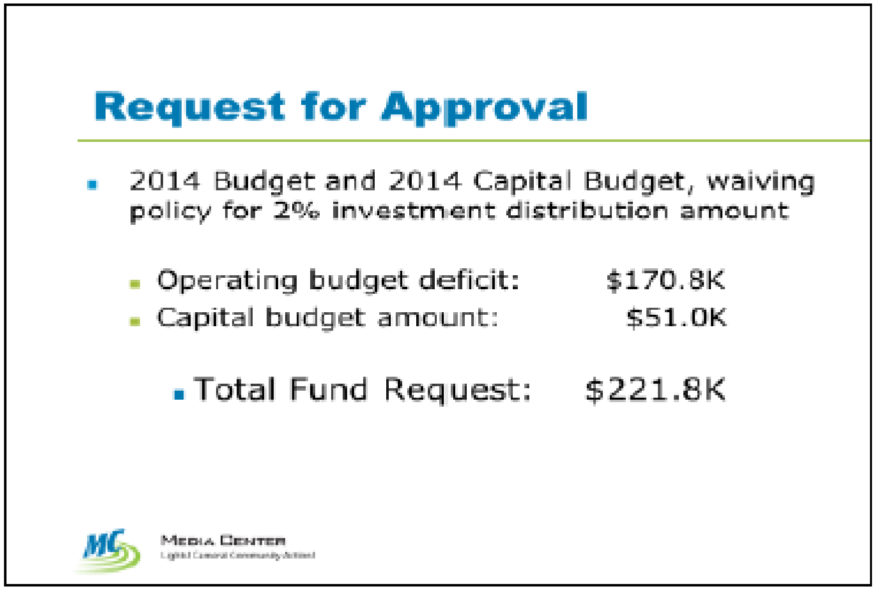
MEDIA CENTER

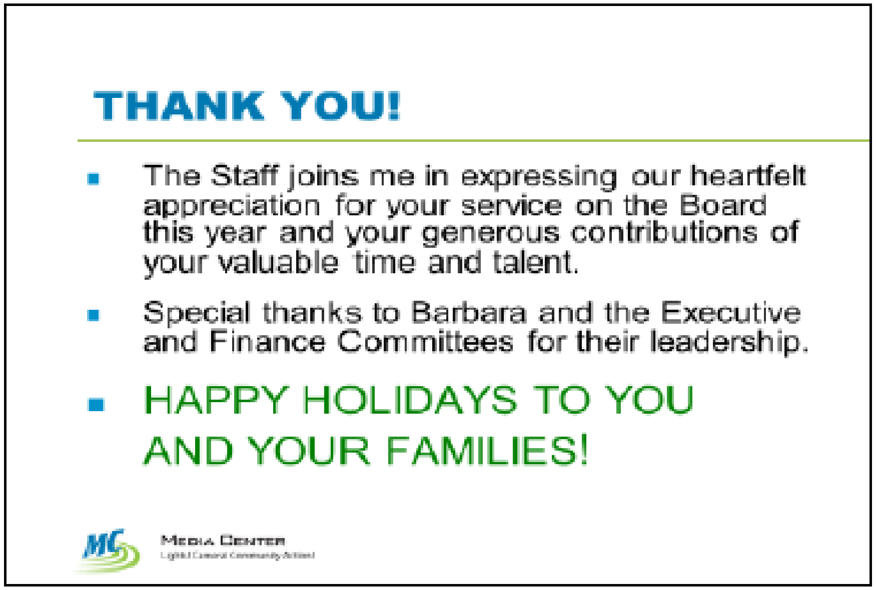
Proposed 2014 Capital Expenditures

- Total New Capital Expenditures: $51K
  - Cablecast system upgrades: $21K*
    - * Alternative is $7K/yr. for 4 years
  - Ceiling mounted A/C for server room: $12.7K
  - Studio upgrade consulting integrator: $8.8K
  - Computers: $3.8K
  - Automated video file transcoding & transfer to cablecast: $3K
  - Replace lobby TV display: $1.7K
- Coming up in 2014
  - Major studio and control room upgrade
  - Replace aging phone system
  - IT file server infrastructure improvements

MEDIA CENTER

Media Center
2014 Board Budget Presentation





Media Center
Proposed 2014 Budget

		2014 Draft Budget	2013 Approved Budget	2013 YearEnd Forecast	*2014 Budget v 2013 Budget Variance*	*2014 Budget v 2013 YearEnd Forecast Variance*
Operating Income and Expense						
Income						
PEG Fees - JPA Contract	$	340,000	340,000	340,000	*0*	*0*
Contracted Media Services		186,100	194,920	181,945	*(8,820)*	*4,155*
Misc. Media Services		67,000	70,500	60,931	*(3,500)*	*6,069*
Contrib/Memberships/Grants		79,400	93,550	88,086	*(14,150)*	*(8,686)*
In-kind Contributions		40,000	40,000	40,000	*0*	*0*
Class and Facility Use Fees		78,930	75,120	75,027	*3,810*	*3,903*
Misc. Inc. / Net DVD Sales		1,610	3,100	1,600	*(1,490)*	*10*
Total Income		793,040	817,190	787,589	*(24,150)*	*5,451*
Expenses						
Salaries		567,220	575,790	563,811	*(8,570)*	*3,409*
Salary Costs/Employee Benefits		103,840	104,810	97,757	*(970)*	*6,083*
Professional Svcs (includes in-kind)		166,600	167,750	154,381	*(1,150)*	*12,220*
Facility Expense		49,510	52,350	51,791	*(2,840)*	*(2,281)*
Operating Expenses & Supplies		23,480	19,980	27,982	*3,500*	*(4,502)*
Equipment Expenses		13,500	31,000	29,008	*(17,500)*	*(15,508)*
Advertising/PR/Outreach		5,480	6,680	4,245	*(1,200)*	*1,235*
Insurance and Vehicle		23,330	20,990	21,150	*2,340*	*2,180*
Conference/Training/Hospitality		10,880	9,960	9,830	*920*	*1,050*
Total Expenses		963,840	989,310	959,955	*(25,470)*	*3,885*
Net Operating Income and Expenses		(170,800)	(172,120)	(172,366)	*1,320*	*1,566*
Distribution from Investments		170,800	172,120	172,366	*(1,320)*	*(1,566)*
Net, after Distribution from Investments	$	0	0	0	*0*	*0*

Media Center
Studio Upgrade
2014-2015

Facilities and Finance Committee Project Report

HD Studio Conversion Project [1]		**Floor Replacement** [2]	$ 12,313
Equipment	347,377	Contingency @10%	1,231
Tax (8.75%)	30,395		
Estimated Tax Savings (3.5%)	- 12,158		
Installation materials	15,900	**Video Server (HW&SW) + Tax** [3]	$ 24,000
Labor	96,390	Contingency @10%	2,400
AV Integrator Subtotal	$ 477,904		
Electrical contractor	1,000	**Telephone System + Tax** [4]	$ 8,893
Workstations & Software (4)	8,000	Contingency @10%	889
Misc Subtotal	9,000		
Total Project	$ 486,904	**Networking Equipment + Tax** [5]	$ 6,100
Contingency @7%	34,083	Contingency @10%	610
Total with Contingency	$ 520,987		
		All Projects Subtotal	$ 538,210
		Contingencies	39,214
		All Projects Total	$ 577,424

Notes:

1. Only 1 bidder. Payments spread over 4 month period with first 25% in November.

2. Four (4) bids considered.

3. Cost reflects a 20% discounted demo system with 6 mos warranty. Next year, we will likely recommend the purchase of 3-year support agreement for $8,000 which would begin May 2015..

4. Three (3) bids considered. Recommended system is VoIP technology.

5. The HD Studio Conversion, New Phone System, and Video Server necessitate an upgrade to our data network infrastructure. Cost reflects special pricing program for non-profits.

6. Upgrade to the studio lighting is deferred and not included in the numbers above.

Media Center
Use of PEG Fees
July 2010-October 2013

	Jul - Dec 10		2010 Allocated To PEG	Jan - Dec 11		2011 Allocated To PEG	Jan - Dec 12		2012 Allocated To PEG	Jan - Dec 13		2013 Allocated To PEG	Jan - Oct 14		2014 Allocated To PEG
Expense															
5501 · Salaries															
5500 · Full-Time Salaries	134,006.50		74,000.00	389,155.34		74,000.00	386,289.06		74,000.00	389,233.57		74,000.00	327,006.41		74,000.00
5500-1 · Bonus Pool	0.00			0.00			20,700.00								
5520 · City Hall Video Operators	24,585.20			44,366.16			39,410.08			42,130.10			37,183.66		
5545 · Programming	22,745.67	x	22,746.00	3,152.28	x	3,152.00	2,642.67	x	2,643.00	2,584.40	x	2,584.00	1,803.40	x	1,803.00
5530 · Equip Monitor/GovScroll	4,572.08	x	4,572.00	12,962.25	x	12,962.00	11,743.45	x	11,743.00	7,550.08	x	7,550.00	5,737.51	x	5,738.00
5546 · Tiltrak	7,692.29	x	7,692.00	15,524.96	x	15,525.00	15,713.99	x	15,714.00	17,493.75	x	17,494.00	14,031.75	x	14,032.00
5540 · Instructors	9,967.97			10,038.24			17,366.80			11,360.13			8,768.25		
5576 · Youth Interns				0.00			373.28			360.00			0.00		
5560 · Studio Techs	5,774.37	x	5,774.00	10,021.44	x	10,021.00	9,660.39	x	9,660.00	14,692.73	x	14,693.00	15,223.40	x	15,223.00
5565 · PT Production Staff	13,547.99			40,923.62			27,254.35			29,885.70			26,087.07		
5566 · Misc. Tech Support/IT	37,316.30	x	37,316.00	26,788.84	x	26,789.00	3,524.50	x	3,525.00	0.00	x	0.00	953.25	x	953.00
5573 · Web/Index Staff	1,140.66	x	1,141.00	3,196.56	x	3,197.00	3,409.45	x	3,409.00	4,298.06	x	4,298.00	3,202.97	x	3,203.00
5574 · Prof. Svcs. Coord.	9,526.71			19,808.47			17,875.80			21,365.00			23,121.13		
5575 · Youth Svcs. Coord.	0.00			0.00			0.00			13,790.00			21,018.00		
Total 5501 · Salaries	270,875.74			575,938.16			555,963.82			554,743.52			484,136.80		
5600 · Salary Costs/Employee Benefits															
5610 · CA Unemployment Insurance	856.42	x	484.00	5,634.96	x	1,425.00	5,810.82	x	1,261.00	5,098.46	x	1,109.00	5,043.78	x	1,198.00
5620 · ETT	32.89	x	19.00	156.45	x	40.00	161.34	x	35.00	154.57	x	34.00	162.81	x	39.00
5630 · FICA	20,593.75	x	11,650.00	44,233.68	x	11,186.00	42,491.33	x	9,224.00	42,414.73	x	9,222.00	37,031.12	x	8,793.00
5640 · Workers Compensation	4,148.76	x	2,347.00	7,308.46	x	1,848.00	10,626.88	x	2,307.00	10,229.20	x	2,224.00	8,263.20	x	1,962.00
5650 · Medical Benefits	17,595.78		9,717.00	38,706.41		7,360.00	42,168.38		8,078.00	39,858.83		7,578.00	33,231.97		7,520.00
5660 · Vacation	(1,142.61)			(2,796.52)			954.93			(1,179.61)			7,433.97		
Total 5600 · Salary Costs/Employee Benefits	42,084.99			93,243.44			102,213.68			96,576.18			91,166.85		
5400 · Professional/Outside Services															
5456 · Instructors	2,400.00			200.00			4,012.50			9,218.75			9,660.50		
5410 · Legal Services	64,396.80			59,551.86			15,011.75			37,485.51			0.00		
5420 · Financial Services	23,418.75			42,150.00			40,575.00			40,908.61			25,593.75		
5430 · Misc. Professional Services	29,746.70			56,750.03			60,922.17			67,603.42			80,745.99		
5433 · Support Services/Consulting	1,160.00	x	1,160.00	0.00	x	0.00	0.00	x	0.00	5,662.50	x	5,663.00	11,250.00	x	11,250.00
5450 · Tech Support/Services	0.00	x	0.00	250.00	x	250.00	250.00	x	250.00	0.00	x	0.00	637.50	x	638.00
Total 5400 · Professional/Outside Services	121,122.25			158,901.89			120,771.42			160,878.79			127,887.74		
5100 · Facility Expense															
5115 · Utilities	14,516.40	x	14,516.00	31,525.77	x	31,526.00	33,369.29	x	33,369.00	30,981.65	x	30,982.00	26,058.95	x	26,059.00
5120 · Facility/Maint. Supplies	1,060.03	x	1,060.00	2,138.42	x	2,138.00	2,484.48	x	2,484.00	2,050.92	x	2,051.00	2,385.75	x	2,386.00
5122 · Building Security	644.28	x	644.00	1,320.72	x	1,321.00	1,386.60	x	1,387.00	1,458.32	x	1,458.00	1,536.62	x	1,537.00
5123 · HVAC Main. Contract	1,592.00	x	1,592.00	2,157.50	x	2,158.00	2,012.00	x	2,012.00	3,077.00	x	3,077.00	490.00	x	490.00
5124 · HVAC Repairs	465.00	x	465.00	500.00	x	500.00	0.00	x	0.00	690.00	x	690.00	0.00	x	0.00
5125 · Janitorial Services	4,815.00	x	4,815.00	8,295.00	x	8,295.00	8,320.00	x	8,320.00	8,315.00	x	8,315.00	5,800.00	x	5,800.00
5127 · Bldg Maint/Repairs/Svcs	316.81	x	317.00	1,971.88	x	1,972.00	3,346.50	x	3,347.00	2,002.84	x	2,003.00	1,389.22	x	1,389.00
5130 · Fire Alarm System	651.46	x	651.00	1,081.02	x	1,081.00	1,203.30	x	1,203.00	1,117.48	x	1,117.00	1,212.48	x	1,212.00
5131 · Landscape Services	540.00			1,080.00			1,080.00			1,080.00			900.00		
5135 · Property Tax	597.54	x	598.00	1,188.65	x	1,189.00	1,210.83	x	1,211.00	1,238.11	x	1,238.00	618.39	x	618.00
Total 5100 · Facility Expense	25,198.52			51,258.96			54,413.00			52,011.32			40,391.41		
5200-1 · Operating Expenses & Supplies															
5208 · Financial Service Charges	2,938.57			6,437.71			6,978.72			7,661.49			7,448.88		

Media Center
Use of PEG Fees
July 2010-October 2013

	Jul - Dec 10		2010 Allocated To PEG	Jan - Dec 11		2011 Allocated To PEG	Jan - Dec 12		2012 Allocated To PEG	Jan - Dec 13		2013 Allocated To PEG	Jan - Oct 14		2014 Allocated To PEG
5209 · Customer Bad Debt Expense	0.00			733.50			3,475.57			3,010.25			(40.00)		
5288 · Telephone/Phone System	2,374.44	x	2,374.00	5,050.26	x	5,050.00	3,972.41	x	3,972.00	4,521.77	x	4,522.00	3,986.39	x	3,986.00
5267 · Billable Expenses	0.00			0.00			0.00			4,057.10			3,063.38		
5268 · Miscellaneous/Give-aways	307.09			1,122.02			2,674.17			2,214.74			0.00		
5269 · Mileage Reimb.	614.02			310.29			682.41			452.44			223.14		
5272 · Office Supplies/Maintenance	2,341.19			4,527.93			5,392.75			6,989.72			4,203.51		
5276 · Postage and Delivery	505.40			766.29			765.77			806.17			1,024.90		
5282 · Decorations/Furnishings	282.01			389.92			1,762.65			1,095.63			1,369.21		
5211 · Books & Publications	2.00			83.13			0.00			0.00			0.00		
Total 5200-1 · Operating Expenses & Supplies	9,364.72			19,421.05			25,704.45			30,809.31			21,279.41		
5200-2 · Equipment Expenses															
5247 · Recycling Fees - misc.	19.00	x	19.00	0.00	x	0.00	0.00	x	0.00	50.00	x	50.00	0.00	x	0.00
5236 · Equipment Maintenance	1,640.57	x	1,641.00	546.35	x	546.00	1,069.03	x	1,069.00	2,205.07	x	2,205.00	2,751.90	x	2,752.00
5241 · Equipment/Studio Set Rentals	0.00	x	0.00	0.00	x	0.00	50.94	x	51.00	95.00	x	95.00	5,000.00	x	5,000.00
5244 · Non-Capital Equip.(under $1500)	9,231.09	x	9,231.00	7,685.46	x	7,685.00	20,728.17	x	20,728.00	20,196.79	x	20,197.00	3,301.56	x	3,302.00
5245 · Software	0.00	x	0.00	0.00	x	0.00	0.00	x	0.00	1,443.28	x	1,443.00	1,475.70	x	1,476.00
5248 · Expendable Prod. Equip/Supplies	6,323.25	x	6,323.00	8,121.65	x	8,122.00	9,045.03	x	9,045.00	4,880.20	x	4,880.00	5,217.22	x	5,217.00
Total 5200-2 · Equipment Expenses	17,213.91			16,353.46			30,893.17			28,870.34			17,746.38		
5200-3 · Advertising/PR/Outreach															
5280 · Collateral/Graphics/Printing	102.00			310.48			355.61			616.99			997.14		
5206 · Advertising and Marketing	1,308.89			375.00			1,282.69			509.00			797.50		
5264 · Internet/Website/Dish	1,171.39	x	1,171.00	1,804.57	x	1,805.00	1,735.67	x	1,736.00	1,738.86	x	1,739.00	1,332.76	x	1,333.00
5231 · Entry Fees	300.00			290.00			300.00			195.00			265.00		
5222 · Membership/Fees/Dues	350.00			1,057.00			1,256.00			1,007.00			644.00		
Total 5200-3 · Advertising/PR/Outreach	3,232.28			3,837.05			4,929.97			4,066.85			4,036.40		
5200-4 · Insurance and Vehicle															
5292 · Van/Truck Expense	1,005.25	x	1,005.00	933.96	x	934.00	598.20	x	598.00	951.18	x	951.00	586.31	x	586.00
5262 · Directors/Officers Insurance	1,274.25	x	1,274.00	2,401.50	x	2,402.00	2,343.00	x	2,343.00	2,364.00	x	2,364.00	1,863.25	x	1,863.00
5261 · Media Liability Insurance	2,066.50	x	2,067.00	3,898.32	x	3,898.00	3,649.00	x	3,649.00	3,686.44	x	3,686.00	2,783.56	x	2,784.00
5260 · Property Insurance	7,283.16	x	7,283.00	13,976.04	x	13,976.00	13,928.86	x	13,929.00	14,570.99	x	14,571.00	9,534.65	x	9,535.00
Total 5200-4 · Insurance and Vehicle	11,629.16			21,209.82			20,519.06			21,572.61			14,767.77		
5200-5 · Conference/Training/Hospitality															
5297-1 · Volunteer/Producer Exp.	3,371.95			2,539.94			3,843.06			3,016.85			603.31		
5284 · Hospitality/Vol. Studio Crews	685.32			1,244.74			2,000.48			1,349.34			1,316.66		
5296 · Board Recognition/Mtg. Expenses	79.36			138.06			274.39			55.39			62.66		
5297 · Staff Recognition/Mtg Exp.	1,741.33			333.28			330.53			774.79			268.02		
5220 · Prof. Development/Training	525.00			630.00			1,903.00			470.00			1,508.79		
5221 · Conferences/Travel	492.00			1,703.91			1,433.54			2,444.39			921.66		
Total 5200-5 · Conference/Training/Hospitality	6,894.96			6,589.93			9,785.00			8,110.76			4,681.10		
Total Expense	507,616.53			946,753.76			925,193.57			957,639.68			806,093.86		
7051 · Depreciation	82,142.69	x	82,143.00	84,341.22	x	84,341.00	83,880.56	x	83,881.00	113,678.70	x	113,679.00	0.00	x	0.00
SUM	589,759.22		317,807.00	1,031,094.98		346,694.00	1,009,074.13		336,183.00	1,071,318.38		367,762.00	806,093.86		223,677.00
PEG fees			166,882.88			336,645.11			351,654.00			340,337.79			289,508.79
Overuse/(Underuse)			150,924.12			10,048.89			(15,471.00)			27,424.21			(65,831.79)
Capital Purchases	34,381.39			8,300.00			81,299.72			164,406.96			64,647.03		

Appendix B

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March 23, 2016

ANALYSIS OF TREATMENT OF PEG FEES UNDER CABLE ACT AND DIVCA

Prepared for
the Midpeninsula Community Media Center
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You asked us to comment on the legal conclusions contained in the draft auditor's report dated April 12, 2016, and in particular, the legal conclusions that the federal Cable Act requires that PEG fees be limited to capital expenditures (Audit, Executive Summary); and that the Midpeninsula Community Media Center ("Media Center") had used the funds inappropriately.

