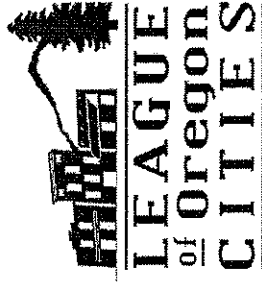


Revenue Restructuring  
Task Force

June 19, 2008



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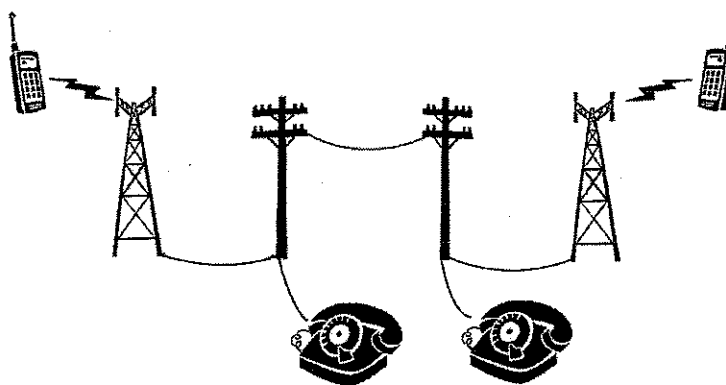
Andrea Fogue, League of Oregon Cities

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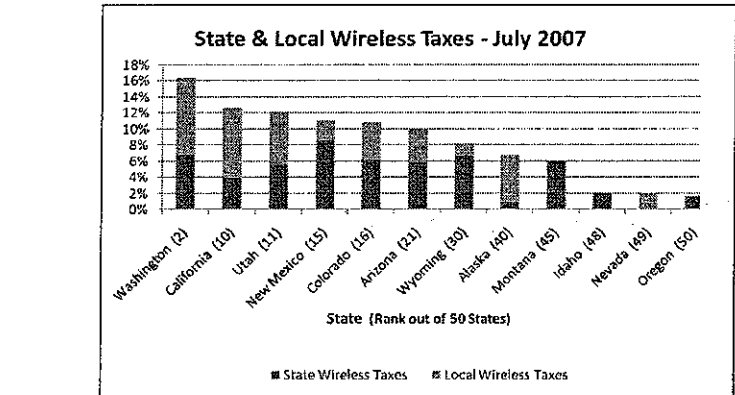
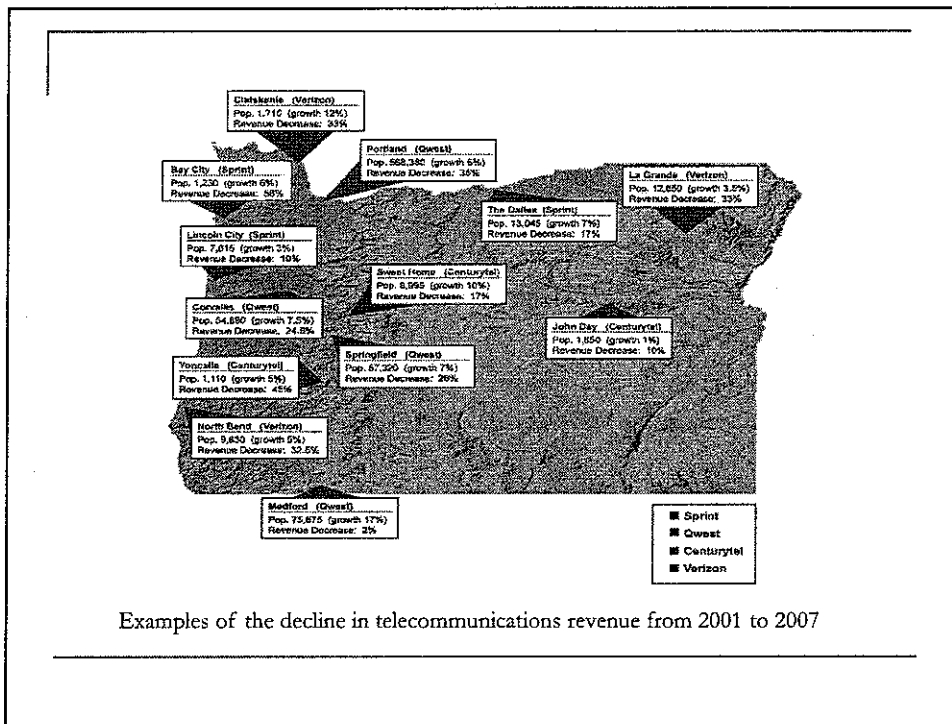
[afogue@orcities.org](mailto:afogue@orcities.org)

