




MEMORANDUM

DATE: August 22, 1996

TO: Mark Crisson, Director of Utilities

FROM: Steve Klein, Light Superintendent 

SUBJECT: Letter from TCI to the Tacoma City Manager Regarding Municipal Ownership of Telecommunication Systems

In 1992, Cedar Falls Utilities began investigating the possibility of installing a broadband communications network throughout the City of Cedar Falls, Iowa. TCI of Northern Iowa, the incumbent cable television provider in the City of Cedar Falls, sent a letter to the Board Chair of Cedar Falls Utilities to help point out all the reasons why the City of Cedar Falls should stay out of the telecommunications business. As the city and utility moved forward with their research, TCI also pursued an aggressive advertising campaign using billboards to convince the community of the drawbacks of municipal telecommunication.

We anticipated a similar response by TCI to the Light Division's investigation of cable services. The letter from TCI to Mr. Corpuz has not changed substantially from their standard campaign letter. It has not been updated to reflect the positive changes wrought by the Telecommunications Act of 1996 (which was signed into law on February 8). It has not been updated to reflect that our exploration of telecommunications is the initiative of a revenue based utility business not a tax funded government. It has not been updated to reflect the fact that if TCI is to upgrade their own system in four years - as repeatedly promised - that they will have to "dig up streets, trench through people's yards and landscaping." It has not even been updated to reflect that what is really being discussed is a telecommunications infrastructure with the ability to deliver multiple advanced telecommunications services provided by many parties not just a cable television system.

Many of the issues TCI raised and the cases they cite become increasingly dated with each passing year, however, some valid issues raised by the letter will be addressed in our business plan as we explore how to best serve the needs of our customers and greater community. TCI has reportedly sent variations of this letter to officials in other communities upon learning that those communities were exploring their telecommunications options.

The attached document is the letter from TCI to Mr. Corpuz with all of the text that is new since the 1992 TCI/Cedar Falls letter italicized so that what new information exists in the letter can be easily identified.

Attachment

Ray Corpuz, Jr.
Tacoma City Manager
747 Market Street, Room 1244
Tacoma, WA 98402

RE: Cable Television Service in the *City of Tacoma*

Dear Mr. *Corpuz*:

The City of *Tacoma* has stated that it is considering owning and operating its own cable television system. Before the City acts, TCI of *Tacoma, Inc.* would like to discuss several important issues which the City of *Tacoma* should carefully consider before embarking on this major business venture.

First and foremost, cable television is a competitive entertainment business offered to customers on a monthly subscription basis. Unlike telephone or other public utility services, it is not considered an essential "public service". Unlike telephone and other public utility service, it is rarely the case that it is taken by most, if not all, of the citizens within your community.

Moreover, cable television is far more than a mere hardware business. It is a service and entertainment business marked by exceptionally high expectations and by changing tastes in what programming should be delivered. It requires skills and resources not typically cultivated by government. Survival in the cable business requires retail and marketing savvy. Given the rapidly changing market environment in which cable television competes, the number and range of these skills are certain to increase in the future.

These simple facts have far-reaching implications concerning the practical and political ability of the City of *Tacoma* to operate such a business over the long haul. The City of *Tacoma's* system would duplicate and compete with TCI of *Tacoma's* existing system, both for present and future subscribers. Available studies, including those commissioned by cities considering municipal ownership, show that such

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"overbuild"¹ systems generally do not work, *prove to be more costly than expected*, and rarely survive for long.

These are complicated legal questions about how the City of *Tacoma* must avoid censorship or political abuse of its system, and how the City of *Tacoma* can compete with the cable industry and regulate it at the same time. *Finally, any consideration the City of Tacoma has given to competing against TCI of Tacoma, Inc. in order to provide better service and rates should have been mooted by federal regulations. In 1992, Congress adopted extensive new regulation of cable television rates, customer service, channels carried, ownership and other matters. Cable Television Consumer Protection and Competition Act of 1992, Pub. Law 102-385, 106 Stat. 1460 (hereinafter "1992 Cable Act"). Under the FCC's implementing rules, local franchising authorities have the right to apply federal rate standards to cable service. Even prior to the 1992 Cable Act, many franchising authorities have had such rate regulatory authority. This is because in 1991 the Federal Communication Commission reregulated rates in many cable systems in the country. In Reexamination of the Effective Competition Standard for the Regulation of Cable Television Basic Service Rates, 6 F.C.C. Rcd. 4545 (1991), the FCC restored rate control to local governments unless six different channels were available off-the-air -- a test which regulated all but a few major metropolitan systems. Thus, both rates and customer service are regulated, and the concerns motivating municipal overbuilds have been mooted.*