We disagree with these conclusions. The Cable Act does not require that PEG fees be limited to capital expenditures. The state franchising law likewise does not require that PEG fees be limited to capital expenditures. Finally, the contract under which the Media Center provides service does not limit the Media Center to using the fees for capital purposes.

What is fair to say, however, is that it can be a matter of debate as to when and under what circumstances PEG fees may be used to defray operating expenses. Therefore, while the conclusions are not correct, a locality could decide that PEG fees should be used for capital purposes as a matter of prudence.

Question 1. May PEG Fees Be Used For Operating Support Without Violating the Cable Act?

The answer should be "yes," and the opposite conclusion in the audit that leads to the conclusion that the Media Center used fees "inappropriately" is contradicted by the City's own past actions, as well as Federal Communications Commission ("FCC") decisions.

The Cable Act allows a locality to require a cable operator "under the terms of any franchise to pay a franchise fee" equal to 5 percent of the cable operator's gross revenues derived from the operation of a cable system to provide cable services. 47 U.S.C. §542(a)-(b). A franchise fee is defined as "a tax, fee, or assessment of any kind imposed by a franchising authority or other governmental entity on a cable operator or cable subscriber, or both, solely

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because of their status as such." 47 U.S.C. §542(g). Fees imposed on cable operators and other utilities are not franchise fees, so long as the fee is not unduly discriminatory. It also does not include:

> "in the case of any franchise in effect on October 30, 1984, payments which are required by the franchise to be made by the cable operator during the term of such franchise for, or in support of the use of, public, educational, or governmental access facilities;" 47 U.S.C. §542(g)(2)(B); or

> "in the case of any franchise granted after October 30, 1984, capital costs which are required by the franchise to be incurred by the cable operator for public, educational, or governmental access facilities;…§542(g)(2)(C)."

In other words, under the Cable Act, where a franchise was initially issued post-1984[1], a community can collect a fee to support PEG in addition to the franchise fee if (a) the fee does not fit the definition of a franchise fee; or (b) if the fee fits within one of the two exceptions above. To be a franchise fee, among other things, the fee must be in return for cable franchise rights,[2] must be imposed on a cable operator, and must be imposed on the operator because of its status as such. Orders interpreting the franchise fee provisions have consistently recognized the point, and recognized that the "operational" limits are not as absolute as the audit assumes.

While the relevant provisions of the law cited above have not changed since 1984, the FCC has issued three orders explaining how those provisions are to be interpreted, two in 2007 and one late in 2015. *In the Matter of 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 (2007) (the "*First Order*"); *In the Matter of 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*, Second Report and Order, 22 FCC Rcd 19633

[1] The first exception allows use of PEG fees for any "support of the use" of PEG, and would include operating support. The exception applies to franchises issued before 1984, but renewed thereafter, as a franchise by definition refers to an initial authorization or any renewal of that initial authorization. 47 U.S.C. §522(9).

[2] For example, the Cable Act was not meant to prevent a locality from charging a fee for use of the rights of way to provide telecommunications services. Comcast is currently challenging fees established by the City of Eugene, Oregon that reach that company's use of the rights of way to provide Internet services.

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(2007)(the "*Second Order*"); *and In the Matter of 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*, Order on Reconsideration, 30 FCC Rcd 810 (2015)("*Reconsideration Order*").

The *First Order* applied only to new entrants in states where franchises are still controlled by local governments and explicitly did not apply to state-issued franchises. With respect to locally-issued franchises, the FCC noted that localities could require PEG monetary capital support in addition to the franchise fee in a new franchise, but also cited with approval *City of Bowie, Maryland,* 14 FCC Rcd 7675 (Cable Service Bureau, 1999) which confirms that voluntary payments made by a cable operator in support of PEG would not be counted against the 5% franchise fee cap. That point was underlined by ¶109 of the *First Order* (which states that the order addresses only "the proper treatment of LFA-mandated contributions in support of PEG services and equipment")(emphasis supplied). That is, the *First Order* recognized that an operator could voluntarily consent to use of PEG funds for operating support without triggering a reduction in franchise fees, but could not be required – mandated – to do so.

The *Second Order* largely determined which portions of the *First Order* apply to incumbent cable operators. While the Commission repeated that "non-capital costs of PEG requirements must be offset from the cable operator's franchise fee payments," *Second Order,* ¶13, it re-cited the *Bowie* holding, and added an additional twist: the Commission recognized that existing operators were not automatically permitted to take offsets or to withhold payments that might otherwise apply, as "franchise agreements involve contractual obligations and also note that some terms may have been implemented as part of a settlement agreement regarding rate disputes or past performance by the franchisee. As a result, we believe that the facts and circumstances of each situation must be assessed on a case-by-case basis under applicable law to determine whether our statutory interpretation should alter the incumbent's existing franchise agreement…" *Second Order,* ¶19.

To put it another way, if a franchise or separate agreement permits PEG funding to be used for operating support, an automatic offset should not be permitted or required. The facts and circumstances under which the funds are permitted to be used for operating support must be considered. Taking the *First* and *Second Orders* together, PEG fees can be used for operating support without counting towards the 5% franchise fee cap where the operator permits that use voluntarily, or where the use is a legitimate *quid pro quo* as part of, for example, a settlement.

A broader question, not yet fully resolved, is whether PEG obligations imposed under state "streamlined franchising" schemes should be treated as "voluntary arrangements" such that

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use of the fees is not subject to the capital/operating distinction. In the *Reconsideration Order,* the FCC considered whether its interpretation of the franchise fee provisions of the Cable Act should apply in states that (like California) had implemented a statewide franchising regime. The Commission stated:

> …it is necessary to clarify whether the findings regarding franchise fees under Section 622, PEG and I-Net obligations under Sections 622 and 611, and non-cable related services and facilities under Section 602 apply to state level franchising. We clarify that those rulings were intended to apply only to the local franchising process, and not to franchising laws or decisions at the state level.

Reconsideration Order, ¶ 7. In a mysterious and inconsistent footnote, the FCC added "Nothing in this *Order on Reconsideration*, of course, changes the fact that in litigation involving a cable operator and a franchising authority, a court anywhere in the nation would be required to apply the FCC's interpretation of any provision of the Communications Act that would be pertinent (e.g., Section 622), including those interpretations set forth in the First Report and Order and Second Report and Order." This footnote creates ambiguity (and is being challenged in a pending appeal of the *Reconsideration Order* and the *Second Order*). However, in light of the explicit holding in ¶ 7, it cannot be said that the FCC's decisions on operating support for PEG apply in California generally, or in Palo Alto more specifically. Rather, it appears that the application of the FCC's general rulings may depend on the circumstances.[3]

[3] The FCC, if faced with the question, might decide that because state franchising laws reach entities that are not cable operators, and grant rights that go beyond the right to use the rights of way to install a cable system for the purpose of providing cable services, fees for PEG fall within the "utility fee" exception to franchise fees, or are otherwise not subject to limitations that would otherwise apply under Title VI to fees that are imposed upon cable operators because of their status as such. The agency could also decide that, because an operator always has the option of insisting upon the protections afforded by the Cable Act, its acceptance of a streamlined franchise amounts to a voluntary agreement to its terms, including terms related to PEG. This might be particularly true where, as in California, a state adopts a uniform system that allows an operator to avoid individualized negotiations and avoid assuming new obligations that otherwise could be imposed (such as institutional network obligations) through the federal franchise process. Support for this view can be found in a recent opinion of the California Attorney General which concluded that payment of a PEG fee established by a local government under DIVCA is "an obligation that [each applicant] voluntarily agreed to pay as a condition of being awarded a franchise," *see* 99 Ops.Cal.Atty.Gen. 1 at 8 (2016).

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The City's own actions, and the actions of Comcast and its predecessors, confirm the common understanding that under certain circumstances, PEG fees provided to an organization like the Media Center can be used for operations without violating the Cable Act. As noted above, the federal law is essentially unchanged in relevant part since 1984. In 1986, the City issued a franchise to a cooperative, which provided cable service within the City until the year 2000. In the year 2000, the Cable Co-op sold its assets to TCI, and the City entered into a franchise and several other agreements with TCI. The City concluded that a transfer from a co-op to a private company would only be in the public interest if the Media Center were kept whole; and so approval was contingent (among other things) on TCI agreeing as part of the transfer that *inter alia,* PEG funding could be used for PEG support generally. The specific support requirements were placed within the franchise agreement, but the voluntary consent to use of the PEG fees for any PEG-related purpose was central to, and part of the transfer agreement. The parties specifically agreed in the franchise that the PEG fees were not, and would not be treated as franchise fees. The July 24, 2000 City Manager's report reflects the understanding that the agreements would provide "funding for PEG access services." Comcast voluntarily accepted the conditions to which its predecessor had agreed when the franchise was transferred to it in 2002. When the City adopted its DIVCA ordinance in 2008 – a year after the FCC orders discussed above had issued – it maintained the existing uses of the PEG fees. Had the City (or City Attorney) or Comcast believed that the Cable Act provided an absolute bar to use of PEG funding for operational purposes, or required that funds used for operating be offset against franchise fees, the provisions with respect to PEG fees could not have been agreed to by the City, the prior City Attorney, TCI or Comcast.

AT&T accepted a franchise subject only to the conditions contained within DIVCA, discussed below, so the agreements that led to the transfer of control of the cable system from the Cable Co-op to Comcast are not relevant to it. However, AT&T strongly takes the position that it is not a cable operator subject to Title VI – most recently in a filing in a rulemaking that is pending before the FCC. *In the Matter of Promoting Innovation and Competition in the Provision of Multichannel Video Programming Distribution Services*, MB Docket No. 14-261, Reply Comments of AT&T Services, Inc. (April 1, 2015), pp 15-21. While the authors of this report disagree with AT&T's contention, it is certainly true that no California court has ruled that AT&T's service is a cable service under DIVCA, and the matter appears to be before the FCC in the above-mentioned and other pending proceedings. The regulatory status of AT&T's system therefore has not been finally resolved.

If AT&T's system is not a cable system, and its services not cable services, it would still owe a franchise fee and PEG fee under DIVCA, because DIVCA imposes these obligations on entities that may not be "cable operators" under federal law. However, the Cable Act's franchise

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fee provisions apply only to cable operators and cable systems. If the AT&T U-Verse system is not a cable system, and AT&T not a cable operator, the federal franchise fee/PEG fee provisions that are the subject of the report do not apply to AT&T. The auditor's report assumes they *do* apply to AT&T. The auditor may well believe the FCC or a court will reject AT&T's contentions. But the auditor's report cannot say with certainty that AT&T's view is wrong. The absolute and unqualified conclusions in the report are necessarily based on the assumption not only that AT&T is wrong, but also that the City may resolve the question of AT&T's regulatory status under federal law.. Further, the conclusions are made without even notifying the City that the issue is contested and is the subject of a pending FCC proceeding.

In sum, the absolute conclusions in the audit that use of PEG fees for non-capital purposes violates the Cable Act, or that the Media Center use of the fees was inappropriate are incorrect. The most that can be said, perhaps, is that different reviewers might come to different conclusions – but that is a far cry from what the audit says.

Question 2: Does use of the PEG fee for operating support violate California law?

There are good reasons to conclude it does not.

The Digital Infrastructure and Video Competition Act of 2006 (DIVCA) was modified on August 28 2006, just prior to its adoption by the California Senate. Before amendment, the legislative counsel's digest stated that the bill would "authorize local entities to establish a fee to support the capital costs of public, educational, and governmental access (PEG) channel facilities, in the amount of 1% of gross revenues, or more in specified circumstances…" As part of the amendments, the word "capital" was struck from the digest.[4] This and other changes adopted on August 28 were consistent with earlier amendments to the legislation, that, with one exception not relevant to this analysis,[5] systematically removed the word "capital" from the discussion of PEG funding. For example, the May 31, 2006 version of the bill provided that, for providers subject to state franchising, "a local entity may, by ordinance, establish a fee to support the <u>capital costs</u> of public, educational, and governmental access…" AB 2987 § 53058.4(m). The word "capital" was stricken from this provision by an amendment adopted on August 23, 2006.

[4] http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab_2951-3000/ab_2987_bill_20060828_amended_sen.html

[5] Section 5870(m) describes how ongoing capital funding requirements are to be divided in cases where a new entrant has come into the market, and the incumbent is still operating under a pre-DIVCA franchise. The section is not relevant in Palo Alto, where companies now operate under DIVCA franchises.

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At the end of the legislative process, reports clearly recognized that localities could negotiate PEG fees for operations under then-applicable law, and indicated that the legislature did not intend to change that status quo. Thus, the Rules Committee Analysis on Third Reading of AB 2987 notes "[c[urrent law authorizes local franchising authorities to negotiate channel set-asides for PEG access as well as support for PEG operations," and explains that under DIVCA local governments will be permitted to set fees "for PEG purposes."[6]

A member of the audit team, Sue Buske, was directly involved in discussions at the legislature that resulted in the amendments made just prior to bill passage, and while her views would not be legally determinative as to how the bill should be interpreted, it may have been useful to the auditor to consult Ms. Buske in reviewing the history of the law, and in determining whether the absolute conclusions drawn were actually justified.[7]

As codified at Pub. Util. Code § 5870(n), the law now provides in relevant part:

> A local entity may, by ordinance, establish a fee to support PEG channel facilities consistent with federal law….The fee shall not exceed 1 percent of the holder's gross revenues, as defined in Section 5860. Notwithstanding this limitation, if, on December 31, 2006, a local entity is imposing a separate fee to support PEG channel facilities that is in excess of 1 percent, that entity may, by ordinance, establish a fee no greater than that separate fee, and in no event greater than 3 percent, to support PEG activities.

The first sentence makes it clear that a fee that does not violate federal law would not violate California law. As discussed above, federal law does permit PEG fees to be used for operations without counting towards the franchise fee cap at least under some circumstances (as when an operator agrees to that use). In addition, because the FCC has determined that its

[6] http://leginfo.ca.gov/pub/05-06/bill/asm/ab_2951-3000/ab_2987_cfa_20060828_211945_sen_floor.html While the legislative history and digest clearly do not determine how DIVCA will ultimately be interpreted, the report should have at least pointed out that the state legislature believed that localities were negotiating and could negotiate arrangements that would allow use of PEG fees for operations.

[7] In addition to Ms. Buske, members of the law firm of Miller & Van Eaton were involved in those discussions; some of the members of that firm are now part of BB&K, including the authors of this memorandum.

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interpretation of the franchise fee provisions of the Act do not apply in California, it is impossible to definitely conclude that use of PEG funds for operational support would be inconsistent with federal law.

Perhaps more importantly, the final sentence indicates that in communities where there was a fee "to support PEG channel facilities" as of December 31, 2006 (as there was in Palo Alto), the community may establish a fee to support "PEG activities." Given the legislative history described above, there are very good reasons to conclude that the state at least intended to allow communities where PEG fees were already being used for PEG support (including non-capital support) to continue to use the fees for agreed-upon purposes. That is, existing arrangements for PEG funding would be extended into the future: if valid prior to DIVCA, those uses would remain valid after DIVCA as a general matter.

Question 3: Does Use of PEG Fees for Operating Support Violate Local Law or Agreements?

Even if state or federal law allowed PEG fees to be used for operating support in Palo Alto specifically, or in California generally, the City of Palo Alto or the members of the JPA could always choose to limit the way PEG funds are used. Palo Alto has not done so yet.

Chapter 2.11 of the Administrative Code of the City of Palo Alto, Section 2.11.070 provides simply that the "PEG support fee shall be used by the city for PEG purposes consistent with state and federal law." It imposes no independent restriction on use.

Likewise, the agreement with the Media Center and the JPA, Section 15.1(B) provides that the "Media Center shall use the funds generated from the PEG Fee only in a manner consistent with DIVCA and the Cable Act, such that the PEG Fee shall not be construed to be a "franchise fee" within the meaning of the Cable Act, 47 U.S.C. § 542(g)." It imposes no additional restrictions on use of funds. The audit report does not suggest that the past uses of fees have been "construed" to be franchise fees, and so cannot conclude that use of the fees has been inappropriate.

In fact, the audit report does not claim that franchise fees due to the City have in any way been reduced because of the use of PEG fees. And at this point, at least for most of the audit period, such a reduction could not occur. Under DIVCA, Pub. Util. Code § 5860(i), a franchise holder must bring a claim that it has overpaid franchise fees within three years and forty-five days of the remittance of the fees. At least as we understand it, no claims have been raised or preserved by the franchise holders, so that PEG fees paid through 2013 could not be treated as

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franchise fees. At least through the end of 2013, the PEG fee has not been construed to be a franchise fee. In concluding that the use was inappropriate, the audit report failed to take this into account.

Miscellaneous Issues.

a. The audit report suggests that the City had a duty to enforce the provisions of DIVCA or of the Cable Act. Technically, DIVCA imposes only one enforcement obligation on local governments: it requires local governments to enforce the customer service provisions of the statute. Pub. Util. Code § 5900(c). DIVCA provides that "[a] court of competent jurisdiction shall have exclusive jurisdiction to enforce any requirement under [the PEG section] or resolve any dispute regarding the requirements set forth in [the PEG section]. Pub. Util. Code 5870(p). To the extent interpretive authority as to the meaning of the DIVCA PEG requirements might lie elsewhere, it would be with the California Public Utilities Commission, and not the City. Likewise, the FCC and the courts would ultimately determine how the franchise fee provisions of the Cable Act are to be interpreted.