## Task Force Findings

- Franchising telecom providers as means for managing the rights-of-way is becoming obsolete
  - Cities are increasingly putting rights-of-way management provisions in city codes
  - Tie to physical presence of facilities in the rights-of-way does not recognize new technologies
  - Revenue should be decoupled from how services are delivered



Delivery methods commonly rely on use of facilities in rights-of-way



Western states: Oregon ranks last among all 50 states in revenue from wireless providers

Next steps

- Education outreach to cities
- Open dialogue with Legislature, industry and key stakeholders

## History of Rights-of-Way Authority in Oregon

For more than a century cities in Oregon have been managing and collecting compensation for the use of the rights-of-way, public assets entrusted to cities. Rights-of-way are lands which have been dedicated to or acquired by a city with public money, to be used for transportation purposes such as roads and sidewalks or installation of public water, sewer and storm drainage lines. This space gives utilities and private companies the opportunity to place their facilities. If the utility had to acquire these rights-of-way separately, it would likely be at great expense.

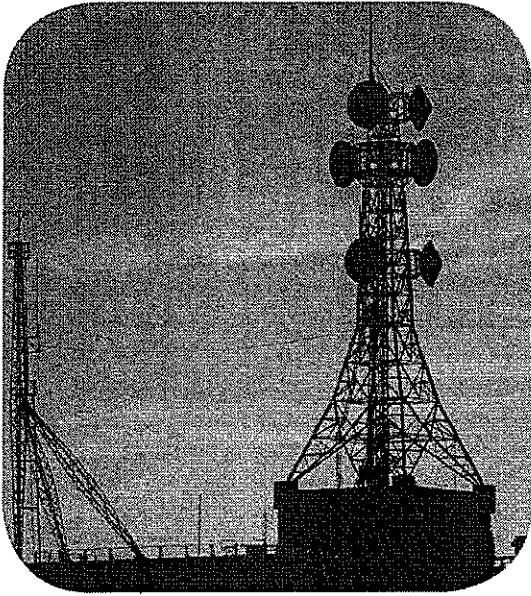
Managing the rights-of-way is a core function of a city, serving to balance the competing needs in the rights-of-way to ensure the safety and welfare of its citizens. The sheer volume of activity in the rights-of-way and competing uses from multiple utilities and companies requires that cities oversee the efficient use of this limited public resource.

One of the most important components to managing the rights-of-way is assuring that it is maintained and operated to fulfill its primary purpose: the movement of people and goods. In addition, the rights-of-way manager must be responsible for assessing administrative costs such as granting and administering permits for facilities and work done in the rights-of-way to install and maintain those facilities, including calculating the amounts necessary to pave and repave streets due to increased street cuts and decreased street life.

Among the facilities permanently placed within the public rights-of-way are water and sewer lines, natural gas pipes, utility poles and power lines, telephone lines, and fiber optic cable. The result is a complex rights-of-way system with numerous users all providing services for the community.

Rights-of-way were obtained through the investment of citizens' taxpayer dollars. As stewards of the rights-of-way, cities have an obligation to collect compensation for private use of this valuable public asset. The ability of cities to collect compensation for private use of the public rights-of-way, generally through franchise agreements and privilege taxes, extends to utilities such as cable, telephone, electric and natural gas.

The Oregon Constitution grants home rule authority to cities—authority which is exercised through city charters and local ordinances, subject to state and federal law limitations. City authority to regulate the use of the public rights-of-way and receive compensation for their use has been consistently and uniformly upheld by the courts. Federal and state law also maintains the ability of cities to control and manage the rights-of-way and to collect a fee for their use. The traditional nexus between placement of facilities in the rights-of-way and compensation for their use remains for utilities such as electric and gas. However, that relationship has fundamentally changed with telecommunications providers. In the future the relationship with those remaining traditional utilities may also be challenged.