Hence, while TCI of Tacoma, Inc. acknowledges the non-exclusive nature of its franchise, and does not shy away from competing with others on a level playing field for its valued customers, after considering the complex questions and issues discussed in this letter, TCI of Tacoma, Inc. is confident the City of Tacoma will agree that cable and other entertainment services are best provided by private enterprise.

I. PRACTICAL PROBLEMS OF A CITY-OWNED CABLE SYSTEM

To fully appreciate the political consequences of a City-owned cable system, you must first understand the practical consequences. The City of *Tacoma* is about to

¹ An overbuild is considered to occur when one cable operator constructs its cable system alongside the existing cable operator's cable system, with the result that residents in the area have the option to subscribe to either cable operators' cable service

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join TCI of *Tacoma, Inc.* in the free-enterprise competitive home-entertainment industry. The City of *Tacoma* must spend millions of tax dollars to build and operate its system. City of *Tacoma* officials may be placing their political futures on the line since they must keep their customers and non-customers happy. They may also be the direct recipient of criticisms from customers and non-customers alike relating to rates, programming, customer service, and the costs associated with owning and operating a cable system. The City of *Tacoma* faces an expensive long-term commitment to continue to ensure quality, state-of-the-art services and facilities. Finally, you must do all of this facing fierce and fast-developing competition, and not just from us, since the entertainment industry in one of the most competitive in the country.

The one fact above all others which must guide your decision is that a cable system is not a public utility, like electricity or water. Cable television is a business. Sophisticated marketing and operations are essential for a modern cable system to survive. As we have already suggested, this fact has far-reaching implications, as the experience of other cities has shown. Many public officials are leery of operating a cable system because they do not wish to be responsible for a non-essential, entertainment oriented service. Cable television is a highly visible target for customer criticism *and the nature of the cable product spurs ongoing consumer inquiries*. It is likely the City of Tacoma will lose significant time and resources responding to customer complaints. It is also unlikely that public officials responsible for building and operating a cable system will bear the full brunt of their dissatisfied customers and non-customers' ire.

*Despite dedicating significant resources to building and operating a cable system, cities that have undertaken such an endeavor have not fared well. A respected cable industry analyst, John Mansell of Paul Kagan Associates, Inc. has noted that no municipally-owned overbuilds make money. Moreover, Mansell says on average, they tend to have fewer channels and are slower to add service than the average cable system.*² It is easy to see that a municipal cable system could prove to be an economic and political albatross.

² K.C. Neel and Bob Diddlebock, "Rate Complaints Prompt Florida Cities to Mull Overbuilds," Cable World, May 3, 1993 at 33.

A. Construction and Maintenance of a Cable System

Start-up costs for cable television are significant. Before the City of Tacoma can give even more of its citizens cable service, it will have to spend millions of tax dollars or otherwise raise capital in a time of clear economic contraction. In most cases where a municipality has undertaken cable operation, capital requirements and operating burdens have far exceeded projections. A few examples illustrate this point.

The City of Paragould, Arkansas turned on its municipality-built system in 1991. The town's 18,500 residents were then required to pay higher taxes two years in a row to pay off the \$3.2 million in bonds issued to fund the project as well as to subsidize the City's cable system. According to the City, it simply did not generate the number of customers it had hoped.³

In Morgantown, North Carolina an election was held by the City paving the way for a municipally-owned cable system. By early 1994, the costs and burdens of operating such a system set in:

Morganton residents are paying more than they think for cable TV, whether they receive the service or not. The Morganton City Council voted in June to subsidize the new cable television system with \$1 million - or 5.7 percent -- of the revenues from the city's electric system. At the same time the city is using Electric Fund dollars to underwrite its cable television system. It has raised city electric rates by more than 9 percent in the past four years. For the average residential electric customers with a monthly bill of \$65.32, the subsidy meant \$3.72 if its goes toward paying for a city-owned cable system which in fiscal year 1992-1993 ran up a deficit of \$600,000. Thus, even Morganton residents who don't subscribe to the city's cable system still help pay for it through their electric bills.