Of course, the City obviously has the right to audit uses of franchise and PEG fees, and to audit payments of franchise and PEG fees. But beyond that, there is not a right to declare what the law is, or a duty to bring actions to obtain definitive interpretations of the law, and the audit report should not suggest the contrary. In this case a" duty to enforce" would require the City to expend taxpayer dollars to, *inter alia,* obtain a declaration that AT&T's system is a cable system subject to the franchise fee limits of federal law.

b. The audit report fails to consider past practices and the relevance of those practices to the conclusions in the report. As suggested above, as part of a transaction that gave TCI, and ultimately Comcast, control of the system from a locally-controlled cooperative, the companies agreed to terms (in a time-unlimited transfer agreement, and a time-limited franchise agreement) that permitted PEG fees to be used to support PEG operations. If the use of PEG fees were ever challenged, particularly in light of the language in DIVCA preserving PEG support, the City would have a good argument that the consent to use remains in place. In addition, of course, it would be able to point to practices before 2010, and from 2010-2013 that implicitly continue that consent – as we understand it, the use of the fees is publicly revealed in the Media Center's budgets, which have been directly presented to the City and have been available to each franchise holder. The report should not suggest in any respect that consent has been, or could have been, withdrawn.

c. The audit report should not suggest that the City has somehow failed in its duties to monitor PEG uses. The report does not contain any information that suggests the

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auditor closely examined emails or other communications between the City and the JPA or the Media Center; or even internal information relevant to the treatment of PEG fees (even though at least one part of the audit team is likely to be familiar with those internal discussions). Absent that examination, the report cannot fairly conclude that the City somehow failed to consider how PEG funds were being used (it obviously knew how they were being used). The most that can be said is that the audit report reflects a different interpretation of the law than is reflected in past actions taken by the City. It is tempting for any report to claim superior knowledge, and to blame the past on negligence; but in order to meet the standards of objectivity required of auditors, such a claim must be based on careful examination of all facts, and not just implied without support. No such examination meeting audit standards is reflected in this report.[8]

d. The audit report does properly focus on the treatment of PEG fees going forward. While the audit report's absolute conclusion that PEG fees may not be used for operating support is incorrect, as is its conclusion that the use of PEG fees by the Media Center for the audit period was inappropriate, that does not mean that it is inappropriate for the City to consider different approaches to the use of PEG fees. The Cities of Los Angeles, Glendale and Inglewood have all faced litigation regarding the use of PEG fees, and while none of those cases has led to a final judgment that provides definitive guidance in this case,[9] it is fair for any City to take the fact of litigation into account in setting policies. It would certainly be reasonable for the audit report to say that a prudent course with respect to use of PEG fees would be to limit the use of those fees to capital expenditures, at least absent a court determination, a clarification by the FCC or CPUC, or a reaffirmation of the use by incumbent cable operators.[10] If the audit report had merely said that, it would not be legally objectionable. But the broad and inaccurate claims

[8] We understand a letter discussing auditing standards in more detail will be included in comments submitted to the City, and will explain that drawing conclusions without having undertaken a full examination of relevant circumstances is inconsistent with the duty of objectivity in government auditing. The Media Center did attempt to determine whether the auditor examined other facts or materials before the conclusions reflected in the report were drawn.

[9] Los Angeles, for example, settled its litigation with an agreement that permits it to use PEG fees for non-capital purposes.

[10] This course is also appropriate in light of the provisions of 47 U.S.C. § 555a (limiting claims against localities to injunctive and declaratory relief).

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made regarding propriety of use, and what the law is in California with respect to use of PEG fees should not be accepted by the City.[11]

[11] The danger of accepting those conclusions is real. In the Los Angeles litigation, Time Warner was seeking offsets for the value of free services provided to the City prior to 2010, under a pre-DIVCA franchise. That offset was based on the FCC interpretations of what constitutes a franchise fee. If, as the audit suggests, the federal law is absolute, and the City had a duty to enforce it notwithstanding provisions of the local franchise and of state law, the consequences could reach far beyond PEG issues. The conclusions do not have to be accepted in order for the City to conclude that, as a matter of prudence, PEG fees should be used for capital purposes going forward.

ASHPAUGH & SCULCO, CPAs, PLC
Certified Public Accountants and Consultants

March 22, 2016

Annie Folger, Executive Director (annie@midpenmedia.org)
Midpeninsula Community Media Center
900 San Antonio Rd.
Palo Alto, CA 94303-4917

Subject: **Review Auditor Report**

Dear Ms. Folger:

You have requested Ashpaugh & Sculco, CPAs, PLC ("A&S") to provide comments on the City of Palo Alto's draft auditor's report dated April 12, 2016 regarding the auditor's statements concerning performing the audit in conformance with generally accepted government auditing standards ("GAGAS") and concerning franchise fees under California's Digital Infrastructure and Video Competition Act of 2006 ("DIVCA") as compared the amount determined under the federal standard. Let me first explain my experience and qualifications.

I am licensed as a certified public accountant in the States of Florida and Missouri and have over 20 years experience in reviewing franchise and PEG fees for over 200 local government entities across the country. This includes such reviews in California for the Cities of Los Angeles, Santa Clara, Los Altos, Napa and Carson, the County Los Angeles, the Marin Telecommunications Agency and the Sacramento Municipal Cable Telecommunications Commission. I assisted in the review and drafting of language in DIVCA.

WAS THE AUDIT CONDUCTED IN COMPLIANCE WITH GAGAS

My source for the following comments are the professional standards presented in the 2011 revision of Government Auditing Standards promulgated by the Comptroller General of the United States United States Government Accountability Office[1], commonly referred to as the "Yellow Book". I have concerns regarding the representations of the auditor that the audit was conducted in compliance with GAGAS.

GAGAS requires the auditor adhere to ethical principles and maintain objectivity and independence as stated in the Yellow Book.

> **Ethical Principles**
>
> 1.11 Because auditing is essential to government accountability to the public, the

[1] Available at http://www.gao.gov/yellowbook.

Ms. Annie Folger
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public expects audit organizations and auditors who conduct their work in accordance with GAGAS to follow ethical principles. Management of the audit organization sets the tone for ethical behavior throughout the organization by maintaining an ethical culture, clearly communicating acceptable behavior and expectations to each employee, and creating an environment that reinforces and encourages ethical behavior throughout all levels of the organization. The ethical tone maintained and demonstrated by management and staff is an essential element of a positive ethical environment for the audit organization.

1.12 Conducting audit work in accordance with ethical principles is a matter of personal and organizational responsibility. Ethical principles apply in preserving auditor independence, taking on only work that the audit organization is competent to perform, performing high-quality work, and following the applicable standards cited in the auditors' report. Integrity and objectivity are maintained when auditors perform their work and make decisions that are consistent with the broader interest of those relying on the auditors' report, including the public.

1.13 Other ethical requirements or codes of professional conduct may also be applicable to auditors who conduct audits in accordance with GAGAS. For example, individual auditors who are members of professional organizations or are licensed or certified professionals may also be subject to ethical requirements of those professional organizations or licensing bodies. Auditors employed by government entities may also be subject to government ethics laws and regulations.

Objectivity

1.19 The credibility of auditing in the government sector is based on auditors' objectivity in discharging their professional responsibilities. Objectivity includes independence of mind and appearance when providing audits, maintaining an attitude of impartiality, having intellectual honesty, and being free of conflicts of interest. Maintaining objectivity includes a continuing assessment of relationships with audited entities and other stakeholders in the context of the auditors' responsibility to the public. The concepts of objectivity and independence are closely related. Independence impairments impact objectivity.

Independence

3.02 In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be independent.

3.03 Independence comprises:

a. Independence of Mind

The state of mind that permits the performance of an audit without being

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affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

b. Independence in Appearance

The absence of circumstances that would cause a reasonable and informed third party, having knowledge of the relevant information, to reasonably conclude that the integrity, objectivity, or professional skepticism of an audit organization or member of the audit team had been compromised.

3.04 Auditors and audit organizations maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by reasonable and informed third parties. Auditors should avoid situations that could lead reasonable and informed third parties to conclude that the auditors are not independent and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work.

The Media Center's response to the draft audit report indicates that certain comments and recommendations were supported by limited data. In particular, certain PEG recommendations were based primarily on a 2008 study from a think tank that has been subject to criticism for bias. Based on my review of the draft report, the Media Center's statements appear justified based on the text of the report although I caution I have not independently reviewed the materials or the research performed by the auditor. There is, for example, no discussion of research done to identify other studies, or to determine whether the 2008 study could be relied upon.

In addition, the auditor appears to have had access to mitigating data concerning the use of funds, i.e. Media Center had capital expenditures paid for by its unrestricted fund (referred to as the investment fund). This information appears to have been ignored by the auditor.

In my view, each of these are significant faults in independence and objectivity that render the findings and recommendations of the audit report with respect to the Media Center of limited reliability.

Franchise Fees under DIVCA

The audit report finds fault with Media Center's use of PEG fees for operating expenses. Assuming that PEG fees *must* be used for capital purposes (an issue I understand is being addressed separately), use for operational funding can have no impact except to the extent that (a) total operational dollars plus (b) total franchise fee revenues (c) exceed 5% of gross revenues as determined under federal law. The audit report seems to assume that the base for determining the limitation needs to be franchise fees

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determined under DIVCA, which is incorrect.

Franchise fees under DIVCA are 5.0% of gross revenues.[2] Gross revenues are defined in DIVCA.[3] However, the definition in DIVCA – at least as I have seen it interpreted and applied by DIVCA franchisees – is treated as being subject to limiting factors that would not apply if one determined franchise fees under the federal "gross revenues" standard. For example, cable operators in my experience often exclude the following from gross revenues used to determine franchise fees under DIVCA, although in my view the revenues could be included under the Cable Act's franchise fee provisions:

- PEG fee revenues (amounts paid by subscribers to the cable operator);
- Launch/distribution fees (amounts paid by programmers to cable providers to (1) carry the channel and (2) to place the channel in certain proximity to like programming, e.g. place a sports channel with 10 channels of ESPN);
- GAAP (DIVCA, in certain instances allows cable operators to report revenues as determined by GAAP, and some operator classify items that could be treated as revenues as contra-expenses under GAAP); and,
- Reductions to revenues for discounts, refunds and rebates, including free service to apartment managers and employees.

DIVCA at 5860 (f) also sets forth a specific formula for the determination of video revenue in a bundled package of services where video is combined with one or more non-video services. This formulaic approach is absent from the federal standard.

While one may dispute the typical application of DIVCA by operators, 5% of gross revenues under the federal standard will generally be greater than 5% of gross revenues under DIVCA. Since franchise fees under DIVCA would be less, the difference would be available for PEG fees to be used for operating expenses without any perceived violation of the Cable Act. I could not calculate that difference, but some amounts often excluded, like PEG fees and launch fees, may be significant in particular years, particularly if bundling impacts are properly considered.

Please let me know if you have questions on the above.

Sincerely,

ASHPAUGH & SCULCO, CPAs, PLC

Garth T. Ashpaugh, CPA

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2 DIVCA 5840 (q)

3 DIVCA 5860 (d), (e) and (f).

No. 08-3023 (L) (Cons. No. 15-3578)

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

MONTGOMERY COUNTY, MARYLAND *ET AL.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION
AND UNITED STATES OF AMERICA,
Respondents.

ON PETITION FOR REVIEW OF AN ORDER OF
THE FEDERAL COMMUNICATIONS COMMISSION

BRIEF *AMICUS CURIAE* OF THE ALLIANCE FOR COMMUNITY MEDIA AND THE ALLIANCE FOR COMMUNICATIONS DEMOCRACY IN SUPPORT OF PETITIONERS

James N. Horwood
Tillman L. Lay
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Attorneys for Amici Curiae

March 4, 2016

under review, if allowed to stand, would harm PEG access and the important public interests it serves.

I. THE FCC'S RULINGS THREATEN THE CABLE ACT GOALS SERVED BY PEG ACCESS.

A. PEG Access is Critical to the Cable Act's Goals of Promoting Diversity and Localism.

In 1984, Congress enacted the Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779, *codified as amended*, at Title VI of the Communications Act of 1934, 47 U.S.C. §§ 521 *et seq.* (the "Cable Act"). To further the goal of providing "the widest possible diversity of information sources and services to the public," 47 U.S.C. § 521(4), the Cable Act ratified local governments' authority to require cable operators to provide system channel capacity for PEG access as a condition for franchise approval, 47 U.S.C. § 531(b). The Act also prohibited operators from "exercise[ing] any editorial control over any" constitutionally protected expression appearing on access channels, 47 U.S.C. § 531(e). The Cable Act thus affirmed the role of public access channels to "provide groups and individuals who generally have not had access to the electronic media with the opportunity to become sources of information in the electronic marketplace of ideas."[7]

Consistent with the purpose of public access channels as open forums for speech, franchises or local regulations traditionally provide that public access channels may be used by the general public on a nondiscriminatory basis for any non-commercial, constitutionally protected programming. Local franchises also typically require operators to set aside channel capacity for governmental and educational channels, which provide local residents with the ability to view their local government councils and commissions in action and to receive local educational and school-related programming.[8]

PEG access advances Congress' Cable Act goal of providing a wide diversity of information and services by responding to the unique needs and interests of each local community. The role of PEG access in developing technological and media literacy has never been more important than it is today. PEG access centers provide constructive outlets for community youth to learn media skills. Seniors actively create programming on a range of issues. PEG channels provide an outlet for otherwise unserved or underserved segments of a

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[7] H.R. Rep. No. 98-934, at 30 (1984), *as reprinted in* 1984 U.S.C.C.A.N. 4655, 4667 ("*1984 House Report*").
[8] *Id.*

community (such as foreign-language speakers) to produce and watch programming responsive to their unique needs and interests. PEG channels give nonprofit organizations an outlet to reach clients and other community members in need of assistance.

PEG channels also furnish a platform for civic debate about local political issues. During local elections, PEG channels provide opportunities for candidates to address the public directly and fully, without being limited to a 30-second sound bite. Thus, PEG channels are a vital platform for causes and organizations that would otherwise not be part of public discourse. Viewpoint diversity is a long-established public interest goal of the Cable Act.

The role of PEG channels is particularly important today, when the amount of programming on commercial television channels that is devoted to local public affairs is small and shrinking. The commitment of PEG programmers to promoting social services, election information, arts and civic events, public safety and other issues close to home demonstrates what is possible when local individuals and community groups, rather than just larger commercial media outlets, are given the opportunity to participate in the television medium.

The quantity of uniquely local original programming that PEG provides to communities is substantial. A 2010 sampling performed by *amicus* ACM revealed that an average PEG access center ran 1,867 hours of first-run local programming on its PEG channel(s) each year. That translates into an average of 35 hours of first-run local programming per week—an impressive number that clearly reflects the robust amount of community involvement with, and the value that communities place on, PEG. Whether they are in an urban area, suburb or small town, PEG channels are focused on the local communities they serve, cablecasting town hall and council meetings, local election coverage, school activities and other local events that rarely receive full coverage on local broadcast or other commercial media. Because of the variables in the number of PEG channels operated in any specific jurisdiction, it is difficult to extrapolate nationwide, but *amicus* ACM has estimated that PEG access channels generate over 2.5 million hours of original local programming per year.[9]

Due to their uniquely local nature, PEG channels are an irreplaceable source of local election coverage. Indeed, PEG content often serves as the only source of local community news and information, so limiting its reach harms the local electorate. *Amicus* ACM conducted a fall 2012 survey of over 200 of its member PEG centers' 2012 election coverage and programming. The survey revealed that 85% of PEG centers produced and/or aired 2012 election programming, and that

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[9] *Examination of the Future of Media and Information Needs of Communities in a Digital Age*, GN Docket No. 10-25, Comments of ACM 15-17 (FCC filed May 21, 2010).

more than 75% of PEG centers collaborated with other organizations to offer election programming, with the League of Women Voters, the Local Chambers of Commerce, local community colleges and universities most often cited as key partners.[10] PEG centers participating in the survey represented a mix of public, educational and governmental non-commercial cable channels from around the country, including urban and rural centers.

In sum, PEG channels are a critical and irreplaceable source of truly local programming. Any harm—or even merely an increased risk of such harm—to PEG arising from the FCC's *Second Order* or *Recon Order* would therefore be inimical to localism and local democratic participation, and therefore to the goals of the Cable Act.

B. The FCC's Rulings that Institutional Networks and Other In-Kind Cable-Related Franchise Requirements are a "Franchise Fee" Threaten the Ability of PEG Centers to Fulfill the Cable Act's Goals.

As Petitioners' note, in the *Second Order* and *Recon Order* the FCC appears to have ruled that certain in-kind cable-related franchise requirements—such as institutional network ("I-Net") requirements and complimentary cable service to

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[10] *See* ACM, *Alliance for Community Media Survey Results Demonstrate Impact of Community Media Centers* (Jan. 10, 2013), http://www.allcommunitymedia.org/latest-news/alliance-for-community-media-survey-results-demonstrate-impact-of-community-media-centers (last visited Mar. 3, 2016).

APPENDIX 3 – Auditor Comments Regarding Media Center's Response

We disagree with the comments in the Media Center's response to the Cable Franchise and PEG Fee audit. However, we have opted to respond only to a few key points. Our lack of response to each individual comment in the Media Center's response should not be construed to mean that we agree with the Media Center's comments. Our comments below focus on four key points: 1) the purpose of the audit, 2) the timeline for when the City became subject to the federal Cable Act restrictions on the use of PEG fees, 3) the Media Center's and others' previous comments regarding PEG fee restrictions, and 4) the Office of the City Auditor's compliance with Government Auditing Standards.

1. Purpose of the Audit

Media Center Response: The Midpeninsula Media Center's (Media Center) response raises concerns that the audit misrepresents the Media Center's accounting system, misinterprets documents provided to the auditor, and did not do the sort of review of internal documentation required to support the implied motivations on the part of the Media Center or negligence on the part of the JPA members. The response questions, several times, what we audited vs. what the Media Center thought we should audit.

Auditor Comments: Performance audits, by their nature, are intended to mitigate risk to the organization for which the audit is performed. The City of Palo Alto is ultimately responsible for ensuring that PEG fees are used in compliance with the federal Cable Act. In recognition of this obligation, section 2.11.070(b)(2) of the City's Municipal Code states, "The PEG support fee shall be used by the city for PEG purposes *consistent with state and federal law*" [*emphasis added*], and section 2.11.040(c) states, "The failure of the city, upon one or more occasions, to exercise a right or to require compliance or performance under this Chapter 2.11 *or any other applicable law* [*emphasis added*] shall not be deemed to constitute a waiver of such right or a waiver of compliance or performance." Because the City of Palo Alto would incur any sanctions imposed by cable providers for noncompliance with the federal Cable Act, the audit objective to determine whether the City met its oversight responsibilities regarding the Media Center's use of PEG access fees was designed to mitigate the risk to the City of Palo Alto, not the risk to the Media Center. However, because the City remits 100 percent of the PEG fees to the Media Center, we were obligated to look at how the Media Center spent the funds to answer our audit objective.

To determine if the Media Center spent the PEG fees in accordance with the federal Cable Act, we reviewed the Media Center's annual reports from 2003 through 2013 and the Statement of Activities from the Media Center's 2012 financial statements. Those reports showed that the Media Center *always* classified PEG fees as operating revenue; did not classify the PEG fees as restricted, which would have been appropriate given the federal restrictions on the use of PEG fees; used the fees to support its operating expenses; and had limited capital expenses, other than those used to purchase and renovate its building, which was before the Cable Act limited how PEG fees can be used. We met with the Media Center's executive director and finance manager to discuss the audit objectives and our preliminary findings and requested that they provide any additional documentation that would support that they had spent the PEG fees only for capital expenses. Media Center staff provided a copy of its five-year capital plan, which did not show planned capital expenditures. When we told them that the document did not support that they had used PEG fees for capital expenses, they provided a copy of the spreadsheet that they also attached to their response, titled "Media Center Use of PEG Fees, July 2010-October 2013." This spreadsheet supports that the Media Center spent the PEG fees *only* for operating expenses, which is prohibited under the federal Cable Act. The Media Center did not provide us with copies of the budget documents that they included in their response; however, those documents also support our conclusion that the Media Center used the PEG fees only for operating expenses.

The Media Center's response states in several places what they thought we should have audited instead of what we audited, including what evidence we should have obtained to support our findings and conclusions. The Government Auditing Standards require auditors to not allow external influences or pressures to impact an auditor's ability to make independent and objective judgments, which includes determining the audit objectives, the methodology to be used to address those objectives, and the evidence needed to be gathered and reviewed or analyzed to address the objectives. Although the Media Center's executive director tried to influence our findings during the audit, and the Media Center's response continues that trend, the auditors are responsible for evaluating the subject matter of the audit and objectively drawing conclusions based on all the facts and circumstances, even if those conclusions conflict with management's assertions.

2. <u>Timeline for When City Became Subject to PEG Fee Restrictions</u>

Media Center Response: The Media Center's response states 1) that the federal Cable Act does not restrict use of PEG fees to capital expenditures, 2) that PEG fees may be used for operating support with operator (i.e., cable franchise holder) consent, and 3) that the City entered into a franchise agreement that allowed PEG fees to be used for operating support and, in fact, "preferred" that the Media Center use the PEG fees rather than its investment fund for operating expenses.