# Changing Telecom Environment Prompts LOC Task Force to Explore Solutions

By Andrea Fogue, Senior Intergovernmental Relations Associate

The rapid evolution of technology has led to a profound transformation of the telecommunications industry both in how it operates and how it interacts with local governments. For most of the telecommunications industry, local regulation is limited to access to public rights-of-way and compensation for that access. The franchising of telecommunications providers, as the means by which cities have historically managed the rights-of-way, is becoming obsolete because it has not kept pace with changes in technology. This has led to increasing threats to city rights-of-way, franchise and taxing authority, and a troubling trend of declining telecommunications revenues. If left unaddressed, this trend will likely result in harmful consequences to the level of services and quality of life both citizens and businesses not only expect, but demand.

To address the challenges presented by the rapid evolution of technology, in November of 2007 the League initiated a Telecommunications Task Force comprised of city officials from across the state. The task force was presented with the ambitious task of finding a way to protect city rights-of-way authority and preserve a critical revenue stream. The members were asked to focus on identifying and assessing technical solutions viable for all Oregon communities.

## THE ANALYSIS

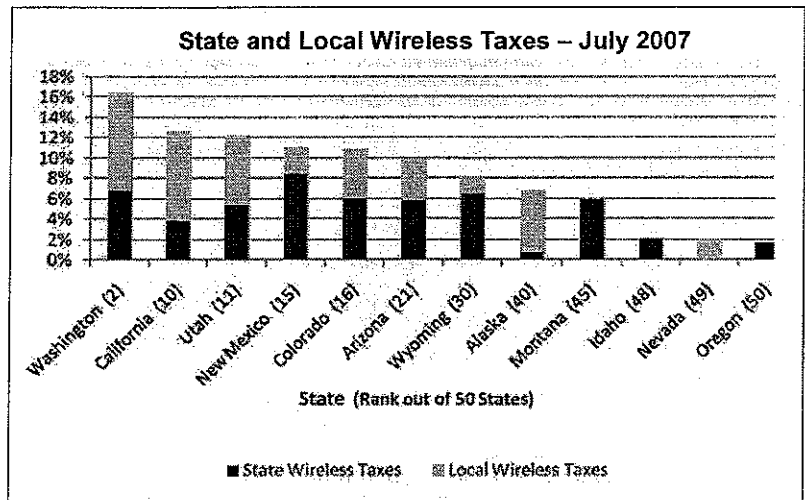
Telecommunications companies, which historically provided only land-line based telephone services, now provide wireless telephone, video services similar to television, and Internet access. Similarly, cable television companies are providing voice and data services. While these services had been managed under separate regulatory frameworks in the past, each company now has the capability to provide all services.

Add to this, one of the most significant changes—the shift from traditional land-line telephone

services to wireless based services. In 2000, there were more telephone land-line based services in Oregon than wireless. By 2007, the numbers had reversed and wireless telephones became the leading communication device. As early as 2010, wireless subscribers could outnumber land-lines 2 to 1.

The predominant system of franchising telecommunications providers in Oregon is tied to the physical presence of facilities in the rights-of-way. It does not recognize new technologies or the significant changes in how facilities in the public rights-of-way are related to the delivery of services. As the customer base shifts from traditional land-line based services that pay a franchise fee or privilege tax, to wireless based services and technologies that can operate without a franchise, compensation for rights-of-way use is decreasing. At the same time, cities are seeing resistance to local franchising regulations and fees from corporate users of the rights-of-way.