³ Larry Young "Paragould Cable to Drive Taxes Higher Once Again," Arkansas Democrat Gazette, July 31, 1993 at 2D. "Paragould, AR to Lose Millions on Overbuild," Cable TV Regulation, July 30, 1993 at 9.

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Morganton New Herald, January 9, 1994 as reprinted by Thomas P. Southwick.
"Morganton Update," *Cable World*, January 24, 1994 at 16.

Even with the subsidy from electric fund payers, it was reported that Morganton was forced to raise cable rates \$2.00 per month higher than the local private operator and \$3.00 a month more than the City had promised it would charge when the voters approved the municipally-owned system in 1993.

In Michigan, a number of cities have simply wanted out of the cable business. Five exclusive Detroit suburbs decided recently that potholes on asphalt highways are easier to face than those on the information highway. The exclusive towns of Grosse Pointe, Grosse Pointe Park, Grosse Pointe Woods, Grosse Pointe Farms and Harper Woods agreed to sell their 16,600-subscriber system to Comcast Corp. in late 1994. The president of the municipal system said that looming competition plus the increasing complexity of the cable business as it moves into telephone and data-based services prompted municipal officials to reconsider their involvement in the business. The system currently needs a \$7.5 million rebuild, equivalent to about a \$460 per subscriber cost.⁴

In Orangeburg, South Carolina,⁵ the City decided in 1991 that it would overbuild the local operator. A feasibility study performed by Malarkey-Taylor Associates found that the City's plan to spend \$3.7 million to build 160 miles of cable plant was completely inadequate. Instead the City would have to spend upwards of \$10 million a year to build a 300-mile system -- a project that the City would lose from \$8 million to \$10 million a year on for the next 10 years.⁶

Moreover, if the City of Tacoma decides to overbuild the TCI of Tacoma, Inc. it may have to spend even more money than TCI of Tacoma, Inc. has spent. As a "single system" operator, the City of Tacoma will likely be unable to take advantage of any quantity or volume discounts, and thus may be forced to purchase all equipment at top

⁴ John M Higgins, "Michigan Cities Sell Out to Comcast," *Multichannel News*, October 10, 1994 at 41.

⁵ The cable system in Orangeburg was never built. The Supreme Court of South Carolina determined after protracted litigation that the City had not been granted the requisite authority by the legislature under the State's constitution to engage in cable operations. *Sheppard v. City of Orangeburg*, 44 S.E. 2d 601 (1994).

⁶ K.C. Neel and Bob Diddlebock, "Rate Complaints Prompt Florida Cities to Ull Overbuilds," *Cable World*, May 3, 1993 at 1, 33.

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dollar. As a necessary part of providing service to its customers, the City of *Tacoma* will have to dig up streets, trench through people's yards and landscaping and restore them to their original condition. Such construction is a very costly proposition both in dollars and in lost goodwill for the City of *Tacoma's* cable business.

-- It is almost impossible to overbuild a cable system without causing some cuts and outages to others present on the poles and in the trenches. The City of *Tacoma*, as must any other cable operator, will be required to compensate the utilities and incumbent cable operator for cuts and outages to their operations during the construction of this new system. The City of *Tacoma* must bear the costs of restoring service and of keeping the citizens aware of what is happening so that they may expect the problem and know that someone is taking care of it.

In addition, the City of *Tacoma* will likely have to hire outside persons or companies to construct, supervise and/or maintain the cable system since, of course, the City of *Tacoma* is not in the business of constructing or maintaining cable systems. It must ensure that the system is properly built and maintained -- once again, a very costly proposition. Cable systems must be operated in compliance with numerous governmental agencies' rules and regulations. Most significantly, the City of *Tacoma* must stay constantly vigilant of these rules as a failure to comply may result in fines, loss of operating licenses, or a complete forced interruption of service. Cable operators have years of experience meeting regarding such requirements which cannot be easily duplicated overnight by the City of *Tacoma*.