Auditor Comments: The Media Center's above assertions are incorrect:

1) We worked closely with the City Attorney, who engaged a consulting attorney who specializes in communication law, to ensure that our interpretation was accurate and that the federal Cable Act does indeed restrict the use of PEG fees to capital expenses if the local entity collects the full five-percent franchise fee. The City of Palo Alto collects the full five-percent franchise fee, and the City Attorney, with advice from the consulting attorney, confirmed that our interpretation regarding the restricted use of PEG fees is correct.

2) Lack of action on the part of the cable providers does not mean that they knew how the Media Center had spent the PEG fees. There is no evidence to support that the cable providers consented to the PEG fees being used for operating expenses, or that the cable providers even knew how the Media Center had used the PEG fees. Transferring PEG fees to the Media Center is based on an agreement between the City of Palo Alto and the Media Center and did not require knowledge or agreement from the cable operators.

3) The federal Cable Act limited the use of PEG fees to capital expenses for new franchise agreements that became effective 60 days after its enactment on October 30, 1984. The Palo Alto City Council adopted a new franchise agreement in July 2000 when the cable television system was transferred and assigned from Cable Co-op to TCI. The agreement required TCI to pay $0.88 per month per residential subscriber "for PEG Access facilities and equipment" and allowed the City to use the funds "for any lawful PEG Access purposes." This agreement, which acknowledged the restrictions

regarding the use of PEG fees, is the point where the restriction became effective for the City of Palo Alto. DIVCA, which California adopted in 2006, says that PEG fees may be established "to support PEG channel facilities *consistent with federal law [emphasis added]*. The City entered into an agreement with the Media Center in 2002, which required the Media Center to "operate and administer the PEG facilities and channels in compliance with applicable laws" and in compliance with the franchise agreements between the City and the Cable Companies." When that agreement expired, the City entered into a new agreement, in 2011, which required the Media Center to use the PEG fees "only in a manner consistent with DIVCA and the Cable Act." These provisions in the City's agreements with the Media Center support that the City always intended for the Media Center to comply with the federal Cable Act restrictions on the use of PEG fees. Because DIVCA was enacted more than 20 years after the Cable Act and because it is a state law, it had no impact toward changing the restrictions on the use of PEG fees.

3. Media Center's and Others' Previous Comments Regarding the PEG Fee Restrictions

Media Center Response: The Media Center's response and its attachment from the law firm of Best Best & Kreiger states that the federal Cable Act does not restrict the use of PEG fees to capital expenses, and that we should have consulted with The Buske Group for an interpretation of the law.

Auditor Comments: It was more appropriate for us to obtain advice from an attorney regarding the legal interpretation of the law than it would have been for us to obtain an interpretation from The Buske Group, which is a telecommunications consulting firm. The comments in the Media Center's response contradict statements that the Media Center's executive director, an attorney from Best Best & Kreiger, and Sue Buske from The Buske Group have made in the past regarding the restrictions on the use of PEG fees:

- The Media Center's executive director, knowing that the Cable act does indeed restrict the use of PEG fees to operating expenses, has actively advocated for changing the federal law to allow PEG fees to be used for operating expenses in additional to capital expenses.
- Gail Karish, one of the attorneys who provided comments in the response from Best Best & Kreiger; Sue Buske, president of The Buske Group; and Annie Folger, the Media Center's executive director, were panelists in a November 2013 workshop that focused on cable franchise and PEG fees. Excerpts from the workshop, which was recorded and is available at https://www.youtube.com/watch?v=w7gpH_WqLNg, include:
    - Gail Karish: "The franchise fees, there's a federal cap, and there is also in the state law five percent, right? So that's what you can pay; that's what you can collect in franchise fees. You can collect PEG fees in addition to that, that will not be credited as franchise fees *as long as they are spent on capital [emphasis added]l*. If you spend something that you call a PEG fee on something other than capital, then the risk is that the operator will say, 'Well, you know what? That's really a franchise fee and it goes towards our five percent franchise fee cap . . . It's now become, now if falls under a franchise fee kind of category and we're gonna assume we can have a credit against the franchise fees that we're paying to the local government.'"

- Sue Buske: In reference to PEG fees - "I think that it is subject to interpretation. But the issue really becomes do you want to take the risk? Okay? At the end of the day, do you want to take the risk, and are they going to send the cable cops after you?"
- Annie Folger: "In the local franchise,[9] the language said that the fee could be used for any PEG purpose . . . So we have been telling ourselves that because our local franchise allowed us to spend that $0.88 per subscriber for operations, we would continue to do so until challenged otherwise, and that's exactly what we've been doing . . . But it would be, you know, a painful experience to have to figure out how, it's essentially about $327,000 annually now that we get in PEG fees as a result of this pass-through fee, that we'd be hard pressed to say it's being spent on capital each year."

The above comments support that the Media Center had prior knowledge of the appropriate use of PEG fees but chose to use them inappropriately.

4. Office of the City Auditor's Compliance With Government Auditing Standards

Media Center Response: The Media Center's response includes a letter from Garth Ashpaugh, CPA, which asserts that although the Media Center had capital expenditures paid for by its unrestricted fund, "this information appears to have been ignored by the auditor." By citing several paragraphs from the Government Auditing Standards, he also suggests, without directly saying it, that this means the audit did not comply with the ethical principles and the independence standard in the Government Auditing Standards. He makes these assertions while also acknowledging that he had not reviewed the materials or the research that we performed.

Auditor Comments: The audit report acknowledges that the Media Center had a small amount of capital expenses during the audit review period that potentially could have qualified as PEG fee expenditures and later provided financial records showing its capital expenditures for calendar year 2014, but that the Media Center chose to use its unrestricted (investment) fund, rather than the PEG fees, for those expenses. When we first discussed our finding with the Media Center a

nd told them that our conclusion was that the Media Center had not complied with the Cable Act restriction for use of PEG fees, we gave them the opportunity to provide additional documentation to support that they were in compliance. The additional documentation that they provided continued to support our conclusion that the Media Center had used the PEG fees only for operating expenses.

Neither Mr. Ashpaugh's response summarizing his background, nor his biography on the National Association of Telecommunication Officers and Advisors' website indicate that he has any experience conducting performance audits that comply with Government Auditing Standards (our internet search did not locate a website for his accounting firm, which could potentially provide more information on Mr. Ashpaugh's experience). The Office of the City Auditor has undergone several peer reviews that confirmed our ongoing compliance with the Government Auditing Standards in the work it performs. Further, City Auditor Harriet Richardson is a recognized expert in the requirements of the Government

[9] This comment refers to the local franchise agreement established in 2000 with TCI, which stated that the fees could be used "for any *lawful [emphasis added]* PEG Access purposes." Because the federal Cable Act restricted the use of PEG fees, using them for operations was not a *lawful* PEG access purpose.

Auditing Standards, as demonstrated by her recent appointment by the Comptroller General of the United States to the Government Auditing Standards Advisory Council. There is no basis for Mr. Ashpaugh's suggestion that the audit did not comply with the ethical principles and independence standard in the Government Auditing Standards. The Government Auditing Standards require auditors to exercise professional skepticism in the work they do, which includes being alert to, for example, audit evidence that contradicts other audit evidence obtained or information that brings into question the reliability of responses to inquiries. Exercising our professional skepticism led us to provide multiple opportunities for the Media Center to provide reliable responses to our inquiries. However, during the audit, they changed the reasons they provided for why they used the PEG fees for operating expenses, which led us to take extra care toward providing assurance regarding our conclusions.

APPENDIX 4 – Legal Response

AT PLACES MEMORANDUM
Office of the City Attorney
City of Palo Alto

POLICY & SERVICES MEETING
05/10/2016
☑ Received Before Meeting
2

Policy and Services Committee Meeting Date: May 10, 2016

May 10, 2016

POLICY AND SERVICES COMMITTEE
Palo Alto, California

RE: Cable Franchise and Public, Education, and Government (PEG) Fee Audit

Dear Committee Members:

Attached is a memorandum from the City's telecommunications counsel.

Respectfully submitted,

/s/

Molly S. Stump
City Attorney

MSS/sh
Enclosure
cc: James Keene, City Manager
Beth Minor, City Clerk

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MEMORANDUM

Via Email

TO:	Policy and Services Committee of the City of Palo Alto City Council
CC:	Molly Stump, Esq., City Attorney
FROM:	Tillman L. Lay
DATE:	May 10, 2016
SUBJECT:	Response to Media Center's Legal Issue Comments on City Auditor's Franchise and PEG Fee Audit Report

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The City Attorney's Office has asked me to respond briefly to the key legal issues raised by the Media Center and its attorneys at Best Best & Krieger. I will be available by telephone to address these issues in greater detail at the Policy and Services Committee meeting on May 10, 2016.

The Media Center raises a number of legal issues, some of which have merit. None of those legal issues, however, disturbs the central conclusion of the audit: during the audit period and prospectively, PEG fees spent on anything other than PEG capital costs are a "franchise fee" under the federal Cable Act and therefore subject to the Act's 5% cap on franchise fees.

To avoid exceeding the 5% federal Cable Act cap on franchise fees, PEG fees should be spent only on capital costs.

The federal Cable Act generally restricts PEG fee use above the 5% franchise fee cap to capital costs, unless another exception applies. 47 USC §542(g)(2)(C). There is an exception to this rule for compensation given by the operator in the context of franchise settlement and release agreements. *See* 47 USC §542(g)(2)(D). Palo Alto had a waiver and release provision in the City's 2000 AT&T franchise (later assigned to Comcast), but that agreement expired when that franchise expired in 2010. Because Comcast now has a state DIVCA franchise, there is no longer any local franchise agreement between the City and Comcast through which a waiver, settlement, or release could be used to shield PEG fees from the Cable Act's PEG capital cost restriction.

Although the Media Center suggests otherwise, PEG fees under DIVCA are subject to the same use limitations as the federal Cable Act, for two reasons. First, the federal Cable Act franchise fee cap applies to DIVCA, and to California cable operators, under the Supremacy Clause of the U.S. Constitution. Second, DIVCA itself provides that the PEG fee it permits localities to adopt must be "consistent with federal law" – in other words, the federal Cable Act. Cal. Pub. Util. Code §5870(n).

The Media Center is correct that both the federal Cable Act and DIVCA permit operators to make voluntary payments in support of PEG access in excess of the franchise fee PEG restrictions in the Cable Act. But this exception is limited to additional benefits voluntarily offered by the cable operator and not compelled by law or otherwise required by the franchising authority. The City's 88-cent PEG fee does not fit this description, as it is compelled by law (the City ordinance imposing the fee), and the Media Center has presented no evidence suggesting that, after expiration of Comcast's 2000 franchise, either Comcast or AT&T voluntarily offered or agreed to pay for PEG operating expenses.

A California Attorney General Opinion, 99 Ops. Cal. Atty. Gen. 1 (Jan. 15, 2016) (Opin. 13-403), cited by the Media Center, does not conclude otherwise. In Opin. 13-403, the AG concluded that the PEG fee allowed by DIVCA is not a "tax" within the meaning of Proposition 26 because rather than being a "levy, charge or exaction . . . imposed by the local government," the PEG fee that DIVCA permits localities to adopt by ordinance is an obligation that the franchise holder had previously "voluntarily" agreed to "<u>in exchange for a cable franchise</u> as part of the state's franchising process." (Emphasis added.) While that may be true for purposes of determining whether the PEG fee is a "tax" under Prop 26, the test for what is a "tax" under Prop 26 is not the same as the test for what is a "franchise fee" under the federal Cable Act. A monetary PEG fee paid by a cable operator "in exchange for a cable franchise" – which is what the AG opinion says the DIVCA PEG fee is – would seem to be a "franchise fee" under the Cable Act. 47 USC §542(g)(1). Moreover, the Attorney General's suggestion that requiring voter approval of the PEG fee might be inconsistent with the federal Cable Act would seem to support the proposition that the DIVCA PEG fee is subject to the same limitations as PEG payments under the federal Cable Act, *i.e.*, that PEG payments are a "franchise fee" unless used for capital costs. Contrary to the Media Center's suggestion, the AG opinion therefore appears to assume that the PEG-related provisions of the federal Cable Act govern DIVCA's PEG provisions.

Although the Cable Act gross revenue base may be larger than the DIVCA gross revenue base, any difference is likely small.

The Media Center is correct that, for purposes of determining whether its use of the PEG fee for operational expenses counts against the 5% franchise fee cap, it is the federal Cable Act "gross revenue" definition, not the DIVCA "gross revenue" definition, that counts. And the Media Center is therefore also correct that, to the extent that the federal Cable Act "gross revenue" term has a larger potential revenue base than DIVCA's "gross revenue" definition, the amount of any franchise fee "overpayment" resulting from the Media Center's use of the PEG fee for operational expenses could only be determined by deriving a separate calculation of the maximum permitted franchise fee under the broader Cable Act revenue base.

But with one exception described below, it's far from clear that the federal Cable Act term, "gross revenue," is any broader than DIVCA's "gross revenue" definition. The major difference between the two is that there is no statutory definition of "gross revenue" in the Cable Act, while there is a detailed one in DIVCA. But it does not follow that, merely because DIVCA's "gross revenue" definition is quite detailed while the federal Cable Act's term "gross revenue" is not, the Cable Act's "gross revenue" term will necessarily yield a larger gross revenue base on which the franchise fee is calculated than the DIVCA definition. The Media Center's outside accountant suggests that the federal Cable Act's "gross revenue" term might include program launch fees and might treat bundled service revenues differently than the DIVCA definition does. It is true that neither of those issues relating to the federal Cable Act "gross revenue" term has been decided by the FCC or the courts. What the Media Center does not mention, however, is that cable operators have uniformly taken positions on launch fees and bundled services under the federal Cable Act "gross revenue" definition that are either consistent with, or even less generous to local governments than, the way that DIVCA treats those items under its "gross revenue" definition.

There is, however, one exception where the maximum permissible federal Cable Act "gross revenue" base does pretty clearly seem to exceed the maximum permissible DIVCA "gross revenue" base. That exception relates to treatment of the DIVCA PEG fee and other fees and taxes imposed on the cable operator. Under the Cable Act's "gross revenue" definition, the law is clear that any taxes or fees imposed on the cable operator (rather than on the user or the transaction) are an operating expense of the operator and therefore need not be deducted from "gross revenue" in calculating franchise fees owed. *City of Dallas v. FCC*, 118 F.3d 393 (5th Cir. 1997). DIVCA, in contrast, excludes all taxes and fees imposed on the cable operator (except for the 5% franchise fee) from "gross revenue." Cal. Pub. Util. §5860(e)(6). Because the DIVCA PEG fee is "not imposed by this section [§5860]," it would appear to be a "fee … imposed by [a] governmental entity on the holder of a state franchise," and thus deductible from the DIVCA "gross revenue" base. Thus, the maximum permissible Cable Act gross revenue base – which is the ceiling against which any alleged overpayment of "franchise fees" resulting from the Media Center's use of those fees for operational expenses should be measured – is at least 88 cents/month/subscriber higher than the maximum permissible DIVCA gross revenue base. (The "at least" qualifier is added because there may be other taxes or fees that Comcast or AT&T also deduct in calculating the DIVCA franchise fee owed the JPA that would not be deductible from their gross revenues in calculating the federal Cable Act 5% cap.) The Media Center does not provide any dollar estimate of how much of a difference this would make, though it appears any difference would be relatively small, on the order of 5% of the total amount of PEG fees paid per year.

It is true that AT&T claims it is not a "cable operator" within the meaning of the Cable Act, but the prudent course for the City is to treat AT&T as subject to the Cable Act's PEG fee limits.

Despite AT&T's assertion to the contrary, the FCC has strongly suggested, and one court has ruled, that AT&T's U-verse video service is a "cable service," and that AT&T is therefore a "cable operator" subject to the Cable Act. And even if AT&T were not a "cable operator" under the Cable Act, it is a "video service provider" under DIVCA, and the Cable Act's limitation on PEG fee use may still apply to AT&T through DIVCA.

The Media Center is correct that the DIVCA statute of limitations may bar an action by the cable providers.

We agree that the DIVCA statute of limitations on a claim for overpaid franchise fees may have run, cutting off all or most of any potential refund claim Comcast and AT&T might otherwise have for a refund of franchise fees. The City also has other potential federal and state law defenses against any franchise fee refund claim by Comcast or AT&T, as well as a potential Cable Act claim that Comcast and AT&T must return to subscribers any refund they receive from the City. But the existence of these potential claims and defenses does not alter the conclusion that the City should promptly bring the PEG fee program into compliance with federal Cable Act provisions limiting the non-franchise fee use of PEG fees to capital costs.

TLL:smh

Policy and Services Committee
TRANSCRIPT

Special Meeting
May 10, 2016

Chairperson DuBois called the meeting to order at 5:03 P.M. in the Council Chambers, 250 Hamilton Avenue, Palo Alto, California.

Present: Berman, DuBois (Chair), Kniss, Scharff

Absent:

Oral Communications

Chair DuBois: The first Item on the Agenda is Oral Communications, to speak about something not on the Agenda. We don't have any speakers for Oral Communications.

Action Items

2. Cable Franchise and Public, Education, and Government (PEG) Fee Audit.

Chair DuBois: We are also changing the order of the Agenda. We're going to be taking the Cable Franchise and Public, Education and Government (PEG) Fee Audit first. I guess I'd like to have the Auditor present her findings, and then we'll take comments from the public, and then we'll have a discussion among the Policy and Services Committee (Committee). Harriet, are you ready? Do I have a Motion to change the Agenda order?

Council Member Berman: So moved.

Vice Mayor Scharff: Second.

Chair DuBois: All in favor. Are you ready?

MOTION: Council Member Berman moved, seconded by Vice Mayor Scharff to change the Agenda order and discuss Item 2 before Item 1.

MOTION PASSED: 4-0

Harriet Richardson, City Auditor: Yes. Good evening, Mr. Chair and members of the Committee. Harriet Richardson, City Auditor, here to present the Cable Franchise and PEG Fee Audit. With me is Houman Boussina, Senior Performance Auditor, who was the Lead Auditor on the project. Somewhere in the audience out there is Lisa Wehara who also worked on the audit with us. The objectives of the audit were to determine whether and to what degree from July 1st, 2010 through June 30th, 2014 the City of Palo Alto accurately accounted for its receipt of franchise and Public, Education and Government, also known as PEG, fees and met its oversight responsibilities regarding the Media Center's use of the PEG Access Fees. The second objective was to determine if Comcast and AT&T collected and promptly remitted the appropriate amount of franchise and PEG Fees to the City. The third objective was to determine whether the City had established and sufficiently defined the roles and responsibilities to administer its Cable Communications Program and State Franchises awarded to Comcast and AT&T. I'd like to provide a little background.

Vice Mayor Scharff: Excuse me. Do you have those as handouts?

Chair DuBois: You should (inaudible).

Vice Mayor Scharff: Are they in front of me somewhere?

Ms. Richardson: They should be. Did they get moved?

Council Member Kniss: They were in the other room.

Ms. Richardson: Did those get moved?

Vice Mayor Scharff: I guess we could (crosstalk) and get them.

Ms. Richardson: You should also have an At-places Memo, if you don't have that.

Vice Mayor Scharff: I have nothing up here. I guess it was in the other room.