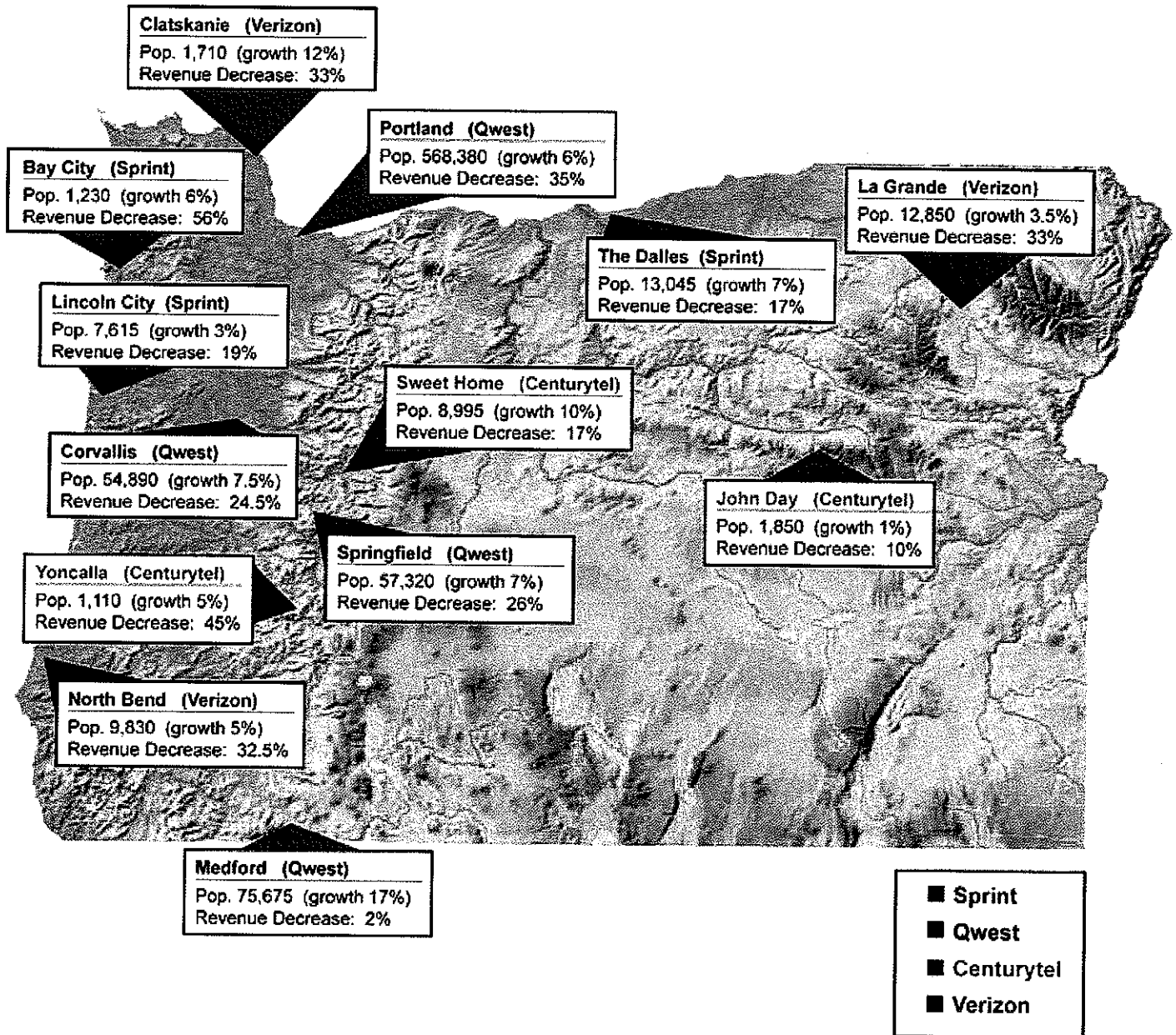
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Oregon ranks last among all 50 states in capturing revenue from wireless providers. Only three Oregon cities—Creswell, Eugene and Oakridge tax wireless providers.