B. Customer Service

Effective customer service is the lifeblood of a cable operator. While City of *Tacoma* officials deal with citizens on a host of problems each and every day, the City of *Tacoma* may not understand the enormity of the job it faces in serving its citizens as cable subscribers. Citizens dealing with government or with utilities resign themselves to the fact that there is only one agency or company to deal with, and that they must accept the service they get. Cable customers, in contrast, are a tougher group to satisfy. They are paying for entertainment and information and demand performance. If they are not satisfied, they can do to competitor, *such as direct broadcast satellite (DBS) services or multi-point multi-districts (MMDS) services*, use their VCR or watch broadcast TV. One brief outage or fuzzy picture often triggers complaints and require a service call. In addition, cable customers have a choice of service levels, and are constantly adding or subtracting services, resulting in service calls. It is extremely expensive to maintain the full-time customer service representatives and repair people necessary to keep customers

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satisfied. *[For example, TCI of Tacoma, Inc. has at least 102 people doing a variety of jobs including installing, fixing trouble calls, and responding to customer service complaints.]*

Again, our experience shows what the City of Tacoma may expect. TCI of Tacoma, Inc. constantly receives telephone calls from customers concerning everything from programming questions, to cable connections and disconnections, to change of service, to questions rates, to of course, service problems.

Additionally, it is reasonable to assume that City of Tacoma staff also have numerous other responsibilities that may compete with the time they may devote to cable problems and complaints. This could result in unhappy subscribers who may decide that the grass was greener on the other side, and return to the competing, private cable system or to other competitors, such as DBS or MMDS. DBS providers now can offer customers virtually identical programming service as those offered by the cable operator -- and do so at a very competitive price. To prevent this loss, the City of Tacoma may have to incur the expense of hiring additional employees who devote their time solely to cable, or of retaining an independent company to handle customer service.

C. Marketing

If the service is the sustaining lifeblood, marketing is the food which fuels the growth of the system. A cable system must attract customers and take step to retain existing ones, and can only do so through aggressive marketing -- especially when faced with head-to-head competition from various sources. The City of Tacoma may not be aware of how costly these marketing efforts are since it does not have to market its governmental or utility services, as they are necessities which people must use.

The City of Tacoma, moreover, may have to spend substantially more than TCI of Tacoma, Inc. for marketing. The City of Tacoma will have the added burden of attracting customers away from TCI of Tacoma, Inc. and overcoming the loss of goodwill caused by its disruption of streets and yards during construction. Finally, the City of Tacoma's (and TCI of Tacoma, Inc.'s) advertising and marketing expenses in an environment of direct cable competition may likely be higher than what TCI of Tacoma, Inc. has been spending thus far.

D. Programming

The City of *Tacoma*, like all cable operators, must purchase much of the programming which is most desirable to its customers. A single municipally owned system may not be able to obtain the volume based discounts for premium and satellite services which multiple system operators such as *TCI of Tacoma, Inc.* enjoy. *Any such higher operating costs* may turn the tables against the economic viability of a municipal cable system.

E. Competition

The City of *Tacoma* may think that it will only be competing with *TCI of Tacoma, Inc.*, but rest assured this is not the case. One reason *TCI of Tacoma, Inc.* presently spends so much for marketing and customer service even without direct cable competition is that cable television is only one part of the consumer-entertainment industry. Cable television vigorously competes on a daily basis with over-the-air broadcast television, *DBS* low power television, subscription television, satellite master antenna television, *MMDS*, video cassette recorders, videodisc players, newspapers, radio and theaters for the consumers' entertainment dollars. The reality is sobering. According to one source, only 66% of all households in the United States that are able to receive cable television do indeed subscribe to cable service. [*TCI of Tacoma, Inc.*'s present average in the City of *Tacoma* is 60% of the households which *TCI of Tacoma, Inc.* has passed with its cable system.] Our penetrations range from 45% to 100% in varying economic and demographic areas of the City. The City of *Tacoma* is, of course, aware that telephone companies have been given authority by the courts to enter the cable business, which not only would add another competitor to the list, but a competitor that already has *equipment placed throughout the City and already has a "business relationship"* with every resident already receiving telephone service. *Thus, the City of Tacoma will not only need to compete with TCI of Tacoma, Inc. for the residents' entertainment dollars, but also will have to compete with other providers of home entertainment. Given the large number of likely competitors, the City of Tacoma may face not only greater costs to increase the attractiveness of its service to potential subscribers, but also lower revenues as it is forced to reduce prices to meet competitors' offerings.*