Ms. Richardson: They're in the other room. I can give you my copy for now. Do you want me to wait to continue until Council Member Berman comes back? I wanted to provide a little background to help you understand the Audit Findings. First is that there are two laws that govern cable communications that are relevant to this audit. The first is the Cable Communications Act of 1984, commonly referred to as the Cable Act, which established a national policy for cable communications. It was enacted by Congress in October 1984 and became effective 60 days later for all new Franchise Agreements. The law allowed certain State Laws already in effect to remain in effect for not longer than the current remaining term of existing franchises. The second law is California's Digital Infrastructure and Video Cable Act (DIVCA) of 2006, commonly referred to as DIVCA, which was enacted to increase competition for video broadband services statewide, create a fair and level playing field for all market competitors, and establish the California Public Utilities Commission as the sole franchising authority for video service. Once DIVCA was implemented, cable operators had the option of switching to a State-issued Franchise Agreement or continuing to operate under the Franchise Agreement that had been issued by the local jurisdictions until that Local Franchise Agreement expired. Comcast and AT&T currently hold State Franchise Agreements that serve our residents and some surrounding areas. There are two fees that the cable operators pay and pass on to their subscribers. The first is the Franchise Fee which is considered to be rent or a toll for using the public rights-of-way. The Federal Cable Act limits this fee to 5 percent, and DIVCA establishes the fee at 5 percent unless the local entity adopts an Ordinance setting the fee at less than 5 percent. Palo Alto does have an Ordinance that establishes the fee at 5 percent. The second fee supports public, educational and government access channel facilities and is commonly referred to as the PEG Fee. DIVCA generally limits the fee to one percent of the cable operator's gross revenues, and the Federal Cable Act limits the use of that fee to Capital Expenses that support PEG access facilities. The City of Palo Alto has administrative and oversight responsibility for cable operations in Palo Alto, Menlo Park, East Palo Alto, Atherton and the unincorporated areas of San Mateo and Santa Clara Counties through the Cable Joint Powers Authority. I'm now going to pass the presentation on to Houman who will discuss the findings and recommendations.

Houman Boussina, Senior Performance Auditor: Housman Boussina, Senior Performance Auditor. The Audit Report has three findings. I'd like to provide a summary of the three in the next few slides. Finding 1, the Media Center inappropriately used an average of $340,000 annually of public, education and government or PEG Fees, or $1.4 million during the audit period for operating expenses such as salaries and benefits, utilities, janitorial service, noncapital equipment and insurance; although, the Federal Cable Act requires that PEG Fees be used only for Capital Expenses to the extent that they exceed a 5 percent Franchise Fee. This occurred because the City didn't fulfill its oversight responsibility to ensure that the PEG Fees were used in compliance with the Federal Law, and the Media Center did not ensure its own compliance with the law despite our agreement with them stating that the fees could only be used in a manner consistent with DIVCA and the Cable Act. Given that the PEG Fee is a discretionary fee that the City and other Cable Joint Power members have the option to impose on the cable service providers and that the cable service providers pass the fee on to their subscribers, the audit raises concerns about the lack of customer usage and satisfaction data for PEG channels and about ongoing usefulness of PEG channels as a result of significant changes in technology since the Cable Act and DIVCA were enacted. While PEG channels do offer benefits including broadcasts of local government meetings, PEG channels do not necessarily offer unique choices with the advent of the internet and websites such as YouTube, where much of the same programming and information may be available. A timeline is helpful for giving context to this Audit Finding. The 1984 Federal Cable Act requires that PEG Fees be used only for Capital Costs related to PEG access facilities and related equipment such as manned studios and cameras for new Franchise Agreements granted 60 days after the law's enactment. In 2000, the City awarded a new Local Franchise Agreement to TCI Cablevision (TCI). The agreement required TCI to pay the City $0.88 per month per residential subscriber to fund PEG equipment and facilities and specified that the City would use the funds for any lawful PEG access purposes. In 2002, the City contracted with the Media Center to support PEG channels. The agreement said that TCI would provide the payments for PEG facilities and required the Media Center to operate and administer the PEG facilities and channels in compliance with applicable laws and the Franchise Agreement between the City and the cable operator. The City's 2011 contract with the Media Center reaffirmed that requirement and said that the PEG Fees shall be used consistent with Federal Law. DIVCA affirmed the applicability of Federal Cable Act restrictions on the use of PEG Fees by allowing local entities to establish a fee to support PEG channel facilities consistent with Federal Law. DIVCA didn't impact Finding 1 or the Federal Law provisions that were the basis for Finding 1. In Finding 2, we contracted with the Buske Group to obtain and review Comcast and AT&T records on our behalf to determine if they collected and promptly remitted the appropriate amount of Franchise and PEG Fees to the City. Comcast and AT&T underpaid Franchise and PEG Fees because they did not always comply with provisions of DIVCA and the Cable Joint Powers Municipal Codes that require payment of a 5 percent Franchise Fee based on gross revenues and payment of an $0.88 PEG Fee per subscriber. Comcast and AT&T did not always calculate the fees due in accordance with DIVCA and the Municipal Codes of the Cable Joint Powers. Underpayments mainly resulted because Comcast and AT&T did not pay a Franchise Fee on all advertising revenue. Comcast did not pay Franchise Fees on all flat fees charged to subscribers, and AT&T excluded customer refunds and credits from gross revenues. Comcast's and AT&T's customer address databases also had inaccuracies and omissions that can cause payment errors, including misallocation of Franchise and PEG Fee payments to the Cable Joint Power members. Comcast and AT&T will owe interest calculated at the highest prime lending rate during the delinquency period plus 1 percent on underpaid fees as required by DIVCA. DIVCA also requires that AT&T pay the City for its portion of the audit costs because AT&T's underpayment exceeds 5 percent of the amount that it should have paid. Finding 3 looks at roles and responsibilities. The City has not clearly assigned or defined roles and responsibilities for its Cable Communications Program or effectively managed the Program to ensure that funds are used appropriately and that Program outcomes are consistent with the City's and residents' cable communications needs. The Information Technology (IT) Department administers the contract and approves payments for the City's Cable Coordinator but does not otherwise actively manage or provide oversight of the Cable Communications Program. Administrative Services Department (ASD) administered the Cable Coordinator Contract prior to IT becoming a separate department. When the Municipal Code was updated to assign responsibilities to the Cable Coordinator, the provision in Chapter 2.08 that assigns responsibility to the Office of the City Clerk was not updated to reflect changes in how cable activities were to be administered in the City. The Audit Report includes nine recommendations to the City Manager's Office including assessing the need to continue collecting PEG Fees, adjust the PEG Fees or discontinue the fee based on a demonstrated need for future PEG Capital Expenses; if it is retained, to establish criteria for how PEG Fees may be used and monitor expenditures to ensure compliance with the Federal Cable Act and determine whether to allocate a portion of the unrestricted Franchise Fees or other funds to subsidize the Media Center's operations. We also recommend sending letters to AT&T and Comcast demanding payment of the underpaid Franchise and PEG Fees, interest due and for AT&T its portion of the audit costs. We recommend that the City work with AT&T and Comcast to develop methods to ensure accuracy of their address databases and the basis for determining the revenues on which Franchise and PEG Fees should be calculated, review the accuracy of future payments and promptly follow up on discrepancies. We recommend assigning responsibility for the City's Cable Communications Program and that we require the assigned department to provide appropriate program oversight, and finally submitting a Draft Ordinance to the Palo Alto City Council recommending revisions to the Palo Alto Municipal Code based on revised assignment of roles and responsibilities.

Ms. Richardson: That concludes our presentation. We're ready for questions whenever you're ready to ask them. I think that's going to be after the public comment.

Chair DuBois: Yes. Unless we have any really short technical questions, I suggest we go out to the public. I think most of the people here would like us to get to this Item, so we have 30 speakers. We're going to have two minutes per speaker. I'd suggest that if you're making a point that's already been made, it'd be appreciated if you could just say, "I agree with that speaker," and maybe keep it short. We're going to proceed. The first speaker is Laura Kinley, and the next speaker will be Judy Gittelsohn, if you could move to the front. Thank you.

Laura Kinley: Hello. My name is Laura Kinley. As an educator and former director of the Silicon Valley Instructional Television Network and the Integrated Learning Technologies Department at the Santa Clara County Office of Education, it has been my job and privilege to integrate the use of technology in television and internet, video and computer in the 33 public school districts of Santa Clara County. We responded to this challenge with the creation of TV shows and series, which you may remember some of them—*Math Mentor* was one, *Math Squares Tournament*, *Writers Workshop*, *History Hunters* and *Silicon Valley High*—and also pages on our website that included the teacher lessons and interactive links to play along, CD ROMs with practice questions as well as YouTube sites for past episodes. What we learned was that the use of all multimedia platforms is necessary and essential to reach students in this day and age. In fact, I wish we had been able to do what the Midpen (MidPen) Media Center has done. They went one better by providing training and how to create your own media and find your own voice. They are educating students of elementary school, middle and high school, college-age as well as lifetime learners to not just consume media but to produce it. They are learning skills they can use for life or for a job, not just for grades. Volunteers of all ages learn how to produce a TV show. In case you're wondering about the relevance of television in the age of mobile phones and the internet, a research article in today's THE journal entitled "How Kids Use Technology: TV is Still the Most Popular Video Platform" reported that television is still king among the video platforms. Please don't take this vital educational resource away from the community. I've left a copy of the article for you to see.

Chair DuBois: Thank you.

Ms. Kinley: Where do I leave this?

Chair DuBois: You can hand it to the Clerk. Judy Gittelsohn followed by Fred Bockmann.

Judy Gittelsohn: Good afternoon. My name is Judy Gittelsohn. I'm a Palo Alto resident, and I was a producer of a television show for a year and a half at the MidPen Media Center. I'm an artist and I serve people with special needs. My show highlighted people with special needs, and it was a really great venue because it was live; I brought in the community. The people with special needs, in particular with developmental disabilities, found their way to being in the public. It brought back resources to their community and it gave them a voice, which is a very rare opportunity for this population. In my experience with the Media Center, I'm not the only one of this kind of ilk that they're supporting. I think the Media Center is a fabulous resource and deserves to be supported by the community. I know Palo Alto had a MidPen Media Center Day that they proclaimed. It's high quality; it's bringing the community together, and it really was an opportunity for me. I really appreciate the venue. Thank you.

Chair DuBois: Thank you. Fred Bockmann followed by Lessa Bouchard.

Fred Bockmann: Hello. I'm Fred Bockmann. I live on Charleston Road and have been a volunteer producing shows at the Media Center for about 10 years now. I have met amazing people from Palo Alto. I've discovered a unique and wonderful way to learn about our community and to communicate with the citizens throughout the country. As I've worked on all these various shows, I've never really produced one from scratch myself up until this past year. Stanford University has created along with 31 other leading university research centers an Alzheimer's Disease Research Center. Its funded by the National Institute of Health (NIH), and they are doing some amazing things there. The statistics that they've shown me show that about 1 in 9 adults over the age of 65 have Alzheimer's or a related dementia, 1 in 3 over 85 have this problem. All of our lives are touched by it. The research grant that they have has identified the need for community outreach and education. I worked with them to put together a series that we started shooting this past winter. The first episode was so well received at Stanford that they've submitted it to the American Psychological Association as an example of community outreach and how they would like to continue working with this. There are many other things that I could say about this wonderful location, the Media Center. It's a group of caring, loving people that really are doing a wonderful job. That's what I'm here to speak in support. Thank you.

Chair DuBois: Thank you. Lessa Bouchard followed by Karen Aclams I'm sorry if I'm mispronouncing your last name.

Lessa Bouchard: Thank you. My name is Lessa Bouchard, and I am a community documentary producer and arts educator. I hope that in any consideration of value of the Mid Pen Media Center you will consider the downsizing that journalism in general has endured nationally, that local newspapers have reduced the number of jobs in the industry by the thousands in the past decade. Financial pressures have increasingly put papers in the position of sensationalizing issues right and left in an effort to stay alive and to maintain relationships with advertisers. These conditions make access to nonpartisan video recordings of government process more important than ever before and, in fact, create an argument for increased funding and support of the Media Center and its insurance needs and its under ten-person fulltime staff, not less. Social media such as YouTube, these are delivery platforms, not tools of content creation. Not everyone has access to the time and the means to record. Not everyone has a smart phone or a computer. Libraries are not the place to edit and post this citizen journalism. Not everyone has the time and education to represent an balanced account of an event. Local journalists and concerned citizens rely heavily on the archiving of these meetings. The recording and uploading of which is done by Media Center employees with barely enough support and compensation for their work as it is. These people, a skeleton crew, work long hours for little pay because they believe in the mission of the Media Center. They believe in a free press and access to the tools of media for diverse and underrepresented voices in the community. Thank you.

Chair DuBois: Thank you. Karen Adams followed by Tom Upton.

Karen Adams: Hi. My name is Karen Adams, and I've been working with the Media Center for over 20 years. I now run our studio. Every year I'm astonished at the number of organizations that make use of our facility. I have a list here of over 900 unique organizations that have come through the Media Center between 2010 and 2015. This is probably a minimum number. These are primarily nonprofit, educational and government groups. Many of them have been to our station multiple times over the years. They use the space and equipment in our center to record their messages, and they take those shows, and they run them on our cable channels, upload them to YouTube, post segments on their websites and social media. Now, with the service that's been in place for many years called PEG Media, they can upload their shows to a national server that's accessed by 3,000 community stations throughout the nation. Our producers can have a national audience. Audiences have never been bigger for access television. In fact, one of our music shows has over 250,000 hits. *Future Talk*, which was sponsored by the Tech Museum of San Jose, is seen in 300 stations throughout the U.S., also in Great Britain and New Zealand. What these amazing numbers might not reflect are the stories that rarely are told in commercial television. We are hyper-local programming that has a ripple effect throughout our community. For instance, we partnered with the East Palo Alto Police Department to help solve cold case murders. Friends and families of murder victims came to the station to put a human face on the crime. We're so much more than a TV station. We provide community. This community represents the entire diverse cross-section of the Mid-Peninsula. That is young and old, rich and poor, families, all flavors of races and ethnicities. I've been privileged to chronicle the stories of our community for the past 25 years. I appreciate your support over those years.

Chair DuBois: Thank you. Tom Upton followed by Ken Allen.

Tom Upton: I'm Tom Upton, a local creative person, a photographer in fact. I willingly give my time to the Media Center programs that need my skills and help, and I'll be doing so when I walk out of this building tonight and drive down to the Media Center. I challenge you to find a more dedicated, open, welcoming and skilled focused group of people. The leadership at the Media

Center is among the best I have seen and inspire dozens of people like me who have real lives to volunteer joyfully. I've photographed a lot of bigwigs in my 30 years as a Silicon Valley photographer. Your being picky-picky chapter and verse regarding operational versus Capital Expenditures at this point in time after so many years of already publicly scrutinized operation is puzzling indeed to me, but I'm just an artist. Calling into question the Media Center's usefulness in the community appears to be more than specious projection, but a rather deft twist of the knife, taking on the distinct flavor of muckraking with a tablespoon of Trumpian hyperbole, well neo-Trumpian hyperbole. Good job, you got our attention. I won't take offense that all the audit people have their backs to me. I want you to understand there are more volunteers at the Media Center than there are staff. We are creatives; we're doers, artists, idea people, activists, techies and makers. You need us, but you don't see us. Please make an effort not to pick the road most traveled by politicians, bean counters, bureaucrats. That is the road of failed imagination. Please open your eyes, examine the books, go over the costs, find the pain points and fix them. Work together, be kind and dig in for a bit of understanding the wide-angle view, the establishing shot. That's a good place to start. Godspeed to you.

Chair DuBois: Thank you. Ken Allen followed by Nancy Wheeler.

Ken Allen: First of all, I'm Ken Allen, Grove Avenue. I believe I speak from a useful perspective because I was the corporate secretary of Cable Co-Op when it funded the Media Center back in 2000. I was responsible for distribution of the funds. I was not involved in the contract negotiations, but they're relevant here despite what the Auditor may have said. From what I've read in the Auditor's Report, it seems as though the primary issue is whether PEG Funds are allowed to be used for Capital Expenditures. I believe the Auditor erred in Finding 1, that the Audit Report is fundamentally flawed. The Report of the Auditor seems to ignore the realities and make it appear that there is an evil intent on behalf of the Media Center and the money grab by the City to the detriment of the Media Center, its contributors, its users and its viewers. I read the Cable Act. I read the State Franchise Law that superseded the Local Franchise Agreement, and I even found an opinion of the California Attorney General that PEG funds were to support PEG operations. I tried to find the case law the Auditor relied on, and I think I found it. It has no statement that limits the use of PEG funds to Capital Expenditures only. All of the discussions were on what is a Franchise Fee. PEG funds were definitely separately defined. There is no such limitation in the Cable Act on the use of PEG funds for Capital Expenditures. The law merely says that Franchise Fees are not to be used on Capital Expenditures, and that PEG funds could be used for Capital Expenditures. The Auditor evidently has no memory of the history of the Media Center. When Cable Co-Op offered to give the entire cable system and operations to the City in the late 1990s, the City refused, agreeing to subsidize operations instead. If you want now to rewrite that understanding and limit the use of PEG funds, then consider the PEG funds as borrowed from the capital of the Legacy Fund and allow the Media Center from this point forward to begin to reimburse that Legacy Fund. It will take nearly two decades to do so. Otherwise, the City and the Joint Powers may be obligated to find other means to support PEG operations as expected by the Cable Act.

Chair DuBois: Thank you, Ken. Nancy Wheeler to be followed by Stephanie Reuder.

Nancy Wheeler: Hello. I'm an artist and also a volunteer for Silicon Valley Open Studios, a local nonprofit for artists. I produce a show called *Talk Art* at the MidPeninsula Media Center. On *Talk Art* we feature many Palo Alto artists and other artists from the surrounding communities. We aim to connect the community to their local artists and the local artists to their community. We also hope to educate people on the techniques and styles of art that are available and to make this more accessible. This is particularly for people who haven't received an arts education either because they're very young and have not yet received one or because for whatever reason they didn't have the opportunity to get one. I think one of the important things about the Media Center is the combination of broadcast and digital delivery. Broadcast enables people who don't yet know what they're looking for or what it might be called to find this. Once they've found it, then the digital delivery gives them more direct, interactive access. I think the synergy is much more effective than just the one or the other. Many of the artists I work with would not be able to reach out to the community in this way without the Media Center. Both because of the expense of the equipment needed to produce a high quality video, which is really needed for the arts, and also because of the knowledge gap as it's very complex and most artists have concentrated on the arts and may not have the technical understanding to approach it. People need the Media Center to cross these barriers. Thank you.

Chair DuBois: Thank you. Stephanie Reuder to be followed by Paul George.

Stephanie Reuder: Hello. My name is Stephanie Reuder; I am the President of the Board of the Peninsula Peace and Justice Center. I'm going to point out some problems with the Study from the Mackinac Center for Public Policy. In questioning the funding for our MidPen Media Center, the Auditor cites this so-called study from Mackinac. I have read the Study, and I have some post-graduate training in reading and evaluating social science research. This Study may not be the most fraudulent piece of social science research that Mackinac has produced, because they're a notorious source of far-right opinion lightly disguised as social science. Like other Mackinac classics, this Study does not collect and test relevant data and then reach a conclusion. Instead it speculates that community media centers are obsolete, that they lack viewers, that they don't serve their community, etcetera. It concludes that cable companies should no longer be required to pay PEG fees. That is not social science research; that's an opinion. It's not a Study; it's just disguised as one and has no relevance to our Media Center's role and value which so many people have already spoke eloquently about, and more will. I'll just say finally that I did get training as a camera operator for the Peace Center in 1988, then we had to go to De Anza to do that. After our Media Center was created, it was certainly easier to do it up here. I've remained involved in a lot of different ways since, and I look forward to hearing the comments of other people who have been involved with the Media Center. I think it's been a great value to our community. Thank you.

Chair DuBois: Thank you. Paul George to be followed Audrey Daniel. Paul, it looks like you want to speak for five others.

Paul George: Yeah. Can we get a little volume discount here, maybe four minutes total?

Chair DuBois: Sure. Paul's going to speak for Richard Duda [phonetic], Henry Morgan, Glenda Jones and Richard Clark.