# Map of Decline in Revenue From Incumbent Telecommunications Providers

## Statewide Examples: Franchise Fee and Privilege Tax Revenue Decline from 2001-2007



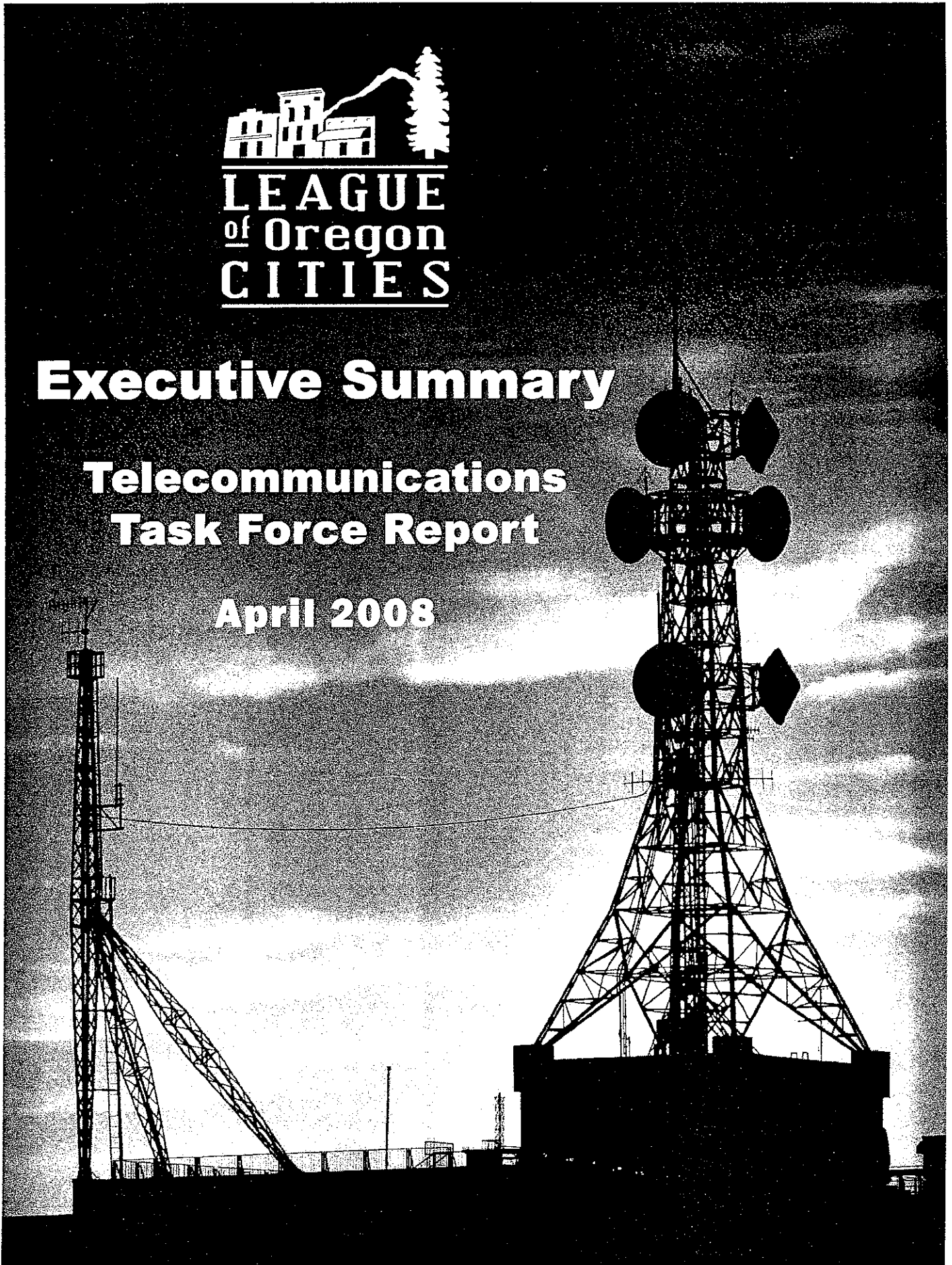
Source: League of Oregon Cities, March 2008. These examples illustrate a statewide trend of the decline in franchise fee and privilege tax revenues.



# **Executive Summary**

## **Telecommunications Task Force Report**

**April 2008**



its bottom line in a developing competitive environment. Technology, however, is changing faster than laws, ultimately leading to an increase in litigation, legislative and regulatory challenges.

The wireline industry has pushed for uniformity among all cities and for wireless providers to be subject to the same fees as wireline providers, while wireless interests oppose any fee that applies to all telecommunications providers regardless of the technology used to deliver the service. Although city home rule authority to manage use of the public rights-of-way and receive compensation for their use has been consistently and uniformly upheld by the courts, the telecommunications industry has used the referendum process to challenge exercises of local authority to move from a franchise based system to a tax system. Even though state statutes confirm this home rule authority granted to cities by the Oregon Constitution, the actions of industry have constrained the ability of cities to implement these choices locally.

The report draws on the technical expertise from cities across Oregon to: identify options for statewide solutions; establish a set of principles from which to evaluate those options; and provide historical context for a recommendation that describes an alternative to the predominant system of franchising telecommunications providers.

An important objective of the task force was to achieve consensus on solutions that cities could stand united to support. It was not the intent of the process that task force members seek the endorsement of the report by their cities. The ensuing consensus recommendation is a product of the combined expertise of the professional staff that comprised the task force membership.