Finally, no other City-operated service must compete with the scope and variety of businesses we have described. The City of *Tacoma* may not appreciate the costs and risks of such competition since the City of *Tacoma*'s traditional services, such as public utilities that, because of their status as utilities, do not compete, can raise rates to make up for inefficiency, and do not face the prospect of economic failure. A cable system will have no such luxury.

II. POLITICAL CONSIDERATIONS

A city-owned and operated cable system will be a political adventure as well as a commercial venture. The City of *Tacoma* will face not only the commercial pressure of surviving in the marketplace, but the political pressure of justifying the use of millions of tax dollars or other generated capital of such a risky venture. This pressure will be enormous and will be a constant distraction of City of *Tacoma* officials. If the City of *Tacoma's* system fails, the public outcry will be deafening. In addition to this obvious political risk, there are several less evident risks.

A. A Cable System Would Be Financed By all For the Benefit of a Few At the Expense of Public Services

In this time of economic retraction, there may be only one realistic way for a municipality to finance a cable system: tax increases, the most politically unpopular act government can do. The citizens are quite naturally going to wonder where these tax dollars are going. *We have already pointed out that only 60% of homes who have access to cable actually subscribe.* Even if the City of *Tacoma* succeeds in obtaining customers equal to half of *TCI of Tacoma, Inc.'s* existing subscribers (which may be an extremely optimistic view), the fact remains that millions of tax dollars will have gone to give a small portion of City of *Tacoma* residents a luxury entertainment service. In these days of rising crime, increasing economic hardship and decreasing social services, the citizens may well question, raucously, use of tax money for cable service already available. Assurances that the system will be self-supporting or even profitable may not be enough to quell the criticism. The simple fact is that "break even", let alone profitability, is years down the road, and, as studies have shown in an overbuild system, may never come.

Of course, for these years of losses, the City of *Tacoma* will have no subsidize the system with tax dollars. One observer has noted that in the few examples of municipal ownership available, the inability of the municipal system to turn a profit led to a decrease in other city services in order to cover the losses of the cable system.

B. Tougher Restraints to Follow

One "political" consequence which may be unexpected is the fact that, simply because the City of *Tacoma* is a governmental body, it must operate under restraints which do not bind private businesses. The City of *Tacoma* must comply with civil service employment requirements, government contracting procedures and other bureaucratic

programs. Thus, the City of *Tacoma* may take longer and possibly spend more money to build and operate a cable system as a result of the various bidding processes and public hearings required. In addition, the City of *Tacoma* may face civil service statutes or other legal obstacles not faced by private enterprise when terminating, counseling, or disciplining unproductive employees. All of these considerations may make for good government, but may not be good business practices. In a service-oriented, competitive business, these restraints may stop the City of *Tacoma*'s cable system from effectively reacting to changing competitive conditions.

C. Is Running a Media Enterprise a Proper Role of Government?

Cable systems are, after all, media enterprises. They deliver electronic information and entertainment, which is quite a different business from utility service. The First Amendment made a very deliberate choice to keep government out of controlling the media. When Congress established broadcasting, it carefully placed ownership of broadcasting facilities in private hands, subject to FCC licensing. PBS is government owned, but it usually occupies no more than one channel per region. Cable has followed the same model, with ownership of media left in private hands (subject to municipal franchising) and typically, one channel provided for government access. These separations between government and media were established to ensure active criticism of government actions by the media. Against such a tradition, local citizens may question whether they really want to turn over control of their cable channels to the City of Tacoma. With limited channel capacity, will the City of Tacoma feel comfortable choosing between a Hispanic channel like Galavision, Black Entertainment Television, Asian American Satellite TV, the Playboy Channel and the Family & Values Channel? Is the City of Tacoma willing to withstand the pressure of protests from a minority of subscribers over programming that the majority of subscribers enjoy? The First Amendment counsels that the risks of such inevitable abuses must be minimized by keeping media in private hands.⁷ Not only must an operator make programming decisions in choosing among the plethora of optional satellite services -- the operator must also provide fill-in substitute programming for syndicated exclusivity "blackout" periods on many broadcast signals; and provide local origination programming. Governmental control of the sole source of programming to a subscribing home is