Paul George: Thank you. As noted, my name is Paul George. I'm Director of Peninsula Peace and Justice Center. In that capacity, I've been producing and hosting an award-winning monthly program at the Media Center for nearly 20 years now. Just so we're clear, could everybody who's here in support of the Media Center just hold your hand up? I thought as much. Just didn't want you to miss that. You know by now that the Mackinac Center for Public Policy—it was just talked about—and whose Study is cited in this audit as a reason for undermining PEG Access Fees, that Center is largely funded by the Koch brothers, the Dubose family and other radical, right-wing billionaires. This is why the Kochs pour millions of dollars into such think tanks each year. You take a radical, right-wing ideology, you dress it up as social science and fling it into the public policy arena. Voila, the Koch brothers are influencing policy here in the MidPeninsula. I'd like to address that Study and the points brought up in the audit about the worthiness and value of PEG access and the Media Center. Suppose I propose that Palo Alto City Council should be dissolved because nobody watches your meetings on TV; that on its face would be absurd and so are the comments in the audit regarding PEG access. Our monthly program is a community forum with an audience in the studio that participates in the discussion. Usually between 50 to 100 people attend each program. Over 20 years, that comes to about 12,000 people who have used the physical spaces of the Media Center as a kind of community commons. I can honestly say that today the Media Center is an even more valuable community resource than it was 20 years ago when we started our program. That's because of the very technologies that the audit cites as a reason to get rid of PEG access. Let me give you just a couple of quick, recent examples. Our program in December was on the Syrian refugee crisis and featured award-winning foreign correspondent Reese Erlich who reports for National Public Radio (NPR) among other outlets. I have no idea how many watched on TV, and I really don't care. I do know that over 300 people watched on YouTube, another 250 on Facebook. When I posted a short clip from the program to Facebook, yet another 500 people watched that. That's over 1,000 people who saw that program. That's enormous outreach for a small organization like ours. A program on Silicon Valley's housing crisis last October packed the studio, and housing advocates from Mountain View participated on the program live from a Mountain View City Council that was taking place right then on the issue of the housing crisis. They were able to do so because the Media Center has now provided us with Skype, which brings me even more people. A program in January on anti-muslim hatred featured the director of the Council on American-Islamic Relations (CAIR). In addition to the hundreds of views on there, CAIR now uses that video for their own outreach, and many other organizations have just done the same thing. The audit says "the idea that PEG channels offer unique choices to viewers is outdated. Much of the programming and local information is available on the internet." That is just so wrong. The Auditor forgot to think about where that programming comes from. It doesn't just show up out of thin air on YouTube; somebody makes it. It's produced at the MidPen Media Center, using the latest technologies and equipment that simply wouldn't be available to an organization like us otherwise, millions of dollars' worth of the latest equipment. It is produced by the people in this community; that's the real value of the PEG access. Please do not accept this audit in its current state. Please get rid of the Koch brothers and acknowledge the astounding, creative, unique contributions of the people in this community. Thank you.

Chair DuBois: Thank you. Audrey Daniel followed by Phillip Pflager.

Audrey Daniel: I've been a volunteer at the Media Center for five years and producer for two. My show is called *Culture Connect*. It's really to help each other understand our different cultures. On the show, we share messages that are important not only to the local community, but to the national community and international. The Media Center offers a place for anyone of any income level, as the previous speaker said, color, gender, political party, religion, educational background to express their ideas through media by learning how media works. What you do with the content, whether it goes on YouTube, Vimeo, community cable access TV, is not the point. It's learning to create good content that can deliver a powerful message. This is what the Media Center is all about. The MidPen Media Center studio and equipment give people with very little means access to professional tools they couldn't afford. To rent a studio generally, just the studio, is $1,000. You tell me anybody in East Palo Alto that has a spare $1,000 to go into a studio and produce a show. That doesn't include cameras, lights, tripods, other costs that are involved. How do you even use that equipment? You can't learn how to use the equipment if you don't have access to it. So much of what I see happen at the studio is people from all income levels and education that share a learning opportunity and a team working spirit to help each other share our individual messages and release them in the world. The more one can learn how to effectively express themselves in a media whirlwind and understand how to navigate the media outlets and audiences, the more their voice can and will make a difference. Thank you.

Chair DuBois: Thank you. Phillip Pflager.

Phillip Pflager: My name is Phillip Pflager; I'm a retired broadcast engineer. I worked for KGO TV in San Francisco for 22 years, and I received a good wage for doing that. Retired now, I volunteer at the Media Center for free because I believe in the mission of the Media Center. The Media Center provides an opportunity for those who don't have a voice to have a voice. It provides a voice for your constituency. There are six corporations that control 90 percent of the media. While they have a large cable channel system, it's a corporate cable channel. The Media Center provides an alternative that provides views and ideas that are not allowed on corporate TV. I come here today to implore you not to reduce the funding to the Media Center and silence the voice of those who are voiceless and reduce the opportunity for people to prevent alternate views that are not allowed on corporate TV. Thank you.

Chair DuBois: Michael Di Battista followed by Barbara Noparstak.

Michael Di Battista: Hello. I'm Mike Di Battista. I've been a member of the Board since 2005 representing the town of Atherton. I've been the treasurer of the Board since 2008. I appreciate the opportunity to speak to you today. I wanted you to know what steps the Media Center is taking in terms of its accounting principles and policies to avoid any future scrutiny regarding the use of the PEG Fees. First, we have redefined and narrowed the definition of capital in our policy to include only those items that are purchased which exceed a certain dollar amount and have a useful life of one year or more. We believe that that should be an acceptable definition of capital by just about any accounting principle. Second, the Media Center now uses PEG income solely for those capital purchases. The Cable Co-Op Legacy Fund, which was previously used, which we refer to as the Investment Fund, will now be used for noncapital expenses. However, capital purchases are generally a small part of the Media Center operation costs. Limiting PEG Fees solely to capital equipment purchases will have a significant effect of shortening the life of the Investment Fund and, hence, the life of the Media Center or at least the extent of services that it's capable of offering. We have developed a forecast model to predict the life of the Investment Fund. The model predicts that limiting

PEG income to solely the amount of Capital Purchases will reduce the life of the Investment Fund by at least 10 years. There is a solution that we would propose to provide for a long-term sustaining of the Media Center. The Investment Fund was used to purchase capital equipment, the property, the building that the Media Center now owns and operates. We propose that future PEG income which exceeds the amount of capital purchased in a year be applied towards the purchase of those items. Ultimately, that would result appropriately in the Joint Powers Authority (JPA) owning those items, and it would extend the use and the lifetime of the Investment Fund.

Chair DuBois: If you can wrap up please.

Mr. Di Battista: At any rate, we hope that our actions and proposal be taken into consideration. Thank you.

Chair DuBois: Thank you. Barbara followed by Andrew Mellows.

Barbara Noparstak: Good evening. I'm Barbara Noparstak, President of the MidPen Media Center Board of Directors. I'm a volunteer. I do it because I love my community and I value public access. We've earned the best station in the nation award from the National Alliance for Community Media, which represents 3,000 public access stations, three times. What's more important is how we are valued by the community we serve. Last year for our 25th anniversary, we received so many proclamations including one from the City of Palo Alto. There are lots of people here today who are testifying to the value of our Media Center and PEG access, government transparency, inclusivity, social capital including youth self-esteem. I want to address one additional important value head-on, integrity. Everything we do is above board and open to scrutiny. Each of the six JPA member jurisdictions is entitled to representation on the Board. I've represented San Mateo County since 2002. Palo Alto's seat has been vacant since the end of 2014 when Donna Grider retired. The Auditor has blocked nomination of a replacement. I encourage you to direct Staff to nominate someone, someone to share our fiduciary responsibilities, to participate actively in our upcoming strategic planning and community outreach and to link constructively to the City. Let's not fight about the past; let's think about the future. Thank you.

Chair DuBois: Thank you. Just so you know, I’m cutting off speaker cards at this point. Our next speaker is Andrew Mellows followed by Rick Row.

Andrew Mellows: I'm Andrew Mellows; I live at 791 Coastland Drive. In respect to your request, I will say I agree with everything that's been said. I will limit my comments to my own little experience. My wife and I have a small video production business in Palo Alto. We have taken classes in the Media Center as our business becomes more sophisticated, and the instruction was excellent and the cost modest. I help with the sports summer camp program at the Media Center. Children are instructed in the use of the Media Center's production truck. During May this year, East Palo Alto children have been producing live coverage of sports at Palo Alto high schools. It is a unique opportunity for elementary, middle and high school children to work as a team on a project that would normally be far out of their reach. To be clear, the children do the entire production including camera, director, audio, replay, graphics and commentary. Many who have been involved in the Media Center have gone on to study film and media in college and have related careers. I have been able to broadcast Grace Lutheran Church's services on cable for 25 years and recently of course on the internet also, all this with no cost. The audience of shut-ins, people who have moved away and people who are traveling is small, but they really appreciate the facility. As a grateful immigrant, the right to public access is a real gift and one thing I love about America. I value the Media Center enough to volunteer as a Board Member, to maintain and repair equipment without cost and to give a modest annual gift in support of operations. I hope you share my enthusiasm for supporting the Media Center as a worthwhile community resource. Thank you to all of you for your efforts for the people of Palo Alto.

Chair DuBois: Thank you. Rick Row followed by Ben Stetson.

Rick Row: Hi. Thanks for getting my name right the second time. Yes, it is Rick Row. I'm a resident of Palo Alto. I am a graduate of the video production class, and I'm actually in the middle of doing a video for the Tuolumne River Trust and one next week for Acterra as well. I just wanted to say that I found it quite reprehensible that the City Auditor went from talking about financial management to commenting on community values. I just find it very inappropriate for someone who's an employee of the City—sorry, I'm not sure whether she's an employee or contractor—to talk at length with the media and (inaudible) media than TV actually about the social value of a program. I noted on one of her slides under Finding 1 she asked the question if PEG channel's relevant given today's technology. She's already given her answer to that, but that question has nothing to do with Finding 1. I don't know whether they're supposed to be spending this money on Capital Expenditures or not. That question is just another thinly veiled attempt to continue the discussion of social values. I think that's between us and our elected officials. Thank you.

Chair DuBois: Ben Stetson followed by Arlen Comfort.

Ben Stetson: My name's Ben Stetson, and I just want to add my support to all that you've heard and the emails you've received in support of the Media Center. I've attended maybe six live tapings of Paul George's interview show.

I found them extremely worthwhile. Again, I just want to add my support and appreciation for the value the Media Center provides us. Thank you.

Chair DuBois: Thank you. Arlen Comfort followed by Roy Blitzer.

Arlen Comfort: I'm Arlen Comfort from Menlo Park. I'm not part of any staff of the Media Center; I'm a user, I'm a customer or however you call it. I'm very happy with what I see from the Media Center. The other thing I would say is that I'm a cynic about everything that I see that's commercial television, cable, on-air, whatever. I believe when I'm listening to Paul George and his group, which is one of my favorites, if they're not telling the truth, they're trying their hardest to get the right information out to us. They're trustable, I can do that. The other thing I get at home, to bring up something here, is a lot of survey calls. My first question is, when somebody calls for a survey, who's paying for this. If they won't tell me, I won't tell them any information, because I don't know how they'll use it, because I know they'll use it for their own purposes, throw out what they don't want and keep what they do want. My question is, who behind this audit helped pay for it, pay for any the Study, was it just the City or was there other people involved. We need to know that because that's part of how you determine whether this is right or wrong. Thank you.

Chair DuBois: Thank you. Roy Blitzer followed by Steven Gredinger.

Roy J. Blitzer: I'm here both as a supporter of the Media Center and also as a former City employee. I sat on the Human Relations Council or Commission for 9 1/2 years and was also one of their Chairs. I guess my first point is to imply in any way, shape or form that the Media Center was not acting in an integrity mode is really ridiculous. I have never met a greater group of committed, honest and basically high-integrity people. Whatever you're after is certainly a miniscule amount of time and energy for a community service that is very worthwhile. I'm also a producer there that helps young people and old people learn more about their careers, that they will be happy and more satisfied at work. I want you to reiterate that this is a process that may not need to take place. The Media Center is a valuable resource to the community. It is something that you should be proud of and not scrutinizing and questioning. Thank you.

Chair DuBois: Thank you. Steven Gredinger followed by Judy.

Steven Gredinger: Hello. Thank you for taking public comment on this important issue. I would like to reinforce and support the comments of the people who have gone before me. In addition, I'd like to note that in fact there is a studio in the MidPen and that you cannot obtain studio-like quality on your cell phone. One of the things that actually attracted me to the neighborhood of MidPen was the fact that there were opportunities to volunteer and produce the kind of educational programming that is created there. Our children are not going to live in a text-only world. We don't even know the relative importance of text-based and multimedia communication into the future. We should allow them as many opportunities as we can to explore multimedia and to explore the integration of web video and other media. Really from my perspective, the only question worth asking here is how do we drive more utilization of the facility and how do we get more kids and more people interested in exploring opportunities there. Now, we could consider enhancing the facility by soliciting some kind of a public-private partnership maybe, but really I would encourage the Council to think about policy and how to make the Media Center even more vibrant than it already is.

Chair DuBois: Thank you. Judy followed by Elliot Margolies.

Judy Adams: I think I'm the Judy in question, Judy Adams.

Chair DuBois: There's no last name. Judy blue eyes wanted (inaudible).

Judy Adams: I can't speak for the fiscal issues which are complex, but I will add my support to the statement that in an Auditor's Report there should not be an analysis of the social, educational relevance of a service. I can speak as others have for the educational opportunities provided by the Media Center and its predecessor in the '70s, which was down by Fry's where MaxiAids used to be. That's where I first got involved in public access TV for the Peace Center as a Board Member which happily hired Paul George, who's still obviously going strong. I use the Media Center more recently for the Women's International League for Peace and Freedom, which put on an exhibit at Rinconada Library for our centennial from November through January, last November and this January, and then other nearby venues. I made a slide show in the '80s of interviews with women peace activists, and the Media Center helped me edit, bring that together as a video program. Now it's true that was shown on Vimeo, available on Vimeo, but it was shown in the community. I continue to learn skills that I learned in the beginning, in the '70s. It's an invaluable resource, and I encourage the City Council to solve whatever issues there are, keep the programming going. As a community resource, as everyone has said, it's unmatched. Thank you.

Chair DuBois: Thank you. Elliot followed by Henrietta Burroughs.

Elliot Margolies: I'm Elliot Margolies. I was the first Executive Director of the Media Center. We put all the Palo Alto government meetings online. In the first half of 2015, no less than an average of 717 views every month came to the Palo Alto meetings page. That doesn't include those who watch at home live on the government channel. In fact, the City Council meetings are the most long-running series we have. Now inspiring speakers tonight have illuminated the incredible value that they bring. Their viewers find them on the cable channels but also on our web streams, our YouTube channel and on the producers' own websites. These are platforms that the one-sided report quoted by the Auditor doesn't even measure. I want to point out that a significant portion of what the Media Center does have very little to do with the cable channels at all and everything to do with community building. Some examples: violence prevention, media projects with teenagers, community forums on health and legal issues in Spanish, afterschool activities in the Ravenswood District, town meetings that we've set up on local issues, dozens of candidate forums and ballot measure debates on almost—yes, we're doing yours later—every local contested election since 1990, and a growing archive of immigration stories that over 5,000 people a month come to visit, and community events such as author readings done in partnership with the Palo Alto libraries. My last line is that the scope of what we do goes far past what plays on the cable channels. Our staff is passionately involved in community building and dismantling the digital divide. Our work is not television per se, but about building bridges of empathy and empowering people with the tools of engagement and storytelling. Thank you.

Chair DuBois: Thank you. Henrietta Burroughs to be followed by Leif Erickson.

Henrietta Burroughs: I'm Henrietta Burroughs, the founder and editor in chief of the *East Palo Alto Today* newspaper and the host and producer of *Talking with Henrietta*. I am delighted to be here to speak on behalf of the Media Center, but not as delighted as I was in the 1980s when I moved to Palo Alto and found that there was a small group of people who wanted to set up community media in Palo Alto. Why was I so delighted? Because I'm a professional journalist, and I worked in New York City as a print reporter and as a broadcast journalist, even hosting a television show. I worked at Rockefeller Center with some of the broadcasters that you know of. Even at the top of my field in the number one media market, I was not happy with the way news was selected and produced. Here was the chance to meet with a small group of people, which I did, on a regular basis, and was delighted that the Media Center was launched. Since that time, I produce one of the first shows at the Media Center as a Commissioner on the Human Relations Commission (HRC) and five years later started the *East Palo Alto Today* newspaper, the *Talking with Henrietta* show that has been going since 2002. I've interviewed Congressional representatives, State officials, City officials, even some of you, business representatives, community representatives on a variety of critical issues. There is no way that I could have had that opportunity outside of a commercial media network, to present the type of quality shows that receive national, State recognition. No institution or agency is perfect, but the Media Center needs to be commended for the way it has kept to its mission, allowed some of us to keep to our mission. I hope, while you might consider cuts, that they not be the beginning of a thousand cuts that would destroy what we value in this community so much.

Chair DuBois: Thank you, Henrietta. I'm available for interviews all week. Leif Erickson followed by Thomas Atwood.

Leif Erickson: I'm Leif Erickson, Executive Director of Youth Community Service (YCS), and honored to be speaking with Henrietta. YCS, Youth Community Service, also is enjoying a 25-year anniversary this year along with the Media Center. Media Center has been an essential partner for our work of civic engagement and social and emotional learning and community service with young people in our mid-Peninsula communities. Media Center folks have trained and broadcast video messages created by our students with messages that it's okay to ask for help when you're having a bad day. They have broadcast public education programming for our parents and our staff and our young people. One of the particular areas of overlap is our community footprint where we also serve East Palo Alto, Menlo Park, Palo Alto and the surrounding community like the Media Center. We appreciate the way that the Media Center not only promotes communication and information sharing within a city, but also across the freeway, across communities in a way that helps to overcome the extreme inequality of wealth and education. In short, the Media Center is a beloved and essential community institution. I'm puzzled at the findings of this Audit Report. I'll look forward to hearing your resolution. Thank you.

Chair DuBois: Thank you. Thomas Atwood followed by Dorothy Fadiman.

Thomas Atwood: Hi. My name is Thomas Atwood, which I guess makes me an anglicized version of your name, Council Member DuBois. I also find it strange that the Audit included claims about the usefulness of the Media Center to the community. Is this evaluation within the scope of an audit? I'm not an auditor, and I don't know the answer to that question. If it's not, then let's focus on whether the Media Center followed appropriate accounting practices and correct any problems. If it is in scope, let's use more reliable sources than the Mackinac Center to make the evaluation. Last fall, I became a producer in retirement when Peninsula New Economy partnered with the Media Center to record a series of three local cable programs on banking, finance and the economy. We brought Marco Vangelisti, a Fulbright Scholar and economist, to deliver these talks. Marco shared perspectives that are virtually unavailable in mainstream media and probably threatened the Agenda of the Kochs and Waltons of this world. I sure hope the programs didn't attract the attention of the Koch brothers and they just don't want to pay the fees. The City's PEG Fee Audit states that government auditing standards require auditors to be free from external influences that could create the appearance that the Auditor's professional judgment may be compromised. What could be a more biased influence than a brief funded by families whose express goal is to make government small enough to drown in the bathtub? The Koch brothers, the Scaifes, the Waltons, the DeVoses and the Bradleys already own more than 50 percent of Americans combined. The five Walton heirs alone own more than 40 percent of us. The death by a thousand cuts tactics of libertarian think tanks are incremental and patient, but they're unworthy of Palo Alto. In summary, if evaluation of the usefulness of PEG channels or the Media Center is not part of the scope of an audit, let's reject it or at least set aside the section of the Report titled Concerns About Ongoing Usefulness of PEG Channels. Thanks.

Chair DuBois: Thank you. Dorothy Fadiman followed by John Kelley.