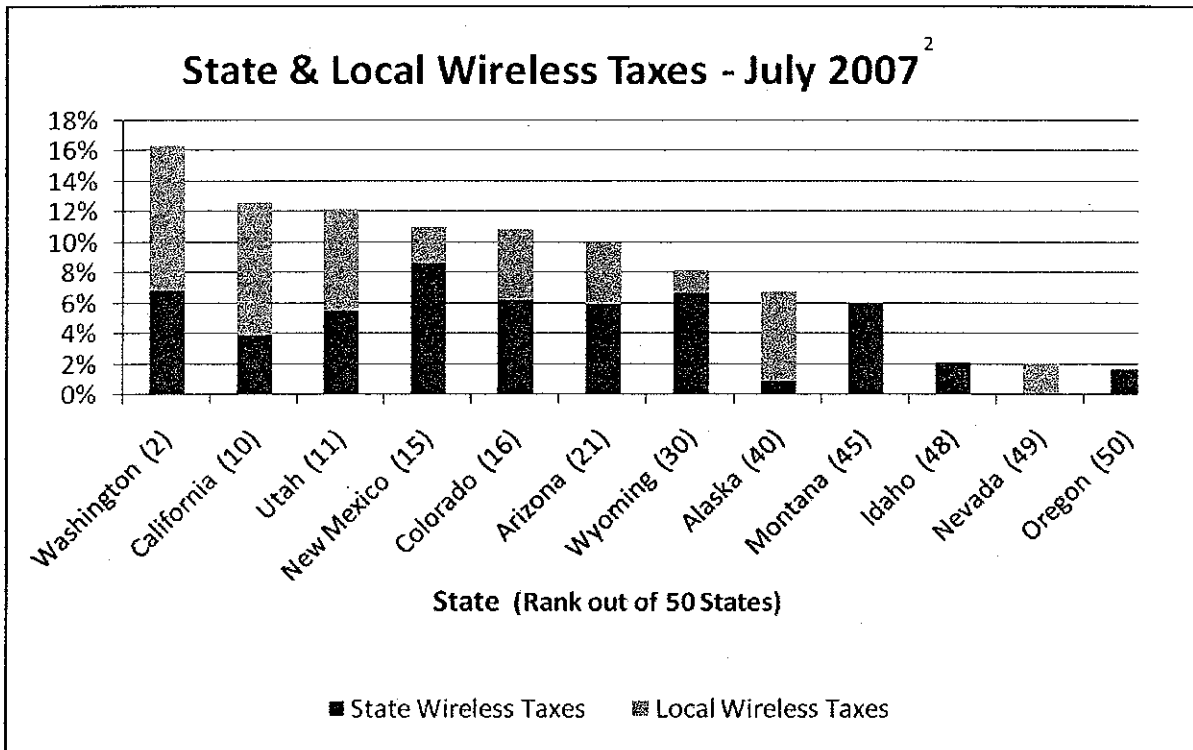
## **Overview of Changes to the Telecommunications Industry**

The telecommunications industry has experienced exponential growth in technology, coupled with fundamental changes to its regulatory structure. Telecommunications companies, which historically provided only land-line based telephone service, now provide wireless telephone, video services similar to television, and Internet access. Similarly, cable television companies are providing voice and data services. Add to the mix the advent of wireless communications such as cell phones and satellite, broadband services, voice over Internet protocol (VoIP), fiber to the premises (FTTP), wireless attachments to utility poles, and even telecommunications services over electricity lines, and the future grows increasingly complex.

The explosion of technological advances has transformed citizens' quality of life and vastly expanded their available choices. Telecommunications services have become integral to their lives, not only in practical applications such as access to 9-1-1 services, but Internet and cable television have become their window to the world. Both citizens and businesses alike expect and demand these services. The ability of cities to ensure that this communications infrastructure exists within their communities is a critical service to citizens—essential to attracting and maintaining businesses to preserve the city's economic vitality.

The graph demonstrates that in 2000, there were more telephone access lines in Oregon than wireless subscribers. By 2007, the numbers had switched and wireless telephones have become more prevalent. From 2000 to 2007, the average growth rate for wireless subscribers was more than 14 percent per year. As the cellular market continues to expand, eventually the growth rate will level off with Oregon's population growth. Wireline, however, will likely continue a trend of decline. As early as 2010, there could be twice as many wireless subscribers as land lines.