⁷ Recently, New York City made the decision to divest its municipally owned radio stations. The Mayor stated that the sale enabled the City to shed "the distorted role" that government plays when it acts as a media owner, saying that [b]roadcasting is not at the core of the business of city government. Cities don't belong and don't do well in the broadcasting business. It fits a different form of government than a democratic one." Donna Petrozzello, "New York City to Sell WNYC-AM-FM," Broadcasting and Cable, March 27, 1995 at 48.

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contrary to the nation's tradition of free speech.

Moreover, a cable television system's decision to carry and not carry certain signals may increasingly subject the system to litigation. Residents in New York and elsewhere have successfully sued a cable television system for failure to carry all of the desired pay services. Carriage of adult programming has caused citizens to file obscenity charges against the cable system. As competing shopping channels, music channels, new channels, and other channels develop, operators, including the City of Tacoma, can anticipate charges to be filed when one is selected over another.

A separate question arises with respect to what the City of Tacoma can contribute to the viability of the cable industry whose core product is discretionary. Over the last few years, there has been a 70% increase in investment by cable television operators into new programming sources. Many satellite services which were on the verge of failure or which could not obtain the necessary capital have survived through infusions of cash by cable operators. The wealth of satellite programming today is a product of this "free enterprise" system. A municipal cable system is comparable to municipal competition with other private enterprises such as theaters, supermarkets, or newspapers. We would question whether the government should extend its control of streets or electrical utility services into competition with discretionary services such as cable television that need a constant infusion of creativity and cash to survive.

III. EXPERIENCE SHOWS THAT OVERBUILDS DO NOT ENDURE

So far we have only discussed the problems, costs and risks to the City of *Tacoma* in the "ideal world" where the systems are equally competing head-to-head for subscribers. In reality, however, the City of *Tacoma* is going to overbuild *TCI of Tacoma, Inc.*'s system and then try to take away customers who have been committed to *TCI of Tacoma, Inc.* for years as well as encourage new customers from those that historically may have chosen to not take cable service. While competition, of course, is generally necessary in our economic system, studies have shown that cable competition through overbuilds is typically a costly failure for both the overbuild system and for customers.

The City of *Tacoma* does not have to take just our word for it. One observer has noted:

Analysts have reached the general consensus that unless a market

has a high housing density -- at least 90 to 120 homes per mile -- and high penetration, it cannot sustain two competing cable systems. The capital costs of erecting duplicate plants simply cannot be recovered if the pie is split in half. There may be temporary rate wars, but several analyst -- including Touche Ross, Booz Allen and Malarkey-Taylor -- have reported how the technical quality of plant suffers, how maintenance is neglected and how programming funds are diverted to the war as operating revenues dry up.⁸

In another instance -- Jefferson City, Missouri -- the city appointed a task force to find ways to increase competition. Instead, the task force found that "[d]ue to the small market size of Jefferson City, the size of TCI (the current franchise holder), and the capital investment required, it is unlikely that a purely private enterprise will choose to risk its dollars and assets in head to head competition in Jefferson City."⁹ The task force also found that "[t]he cost to overbuild the system is as great as to build the system originally," which was estimated to be "\$2 million dollars."¹⁰ Finally, the task force reported that two cable operators were interested in the city; however, "[n]either operator expressed interest in competing with TCI on a head-to-head city-wide basis. When informed of franchise requirements¹¹ for city-wide plans, both operators withdrew their expression of interest."¹²

A. Historically Overbuilds Have Not Succeeded

Studies show that overbuilds do not endure, make financial stability of the companies questionable, restrict service expansion and system improvements and do not

⁸ Glist, Exploring the Hidden Costs of Overbuilds, Cable T.V. and News Media, Vol VI, Number 11 (Jan., 1989).

⁹ Report of Cable TV Task Force, City of Jefferson City, Missouri ("Task Force Report"), December 5, 1990, at 1.

¹⁰ Id. at 4.