Dorothy Fadiman: My name is Dorothy Fadiman. I'm an independent documentary filmmaker. I had five minutes prepared because I didn't know, and I got it down to a minute. After everyone spoke, I got it down to about 45 seconds. I'm always looking for ways to share my completed work. I've been nominated for an Oscar; I have an Emmy. Still I face the same old challenges of how can I share what I've produced. Through the Media Center's broadcasts and my ability to be on their channels and speak about my work, I'm able to reach not only my own community but, once the films are online, they can be seen by millions of people anywhere in the world. Through PEG access, my films are picked up and shown station by station in places which I could never reach myself through DVDs or on foot. I've worked on various shows at the Media Center, both as a producer and on camera. Afterwards, when I thank the volunteer crew, invariably every one of them says something like, "Thank you for giving us this opportunity." What the Media Center does is create a two-way highway between producers and on-air guests and volunteers. All of them make it possible for us to reach audiences. They produce our programs with us and then thank us for the opportunity. They never make us feel that they're doing us a favor. I always feel that they're giving me a gift. Thank you.

Chair DuBois: John Kelley followed by Peter Drekmeier.

John Kelley: Thank you. I'd like to associate myself with the remarks of Ken Allen, with Andrew Mellows, with the gentleman from the Media Center who was talking about how they plan to go forward on a financial basis, and with the woman whose name I can't remember who talked so eloquently about the need to increase funding for the Media Center, not cut it. I would like to add very quickly—I could probably talk for two hours on this subject. I was the President of Cable Co-Op for over a decade. I was a member of its Board of Directors for 19 years. I was the person who lead the franchising effort. I spent a lot of time here in the early '80s trying to win the franchise for Cable Co-Op. I was also the person who negotiated the agreements with MPAC and in the sale. I know this stuff cold, at least as it was originally funded. I can tell you that, from the consumer's perspective, providing support for PEG channels, providing support first for Midpeninsula Access Center (MPAC) and then the Media Center in its creation was fundamental to our franchising effort. It was continually reaffirmed not only by the community and its elected officials, but also by the subscribers themselves. That was part of what the subscribers voted on to dedicate a substantial portion of the proceeds from the sale of Cable Co-Op at the time that we turned the system over to AT&T. The other thing I'd like to say is from Ken's remarks and from what other information I've gleaned from the audit itself, there's at least an open question about the treatment of the Capital Expenditures. I think if you're going to go back and look at things, going back five years, you should really go back and look at the money that went into the building of the—that went from Cable Co-Op to the building and perhaps amortize that over almost 20 years now. I think you would probably end up owing a great deal to the Media Center. Finally I'd like to say that the real challenge, particularly now when the City's looking at constructing a fiber network, is how to provide more and better content that's relevant to this community. I think you should be directing the Staff not to find ways to cut funding for PEG programming, but to increase it, particularly if you're going to build a fiber system here in Palo Alto. Thank you.

Chair DuBois: Thank you. Peter Drekmeier followed by Larry Klein.

Peter Drekmeier: Good afternoon, Chair DuBois and Committee Members. I thank you for your great service to our community. Like others, I just wanted to share the value of the Media Center to me and my community. When we started Bay Area Action on Earth Day 1990, we had a number of projects, and one was a video project. We had a member who was producing public service announcements for Beat the Backup Day, for the Downtown Environmental Action project. He encouraged us to go through the training, so I did it at MPAC. It opened up a new world for me. I produced several documentaries including one on San Francisquito Creek that is now available on the Media Center YouTube channel. We had a program called *Common Ground*, a monthly program, that lasted for several years and had quite a strong following. I used to broadcast the City Council meetings; that was when I learned that it might be fun to serve on Council at some point. I was working with Vince, who's now doing KZSU, so you can imagine it was quite a scene in the broadcast room. Just the broadcasting of debates, of community forums is so important. We had a community forum in the chambers here on December 11, 2014, with the City, the Water District and Stanford, and it was on water reuse. I mention December 11 because that was the biggest storm we've had in the last five years, and here we are talking about the need to reuse water. People were getting texts that you shouldn't drive unless you have to. A lot of people who had signed up worked for Public Works Departments, and they had to be on call. About half the people, about 100 people, didn't show up, but it was videotaped by the Media Center, and they all got to see it. It was really great information. Just last night I realized we had the Tuolumne River film and culture fest at the Menlo-Atherton (MA) Center for Performing Arts. One of the documentaries about the Tuolumne Wild and Scenic Campaign from 1983, I was able to convert it at the Media Center from 3/4 inch to digital. Rick Row, who you heard from earlier, was videotaping that event so other people would be able to see it. Thank you, and thank you for providing the best reality TV on Monday nights. We all appreciate that.

Chair DuBois: Larry Klein followed by Ellen Forbes.

Larry Klein: Good evening, Committee Members. I'm here to urge you to adopt the position of the Media Center as set forth in their March 24th letter to you. Four reasons. First, I would urge you to look at this from the 30,000-foot level. You've heard a great deal of testimony this evening about how valuable the Media Center is to the community. You've heard nothing on the other side. There's nobody here complaining except perhaps the Auditor. No citizen has come down here to criticize anything about the Media Center. You haven't heard anything even from Comcast and AT&T. We've heard nothing that the Federal Government doesn't like the way the accounting has been handled. We've heard nothing from the State. The only person complaining against all these citizens is our Auditor, and that to me is strange. Second, you've heard a lot of about this Capital Expenditure issue versus operating costs. I'm not going to get into that. You've heard some very eloquent speeches, and I want to add that Ken Allen, perhaps out of modesty, did not mention to you that he has been voted one of the distinguished patent lawyers in the world and has 40 years of experience in dealing with statutes like the Cable Act of 1984. There's an easy way to find out who's right on the issue of capital versus operating expenses. You can ask the Federal Communications Commission (FCC) for their opinion. We don't have to have this duel of lawyers. The FCC has the right to issue opinions. Lawyers frequently use things like that to Federal Agencies. The criticism of the PEG channels by the Auditor, I think, is out of bounds, but it's also using the wrong lens. This isn't a question of a cost-benefit analysis or Neilsen ratings or things of that nature. This is a service to the public. I don't think we should look at it in that narrow of a light. Lastly, I would urge you to do no harm. We have a great asset here; don't harm it.

Chair DuBois: Ellen Forbes to be followed Batya Bell de Berenfus.

Ellen Forbes: Good evening. I'm Ellen Forbes, President of the League of Women Voters of Palo Alto. Since you have the League's letter on this subject in your Packet, I will limit my remarks here. As I was sitting here tonight, it occurred to me that all three categories, public, education and government, apply to the League's work. The mission of the League is an informed electorate; therefore, any question that public access to governmental affairs might be pared back deeply concerns the League of Women Voters. The League believes that the democratic government depends on informed and active participation in government. Democratic government also requires that government bodies protect the citizens' right to know by giving adequate notice of proposed actions, holding open meetings and making public records accessible. Most of the City's public meetings are available to the public via the PEG access channels maintained by the Media Center. Should there be limited PEG access channels, the City would be impairing the citizens' right to know. The League of Women Voters of Palo Alto heavily relies on PEG access channels to air its many voter education activities such as City Council candidate forums, presentations of the pros and cons of the ballot measures and many more events. If PEG access channels were not available, the League of Women Voters would lose this valuable means of educating voters and ensuring that our democracy works. Thank you.

Chair DuBois: Thank you. Batya Bell de Berenfus, and then our last speaker will be Beth Charlesworth.

Batya Bell de Berenfus: My name is Batya Bell de Berenfus, and I actually moved to Palo Alto in 2002. I'm a businesswoman, and was told by a political candidate in Menlo Park about the Media Center. One thing that I did want to say is—I wrote a letter to you not knowing if I'd be here—that Capital Expenditures are only as good as the people who steward them that benefit the local communities. The MidPen Media Center is a thoughtful and responsible custodian of these assets, doing a value-added job. The Media Center's operations and cutting-edge equipment is a necessary component to the continuum of informal and entertainment community engagement that is essential to and among other things First Amendment rights, workforce development, community relevance, affordability and access. On one hand, people have mentioned that YouTube is that impulsive, creative mind armchair way of engaging with people. On the other end of the continuum is the Holly Bollywood entertainment industry. The Media Center is conveniently and comfortably nestled in the middle of this continuum with professional supervisors, seasoned and knowledgeable trainers and nationally recognized, award-winning TV and film productions. When we talk about free speech, you already heard from a few people here. Yes, there's public access options throughout Northern California, but the Media Center puts the Mid-Peninsula on the map. It's the only Media Center where East Palo Alto, Palo Alto and Menlo Park issues are regularly addressed in a thoughtful and cohesive way.

Karen mentioned *Making the Call* as an example, and then *Talking with Henrietta* is another example. In terms of workforce—there is workforce development and community relevance that other people have also addressed. What I want to say is please weigh the assumptions of the audit carefully against the merits of the Media Center that offers a unique benefit to the community where there is no other option.

Chair DuBois: Thank you. Beth Charlesworth. I missed one speaker; Annie Folger will be our last speaker.

Beth Charlesworth: Thank you for giving me the opportunity to share a few thoughts with you about the Media Center and about this Audit Report, which I have read. The thing that disturbs me most about the Report is the attitude that the marketplace should be the arbiter of how citizens exercise their First Amendment rights. The Mackinac Center, which is the sponsor of the 2008 Report cited by the Auditor to support her views, is explicit about that in the conclusion section of the Report where it states that the video marketplace will sort out issues such as the value of PEG channels and the funding of media centers. The City Auditor and the Mackinac Report both suggest that PEG media facilities are no longer needed because there are alternatives in the marketplace to the Media Center. It's true that commercial means of self-expression have arisen since the Media Center was founded, such as YouTube and Facebook, but this ignores another vital purpose filled by the Media Center which is teaching citizens to use the technology to communicate as effectively as possible including on YouTube and Facebook and other hosts as well as on local TV channels. Creating a video to promote your small business or nonprofit or school or political views takes more than waving an iPhone and then uploading raw footage to YouTube. The Media Center provides education on getting good quality video, good audio, editing raw footage, promoting the video and getting it out on host services. It provides that education at a cost far below market price. Finally, I question, as another speaker has, why the political attitudes of City officials and employees should have any role in an audit. The residents of Palo Alto, I believe, are entitled to an audit process which is fair, neutral and has no political axe to grind. Thank you.

Chair DuBois: Last speaker, Annie Folger.

Annie Folger: Hi. I'm Annie Folger, the Executive Director of the Community Media Center. Thank you, and thank you especially to all of our amazing speakers here for validating so eloquently our value. In wrapping up, I'd like to briefly summarize for you three major points. First, while we appreciate and support the principle of an independent audit, in our audit response we address why we believe this Report is critically flawed and why it's recommendations ought to be rejected. Rather than spending City Staff time and the public's money on investigating whether PEG access has value, we think it makes more sense for Staff, the Center and other concerned parties to work together for the real mission to inform, inspire and empower people to speak and act on behalf of their communities. Let's focus on the future. The Cable Act of 1984 mandated public access to ensure our communities could express their First Amendment right of free speech on television. Television is a 20th century tool. Our goal is to do our best to see that our 21st century legislators continue to support the need for public discourse in emerging communication technologies. We want to work with the City Staff, with the City's fiber to the home and similar initiatives and be part of solutions that allow local residents active participation in civic affairs. Democracy is not a spectator sport. We challenge ourselves to use our entrepreneurial spirit to invent new, interactive ways to participate in choosing our future. Second, we don't think that PEG fees should be cut or eliminated or that they should flow through each of the JPA cities' individual accounting systems. We disagree with the audit's recommendation and want to put this matter behind us. We recommend that the PEG fees continue to flow to the Media Center, to now be spent only on capital. We will continue to be transparent in our accounting and reporting. In order to preserve free speech, we were set up as an independent agency. It is our responsibility to define Capital Policy and take the liability if we define it wrong. Third and last, our agreement to use PEG Fees only for capital represents a severe change in how we continue to fund our efforts, but we believe we've offered a solution. Mike Di Battista, our treasurer, gave that to you earlier. I would just like to respectfully urge that you direct the City to work with the JPA and with us to finalize the feasibility of this plan that will allow the Media Center to continue to serve our cities. Thank you very much.

Chair DuBois: Thank you. We now shift to the Committee. I was going to suggest that we look at the findings one at a time, but I know Marc Berman needs to leave and participate in public discourse at a candidate debate. Marc, if you want to make a few comments before you leave.

Council Member Berman: Thank you, Chair Tom. I find myself more conflicted than I anticipated when I walked into this meeting. It just dawned on me during all of your public comment that, if the Media Center has less funding, then the things that I say at 11:00 at night, six hours into a Council meeting, won't be preserved for all of eternity. I'm having a tough time—no. In all seriousness, thank you everybody for coming out and telling us how much you value the Media Center as a community asset. I do apologize; I have to run off for something that's going to be taped by the Media Center and played later. I just want to say a couple of quick things. One is—I do want to say that I have full faith in the integrity of our City Auditor and the Auditor's Office. That doesn't mean that we're all—none of us are perfect. Sometimes we might choose sources that aren't great, and sometimes we might make judgments that the rest of us don't agree with. I do have 100 percent faith in the integrity and the independence of our City Auditor's Office. This is something that was funded fully by the City, to just answer another gentleman's question. Clearly not every benefit of an asset can be quantified, and sometimes it shouldn't necessarily be quantified. I think we've heard clearly tonight that you could justify the Media Center through metrics, but there are also a whole lot of other benefits, intangible benefits, that it provides to the community in giving a platform for people to express themselves, to learn new skills, to educate the public. Those are all critically important things for the City of Palo Alto and for the region that the Media Center serves. There are two questions. To me, there really aren't two questions, but clearly there seems to be two questions. One is, is the Media Center a valuable asset to our community. Clearly the answer is unequivocally yes. There are legal questions that I'll leave my colleagues to have to haggle over and hash through. I'm confident that we can do that in a way that doesn't negatively impact the Media Center. I do think it's important that we do it in a way that makes sure that the City is abiding by Federal Law. There's clearly some question amongst lawyers as to what the law states. I also have a lot of faith in our City Attorney who is fantastic. Those are questions that will be debated tonight, and it'll go to Council. I'll be there to participate in that conversation. I apologize that I have to run off now. Thank you all for coming out to let us know what you think and how much you guys value the Media Center. Appreciate it.

Council Member Berman left the meeting at 6:37 P.M.

Chair DuBois: I know we were going to call in an attorney. If my Colleagues agree, I thought we could break this into three parts and talk about the findings on the use of funds and then on the underpayment. The last one was roles and responsibilities of managing the communications program. I think ...

Council Member Kniss: Just some general comments I want to make at some point.

Chair DuBois: We can make general comments and talk about the finding on use of funds. Looks like our Auditor may want to make a comment.

Ms. Richardson: A couple of things I wanted to just address in response to the comments that were made. First of all, the audit did not question the value of the Media Center. We did not look at the value of the Media Center, and we did not question their value or the social aspect of the work that they perform. What we did do was question the value of the PEG channels. Based on the research that we found, the research that supports PEG access channels was all done by people in the industry. As an auditor, we try to be as objective as possible. When it's based on the industry promoting itself, it's more difficult to view it as an objective source. When we looked at the Report from the Mackinaw Center, they did rely on other resources. We also spoke to the author of the paper before we determined that it was appropriate to use, and then we corroborated their comments with our own National Citizens Survey, which is a statistically valid survey, that does ask a question about viewership of government access on TV. Based on those, we felt it was a reliable, appropriate source to use. It was an independent source. The fact that it was funded by the Koch brothers, we don't look at that kind of thing. They get funding from a lot of different sources, and that was just irrelevant to us. We also note that we did not say stop funding the Media Center. What we said was stop providing the PEG Fees automatically, determine if there is a bona fide capital need for the funds, and then put the funds into a reserve account either for the City to use—the City has some identified PEG access needs—or allocate those funds based on actual documented expenses. We also suggested an alternative which is to fund the Media Center through an alternate source that would not be restricted funding. We have not recommended just pulling the funds. We've looked at options. I think the City Manager's Office concurs with us that there is a need to review what the options are and make some decisions based on City needs as well as if there is an option for funding the Media Center in an alternate way. One more thing that I wanted to point out is that the audit is really about the need for accountability. We know that the Media Center has had these funds for a long time. The discussion about backing up, going backwards and retroactively applying those funds all the way back to when they purchased the building, that doesn't make sense because the fee restriction was not in place at the time they purchased the building. That is their big Capital Expense. Since then, the expenses have been limited up until recently when they determined it was time to upgrade their studio to High Definition (HD) quality. Based on that, we do not recommend going backwards. We have not recommended pulling the money back. Our recommendations are looking forward.

Chair DuBois: If we'd like to make some general comments.

Council Member Kniss: I'm (inaudible) whenever you're ready.

Chair DuBois: I'm sorry. One second.

Molly Stump, City Attorney: Chair DuBois, thank you. City Attorney Molly Stump. I just want to introduce myself, because I'm joining you from the Clerk's table today. We are in this beautiful room without modern telecommunications equipment. We have a challenge because the City's outside counsel, specialist counsel on telecommunications issues, Tillman Lay with the law firm of Spiegel and McDiarmid, is in Washington D.C. He is on this cell phone, which is pointed at a microphone. Hopefully if there are technical legal questions, between Mr. Lay and myself we can assist the

Committee today. I just did want to introduce myself and Tim. He is on the phone. We await your questions. Thank you.

Chair DuBois: Tim, if you can hear me, thank you for joining us.

Tillman Lay, Spiegel and McDiarmid: (Inaudible.)

Chair DuBois: Go ahead.

Council Member Kniss: Let me kind of go backwards on this and maybe start from the top. Harriet, I have no question that you certainly went about this in the way that an auditor would go about doing this. That is clear. Questioning your integrity, certainly not. What I would question, though, is how this community operates and what they believe has value. I've been involved with the Media Center for so long—Elliot, I know you're out there somewhere, if you'll wave—that I couldn't remember when I first began. I have done things like be there—Karen Adams is here—for the nights when we've announced who has won the City Council. I have been there to be interviewed by Henrietta—are you still here, Henrietta, or did you—and by Mike Cobb when he used to be the Mayor. I have been involved at that Center over a very long period of time. I think our job tonight is to find a way to keep this functioning. I'm very troubled by this alternate source of funding. I can't hear the need for that. Maybe my colleagues will. It sounds to me as though this—unless it's broken and needs fixing, which I don't hear, I don't think we need to go forward with our tool kit at this point. I'm just not hearing that. I think there must be other ways for us to go about this that will make sense financially. I was particularly interested in John Kelley's comments, because I know John has been involved in this for such a long period of time. He took it way back. The only person we're missing tonight is—where is Bob Moss? I can't believe he's not here, who is extremely involved with this. I was fascinated. Who is the gentleman who spoke about the capital, the PEG funding solely on capital, what would happen to the Investment Fund? What was your name? I'm so sorry.

Mr. Di Battista: Mike Di Battista. I'm the treasurer of the Board.

Council Member Kniss: Thank you. I apologize; I didn't remember your name. We don't need to work this all out in public tonight. That's too complicated, I think, to go through each part of this. I think that if we say to both the Auditor tonight and we say to Molly Stump, our legal counsel, there is a way to work this out financially. We would like you to do that before we come back to the full Council. I think that can be done. Harriet, I'm looking at you. Do you believe that can be done or do you not believe that?

Ms. Richardson: I think there's a legal question here for Molly and Mr. Lay on the phone. The real issue is the Federal Law is what restricts the way the money is spent. The Media Center has not had sufficient capital needs up until this year when they made—last year when they started working on the studio. They had not had sufficient capital needs to offset the amount of revenues they were getting from the PEG fee, which does have a legal restriction. To continue using the PEG fee as a source puts the City at risk. Ultimately it's the City that's liable, not the Media Center, if those funds are misspent. Molly may want to chime in right here.