The wireless industry is taxed in many states and cities across the country. In Oregon, only three cities—Creswell, Eugene and Oakridge—currently have taxes on wireless services. As illustrated in the following representative sample of Western states, Oregon ranks last among all 50 states in taxing wireless providers:



In addition to the shift in wireless technology, many telecommunications service providers are expanding the range of telecommunications services they provide. This trend, often called “convergence,” has made the old regulatory framework, in which the premise was that a company provided only a single service, obsolete. Convergence, also described as vertical integration, allows for one company to have the capability to provide all services. For example, cable companies now offer telephone, video and data services. They no longer need to rely on traditional telephone connections. The result is that one company can now provide a broad range of services that had formerly been managed under separate regulatory frameworks.

As the customer base shifts from traditional wireline telecommunications services that pay a franchise fee or privilege tax, to wireless based services and growth in technologies that can operate without a franchise, compensation for rights-of-way use is decreasing. Although not all

The six principles identified by the Telecommunications Task Force include:

**1) Preserving Authority to Manage Public Rights-of-Way and to Obtain Compensation for Their Use is Paramount**

- Cities must maintain the authority to manage the use of rights-of-way including location standards, construction standards, local permitting authority, and cost recovery based fees. This authority is separate and distinct from the authority to seek and obtain compensation for use of the rights-of-way.
- Cities must retain the authority to seek and obtain compensation on behalf of taxpayers for the use of the public rights-of-way.
- Compensation should be based on as many of the services offered by telecommunications providers as possible.
- Cities must retain the authority to tax businesses that benefit from the concentration of economic power in cities, including telecommunications providers.

**2) Any Change to the Current Franchising System Should be Industry Focused and Uniformly Applied**

- Changes should be limited to telecommunications providers, defined as broadly as possible.
- Changes should apply to all telecommunications providers.
- Municipal providers of telecommunications services should be included.

**3) The Ability of Cities to Collect Revenues Should Not be Adversely Affected**

- Cities as a whole and individually should not lose revenues.
- Cities should not be provided with windfall revenues, but should be allowed growth.
- A statewide rate should be adopted:
  - Considerations should include a base rate set in statute that allows cities the local option of imposing a higher rate.
  - Cities recognize that telecommunications providers can recover these taxes and fees from their customers to the extent provided by law.
- Any new compensation framework should grandfather the rights of cities that have previously enacted alternative models and should respect their ability to retain and enforce those models.
- A company's gross revenues should be as broadly defined as possible.

## **Analysis and Recommendation for an Alternative Revenue System**

Several options for alternative revenue systems were identified by the Telecommunications Task Force and evaluated in the context of the established principles (see page 5).

The task force reached a consensus that a gross revenues tax system best meets their established principles. Specifically, the gross revenues tax meets principles one, two, four, five and six. It may not meet all of principle three. This analysis acknowledges that there are many variables and it is difficult to ensure that cities both as a whole and individually do not lose or gain. It is critical that any alternative system succeeds in minimizing these differences.

A gross revenues tax provides that management of the rights-of-way would continue under local road authority construction and maintenance standards, as well as the permitting, inspection and fee requirements applicable to all entities desiring access to the public rights-of-way. By decoupling franchise revenue from management of the rights-of-way, a gross revenues tax fulfills the charge given to the task force to “develop viable statewide solutions to preserve and enhance city rights-of-way authority and telecommunications revenues.”

The task force concluded that a statewide uniform gross revenues tax, collected locally on all telecommunications services broadly defined, can preserve the financial health of cities while protecting the fundamental authority of cities to manage the public rights-of-way. It would bring all telecommunications providers into the same tax structure, regardless of how those providers deliver their services. A gross revenues tax system would enable cities to adapt to a changing future by capturing new technologies and allowing for growth as local economies expand. It could also address attempts by industry to constrain the ability of cities to implement choices locally.

While it is improbable that any modifications to the current system could be precisely revenue-neutral for all cities, a new system should not result in any significant loss or gain in revenue for any city. Even presented with this challenge, the task force determined that the continued erosion of revenues requires the consideration of a wholesale transformation of a long established relationship between cities and the telecommunications industry—an industry that has gone through wholesale transformation—and that this relationship must fundamentally change at some time.

The task force recognizes that any change from the existing franchising system would represent a compromise, and that it is unlikely all of the established principles could be met. If cities choose to move from the traditional franchising of telecommunications providers to a gross revenues tax, the new system should be structured within the context of the established principles.