Ms. Stump: Thank you, Auditor Richardson and Council Member Kniss. We do believe—there is a lot of information in the record this evening about various aspects of the legal arguments, but we believe it's clear; our outside counsel concurs. Essentially through all of the detail, we read the Media Center's response as not objecting to the essential conclusion that on a going-forward basis the PEG Access Fees need to be used for Capital Expenditures. There are lots of policy issues to be explored. I think there are lots of avenues by which that could be accomplished. I'd certainly agree with the sentiment that the City Manager and the Staff and the Media Center and the community folks who are involved with this wonderful institution have a lot of work to do to develop a plan to come into consistent compliance with that, if that's what you meant, Council Member Kniss. We do believe that that ...

Council Member Kniss: As always, Molly, you've put it very well and beautifully. Even though I can't see your mouth which is a little bit (inaudible).

Ms. Stump: It is very odd sitting over here.

Council Member Kniss: I'm just watching one part of your face.

Ms. Richardson: Can I say one more thing to that? I think the City Manager's Office is also committed. Ed Shikada is here. I believe that they're also committed to resolve the issue. We did have a meeting today to discuss it. David Ramberg is also in the audience where he might want to discuss some of the financial aspect from an ASD perspective.

Council Member Kniss: What I'm hearing tonight is this can be resolved. I think that none of us want to look at, at least I don't want to look at this alternate source of funding, which to me would say it comes out of the General Fund or something else like that. It is a puzzle to me that this has gone on—I realize two laws have intervened, but this has gone on for this long without it being questioned by the Federal Government. Am I correct? Are they breathing down our neck? Just yes or no.

Ms. Richardson: No, but they have not—but typically they would not come in and look at that. It would be up to us.

Council Member Kniss: I'm not suggesting we break the law. I'm simply saying I think there's a way that we can work this through. I think that when something has this much value, and you can look at what looks like 40 or 50 people here tonight. I'm not talking about one particular aspect of the Center, but multiple aspects of the Center. I've worked with Leif and his kids with YCS, with—looking around in this room, Judy Gittelsohn who put on her show for a year and a half. This makes a difference. Our job, I think, is to make this continue to operate and to operate, yes, within the letter of the law, but to operate wisely and to operate in such a way that it continues to serve us as a cultural resource in our community and as a terrific place for people to go and learn more about public access and about government.

Vice Mayor Scharff: Thank you all for coming today. I don't think there's any question that the Media Center is a community gem. I think that's—it goes without saying. I think everyone of us up here—I'm going to speak for Tom before he speaks—would support the Media Center. I think that's true for all of Council. I don't think any of you should feel that that's not true. However, with that said, I do think—I've talked to Annie out there. I do think there's no question that we can't continue to use PEG fees for noncapital expenses. I think that's fairly clear. I don't think it's a close call. With all respect to my dear esteemed former Mayor colleague, Larry Klein, I actually think if we asked for an FCC opinion, we would probably get an opinion that hurts the Media Center, and we'd be going down a road that makes things worse, not better. I also agree with all the comments that we need to figure out a way to make this work. I think that's where Council Member Kniss was going. I think what would be useful today too is to have the City Manager's Office go look at issues of how do we make this work, how do we come up with a plan that works for all. We want the Media Center to continue. We want them to offer all of the great programming they offer and all of that. However, we can't violate the law. I don't think we can say we're just going to wink, wink and hope that nothing bad comes. I think that's not a good government and not a good approach. I don't think that works. One of the speakers did talk about the City possibly buying the building; I think that's what they meant by that as opposed to going back and looking at old Capital Expenses. I think what they said is why don't we, the Media Center, sell the City the building and you use the PEG Fees to pay for it over time. If I'm misstating that—I see you guys nodding. I think the City Manager's Office and the Auditor should look at that and the City Attorney and say is that a possibility. What I'd like to see happen is the City Manager's Office come back to us—frankly I think before we go to Council, because I don't think it would be useful to go to Council without more information frankly than what we have today, information of what are the options here. The options are obviously we could say we're not going to give the PEG Funds unless they're for Capital Expenses. We could fund with the General Fund. We could maybe do something creative like that. Maybe there are other options. I don't think we could design it from the dais today; I don't think that's what we should do. What I'd like to see is the City Manager's Office come back, working with the audit, with a City Manager's Report (CMR), saying here are the options. The other thing I do want to say is that I'm not happy with part of what we have which is the quality of the technology in this room. I think the City Attorney said that right there. I think it's obvious. I'm not happy that the fact that we don't use HD when we record the Council meetings and all that, that the technology we have here is poor. I've talked to the Media Center about that. I think they agree with us. I would like to see us invest in that, and I think we should use the PEG fees for that. I personally think it's a waste of time to decide whether or not we should collect the PEG fees. I think we should collect as much of the PEG fees as we could possibly collect because, as far as I can tell, there is a huge unmet need for capital that we need to invest in. We need to use those funds to invest in great capital so we have the most up-to-date technology, and we have the best user experience for the people of Palo Alto. That's the broad things. I also would like, when the City Manager's Office comes back, them to analyze that and say what do we need to have to have the best possible user experience with the highest quality when people watch our City Council meetings, when we record things here and all of that. That's sort of what I'm looking for. I also wanted to say that I appreciate all the volunteer time in the Media Center. I don't think that anyone is saying that anyone at the Media Center did anything wrong or underhanded or anything like that. I think that's really important to say that, because I know you all volunteer. I know sometimes as a Council Member, I've got to say I sort of feel that same way. You volunteer, you stand up. I know you sort of feel a little like wow. I understand that. The Media Center's great. I just think that we need to on an ongoing basis, however, make sure that we do this correctly, so that we don't end up with problems down the road. I think it's important to note that the Media Center is in agreement with that. I don't think it's an issue of whether or not we should go back and say, "Can they use it for these or not?" I think everyone's in agreement including the Media Center that we're not going to use PEG fees for operational expenses. We're going to use them for capital. With that said, then the question is let's move on to make sure that we continue to fund the Media Center in a way and what options we have and how this all works.

Council Member Kniss: Could I do a clarification with the Council Member? I think when I—Greg, I think we're concurring with each other. I think one of the things I'm hearing you say is keep it in policy until our policy is clearer than what we are probably able to come up with tonight.

Vice Mayor Scharff: Let's at least give the Council options as opposed to—let's give (inaudible).

Council Member Kniss: I would totally agree with that. I just wanted to make sure I'd heard it correctly.

Chair DuBois: If I could just make some general comments. First of all, I see a lot of value in just independent audit process. I want to thank the Auditor for completion of the audit. No one mentioned the finding of underpayment, which is another purpose of the audit, which generates more money for both the Media Center and for the General Fund. We want to make sure that our telecommunications providers are meeting their obligations. To me this kind of boils down to the fourth branch of government, a free press. The DIVCA Act has forced a lot of communities to lose their community access because of this issue of operational costs. We're very lucky here that we have the funds from the Cable Co-Op and some flexibility. To me, this is primarily how do we fix the accounting going forward to be compliant. I agree maybe that the concept of channels may be archaic. As several speakers suggested, we need to separate the creation of content from the distribution mechanisms. I would expect that some of these laws—2006, I think it is, they're going to be updated to deal with new media, media on demand, things like interactive media. I can see storytelling and virtual reality. I don't see capital needs ending anytime soon. I think there's a role for PEG fees. Again, it's just making sure that we're tracking and allocating it correctly. I think as a Council we need to make sure we address our fiduciary responsibility. As Marc Berman said, we can do that in a way that doesn't harm the Media Center but protects the City. I think we have the issue of how do we deal with the past fees. I think we can just largely wait and see if anybody comes calling on those. As Liz and Greg have both said, we need to fix the accounting structure going forward. I do think the proposal that we spend PEG fees to purchase the asset of the building is interesting and would like to explore that option and see if Staff comes up with other options in terms of the use of funds. Those are my comments on the First Finding, on the use of funds.

Council Member Kniss: Might we just look at Ed and see? Ed, you've heard what the three of us have said, are you in concurrence with us? Do you have a ...

Ed Shikada, Assistant City Manager: Absolutely. On behalf of Staff, we'd be happy to follow up with the Media Center and identify a go-forward plan in order to ensure the various parameters that the Committee has referenced can be reinforced. Certainly to the extent through your discussion tonight, that helps give us some clear focus areas. Hope the Media Center takes that as well in identifying the primary issues of concern and priorities for the City.

As we try to identify what those options are coming forward, that we're focused in the most productive areas.

Council Member Kniss: If I might. We have many other similar provisions of content and so forth in the Bay Area. We might look at some of the others. You've been in San Jose where they have their own set up. Mountain View has their own station, which I imagine will be televising Marc Berman tonight. We do have some others we can look at and see whether they have run into some similar situations.

Mr. Shikada: We do. I'll say in the interest of full disclosure and keeping the options open, I recognize that some of the options could involve the City self-performing in some measure the services for broadcast and the like. If we're looking at options, we would want to look at the most cost-effective options for the City as an institution. I think we'll proceed accordingly.

Vice Mayor Scharff: That was my intent, that we'd look at full options, that you'd come back with all the difference options, and then it becomes a policy issue of how we proceed. I also think, in terms of the structure, a lot of people seem to conflate in their mind—I believe we pay separately for the broadcast of the City Council.

Ms. Richardson: That's correct.

Vice Mayor Scharff: I think what would be great is to have a framework and a CMR so everyone understands—it's clear in everyone's mind what services we pay for, what services the PEG fees go to, so every understands the structure, and then we move forward based on full information of how all this works.

Chair DuBois: I'd like to add, though, that when we look at those options, one of the goals is really preserving the Operational Budget for the Media Center and to keep the life as long as possible.

Council Member Kniss: I don't want to lose the fact that we value this Media Center so much that our goal is keeping it functional, keeping it relevant, keeping it an exciting place to be. I don't think there's any message at all from this dais tonight saying we wouldn't continue to find that way to fund the Center and for everyone to keep up not only their good work, but apparently their learning. So many of you said tonight you've taken classes or you've learned from someone else, and that has great value.

Chair DuBois: Do we want to break this up and have an actual Motion about the use of funds?

Vice Mayor Scharff: Sure, I'll make the Motion. I'll just make a Motion of what I would like to see, and you can see the same. I would simply like to make a Motion that the City Manager's Office come back to us with options as we discussed today along the lines of what we discussed. I don't need to be more specific; I think they know what (inaudible).

Chair DuBois: Do we have a second?

Council Member Kniss: You have a second.

MOTION: Vice Mayor Scharff moved, seconded by Council Member Kniss that the Policy and Services Committee direct Staff to work with the Mid-Peninsula Media Center and develop options for the Council to consider for a plan going forward that complies with PEG funding restrictions while supporting the Media Center’s public access function, such as:

a) A framework for meeting City communications and public access needs; and

b) Consider approaches used by other agencies; and

c) City purchase the Media Center’s building; and

d) Upgrading City Hall broadcast technology.

Chair DuBois: All in favor. We've got three out of four.

MOTION PASSED: 3-0 Berman absent

Chair DuBois: I would like to shift now to maybe findings on underpayment, because I actually had a few questions in that area. I don't know if either of you have comments or questions.

Vice Mayor Scharff: On underpayment?

Chair DuBois: Yep.

Vice Mayor Scharff: Yeah, let's go get the money. I'd like to get that done as quickly as possible.

Council Member Kniss: I think that one's pretty simple. That one just says ...

Vice Mayor Scharff: Right. I'm all for it.

Chair DuBois: If I could ask a couple of questions particularly with our Attorney; hopefully he can hear me.

Ms. Stump: As it turns out, it is very difficult for him to hear. I know, Chair DuBois, you do have some questions. I got a ...

Chair DuBois: I actually had some different questions.

Ms. Stump: You do have different questions. I wonder if it would be more efficient, if you can get those to me offline, and I can transmit them to our outside counsel. When the Item comes back, we might be able to have a more thorough conversation and even have outside counsel here in the room where it's easier to communicate. I think it's going to be difficult. I will have to translate your question.

Chair DuBois: Okay. I have one question maybe you can answer or Harriet can answer. How does the State DIVCA Law and Federal Cable Act interact with each other? Does one take precedent?

Ms. Stump: In general, Federal Law takes precedence over State Law through the supremacy clause of the U.S. Constitution. There are some complex ways that those two laws work together. The State Law references the Federal Law. I suspect that behind your question is a practical, more specific inquiry.

Chair DuBois: It was just really understanding which law ruled. Again, there seems to be some discussion nationally about media communications in general and this idea of video versus Broadband Franchise Fees. I did note that Google is registered as a video provider, so we potentially would have a third source of income from Video Franchise Fees and PEG fees.

Ms. Stump: These are very cutting-edge questions. I do want to get some specialized advice for you on them. My recommendation, given our challenges today, is that you do what you are so good at which is to write or we can chat, and then we can get answers for you perhaps when the Item comes back to the Committee. Will that be satisfactory?

Chair DuBois: Yes. For my Colleagues, it's just really quickly this idea that video services are now being bundled with voice and broadband. There's a lot of ability to shift pricing to minimize these Franchise Fees. I think there's a question, probably at the State level and the national level, should we be looking at overall revenue for media communications and not just video and where the law has changed to do that. We can take that up in the future. I guess there is really no Motion to be made here. I think we're going to pursue that revenue as you outlined, or do we need to make a Motion?

Council Member Kniss: You need a Motion to go out and get the money?

Ms. Richardson: We don't have a Motion yet about the status of the audit. If you're wanting us to come back later before you refer the audit to the full Council, it might be good to have a Motion right now on that aspect of it.

Vice Mayor Scharff: Are we going to make the Motion?

Chair DuBois: Sure.

Vice Mayor Scharff: I'll move that on Finding 2 we move forward to go ahead and collect the money.

Chair DuBois: I second that.

MOTION: Vice Mayor Scharff moved, seconded by Chair DuBois that the Policy and Services Committee recommend the Council move forward with Finding No. 2 recommendation to direct the City Manager's Office, in coordination with ASD, IT, and the City Attorney's Office:

a) Send a letter to AT&T and Comcast describing the results of the audit and demanding payment of the underpaid franchise and PEG Fees shown in Exhibit 4, plus interest calculated in accordance with DIVCA requirements; and

b) Include in AT&T's letter a demand for payment of the audit costs that are attributable to AT&T; and

c) Work with Comcast and AT&T to develop methods to ensure:

i) Their address databases accurately reflect all potential service addresses within the Cable Joint Powers geographic areas; and

ii) They have a separate billing code for each member jurisdiction and accurately report and remit payments to the City of Palo Alto based on those billing codes; and

iii) Develop criteria for assessing the accuracy of future Comcast and AT&T franchise and PEG Fee payments on an ongoing basis,

iv) Communicate the criteria to Comcast and AT&T and that it will be used to review the accuracy of future payments; and

v) Require Comcast and AT&T to report the breakdown of their fees in more detail, including identifying what is and is not included in the gross revenues used to calculate the fees and the reason for any exclusions; and

vi) Review the franchise and PEG Fee payments to ensure that they were calculated on all revenues that are subject to franchise and PEG Fees and promptly follow up with Comcast and AT&T regarding any discrepancies; and

vii) Request that San Mateo and Santa Clara Counties revise their municipal codes to reflect only a single adopted rate to accommodate the cable companies' billing system capabilities, if the PEG Fee continues to be collected.

Council Member Kniss: It'll be hard to vote no on that one.

Chair DuBois: All in favor.

MOTION PASSED: 3-0 Berman absent

Chair DuBois: The third finding is worth a little bit of discussion as well, which is the role of oversight and really the nature of that oversight. Do you have some comments?

Ms. Richardson: I think there's going to be some decisions that need to be made about—I think it's going to wrap up really into part of the Finding 1 issue about the policy about what functions the City might perform versus what functions we leave at the Media Center. If there's more of an IT role for what the City might do, then I think those roles need to be defined based on the revenue piece of it, which is more of an ASD function, and then the communications piece which would be more of an IT function. Jasmine might want to speak a little bit to that on the IT piece.

Jasmine Frost, Information Technology Chief of Staff: Good evening. Jasmine Frost, IT Chief of Staff. Currently we do fund and manage the coordinator. I defer to whatever the Council wants to say. We'd be happy to take on that responsibility should the Council wish.

Mr. Shikada: Just to amplify on that. As Harriet pointed out, the current staffing for the JPA effectively is through the IT Department. Depending on where the primary body of work ends up with respect to the City's role versus the Media Center, we may want to reevaluate how that staffing is handled in addition to the question of the complexity of the financial transactions that might be involved depending on the providers and the follow-up necessary there. Ultimately, this would be a longer-term conversation; it's a question of the role of PEG in general in our digital communications strategy with the community. Clearly that's one that might dovetail in a number of different directions. I think that we'd want to give some thought as to how best to tackle that based upon where we end up on PEG specifically.

Chair DuBois: Can you just clarify when you guys talk about staffing versus participating on the Board? They seem to be very different. It's not clear to me why that's IT versus communications.

Mr. Shikada: It's actually, I suppose, primarily a legacy of the organization and how responsibilities have been handled originally, I understand, through the City Clerk's Office to ASD. When IT was split off from ASD, the contract administration went to IT.

Chair DuBois: Are we talking about different functions? Is there a Staff ongoing function that's in IT now?

Mr. Shikada: The Staff person who serves on the working group, I guess is the appropriate term, is a contractor through IT.

Mr. Richardson: That is a different position than being a Board Member on the Media Center Board.

Chair DuBois: I think there's that question of both of those levels of interaction, the City has not been represented on the Board, even though I believe in the Charter we're supposed to have a representative. We may want to fill that position.

Ms. Richardson: The delay on that was really trying to identify who should be the right person. Until the roles were clearly defined, it didn't seem appropriate to just draw the City Clerk back into it when the City Clerk isn't actively involved in the process. I think it wraps into part of this decision making about what roles each department plays in the overarching issue of PEG fees, Franchise Fees, provision of services and that sort of thing.

Chair DuBois: I'll make one last comment, and then I'd like to hear what you guys think. I think there's two levels here, which is the financial interactions, but I think there's also this role of communications which it might be nice to continue to involve the City Clerk or somebody maybe in the communications area in the City.

Vice Mayor Scharff: Again, I'd prefer to see the City Manager's Office come back with options. I don't really see a role for the City Clerk's Office in this. It doesn't seem like the right—I'm not sure what the expertise is in the City Clerks' Office frankly, what role they have and why they should be involved. I'm open to it. If you're worried about communications, I actually wonder why Claudia might not be a better choice frankly. There's all sorts of IT issues in that. I just would want the City Manager's Office to analyze and see who should be the representative. What we're looking for and what the point is, I'd just rather they come back and tell us what they think.

Council Member Kniss: I think this is—we're making it surprisingly complicated. What I'm hoping is, Ed, that you and others can work with this and bring it to the fore in such a way that we can have clarity in how we're working together. I'm sorry that it's been empty now since Donna Grider left, but I wouldn't begin to guess who exactly the right person would be.

Vice Mayor Scharff: I think it's Liz Kniss.

Council Member Kniss: I had forgotten her. That might be okay.

Chair DuBois: I support the idea of Staff coming back. Again, I want to distinguish between a Staff role of tracking the finances versus a community communications and outreach role, which either the City Clerk or our Communications Director—again at the level of discussion about just communications out to the community, it's a different area. I'll make a Motion that we roll that into the First Finding and that Staff come back with some proposals on the roles and responsibilities for oversight.

Vice Mayor Scharff: You have a second.

MOTION: Chair DuBois moved, seconded by Vice Mayor Scharff that the Policy and Services Committee direct Staff to return to the Committee with clearly defined roles and responsibilities for oversight of tracking funds and communications.

Chair DuBois: All in favor. That concludes this Item. Thank you everybody for coming out tonight and speaking.

MOTION PASSED: 3-0 Berman absent