¹¹ In accordance with [Florida] statutory requirements, any second operator, even a City-owned system, would have to obtain a franchise which is not less burdensome or more favorable than the franchise that Operator received from the City. [See Section 166.046(2) (a)-(h) Florida Statutes].

¹² Id. at 6.

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foster different programming offerings.¹³

One consultant on overbuilds has stated that the history of overbuilding shows that generally only one company survives an overbuild.¹⁴ In fact, the existence of "only a handful of over 7,000 cable systems in the U.S." shows that there is "little if any economic incentive for a cable operator to consider an overbuild seriously."¹⁵ The economic drain on both operators in an overbuild may cause them to reduce construction and expansion of their system, causing their long term service to suffer. In fact, applying that observation to the situation in the county at the time, TMC found that permitting overbuilds would slow-down current construction efforts in which the incumbent operator was engaged.¹⁶ Furthermore, as one analyst has written:

It is generally assumed that cutthroat competition results in both companies operating at a loss because of low prices. Soon, one or both companies are not able to sustain the loss, so attempts are made to reduce expenses by cutting back on system maintenance, subscriber services, etc. Eventually, the strongest company dominates and seeks to purchase the weaker company. Then, according to the scenario, the remaining company [raises its rates].¹⁷

Thus, even though the City of *Tacoma* may hope its overbuild will bring the benefits of competition, studies suggest that it more likely will bring a failed system, a damaged incumbent, and higher rates to make up for the harm.

¹³ See Touche Ross and Co., "Financial Analysis of Potential Additional Cable Television Franchise Awards" for the Sacramento Metropolitan Cable Television Commission, July 30, 1986; Touche Ross & Co., "Financial Economic Analysis of the Cable Television Permit Policy of the City and County of Denver," December 23, 1983, plus the other reports referred to herein.

¹⁴ Telecommunications Management Corporation Report on Overlapping Cable Television Franchises and Overbuilding of Cable System to Hillsborough County, Florida ("TMC Report"), at 53. "The long-term impact of an overbuild depends, therefore, as to whether the overbuilt areas can be self-sufficient or even profitable on its own, or must be subsidized. If the latter, and if the subsidy is large, the overbuild generally will be unstable, with the weakest operator eventually bought out or driven out." *Id.* at 110 (emphasis in original).

¹⁵ *Id.* at 93.

¹⁶ *Id.* at 50.

¹⁷ John Mansel of Paul Kagan and Associates.

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Before the City of *Tacoma* takes such a risk, it must carefully examine whether its proposed system has any realistic chance of success.

B. Financial Feasibility

The City of *Tacoma* must begin by not only studying the present situation, but also by getting financial projections concerning all aspects of future cable operations. If the City of *Tacoma* does not have in-house cable experts and economists to do these projections, it will have to hire them, as do many private cable companies.

One analyst who has done many feasibility studies for cities considering going into the cable television business has cautioned against such a venture, stating that "no cable investment is without risk. In an overbuild situation, there is less certainty, for a variety of reasons, over expected cash flows which are largely driven by overall subscriber levels and service rates."¹⁸ Feasibility studies or financial projections must be extremely detailed and account for all possible variables. They must also contain enough specific information to let you understand the proposed operation. The assumptions and projection techniques used must make sense in the context of cable operations. Finally, projections may be worthless unless they are based on realistic information and an assessment of whether the City of *Tacoma* has the ability to carry out the plans on which the projections are based. For example, one critique of a feasibility study done by Rice Associates for the City of Cambridge, Massachusetts, Communication Strategies Incorporated found that "[s]everal capital expenditure items have been understated or omitted," which amounted to an underestimated capital expenditure of several million dollars.¹⁹

Additionally, the City of *Tacoma* must consider the economic outlook for the coming years. Presently, as we all are well aware, the economic condition in this country is not very good. In hard times, luxuries such as entertainment may be the first to go. Moreover, considering the problems that Savings and Loans and other banks are experiencing, such institutions may not be very anxious to lend such substantial amounts of money for the construction and the other start-up costs of a risky venture such as a second cable television system. Thus, the City of *Tacoma* may not be able to obtain such

¹⁸ Cable Television Feasibility Study for the City of Tallahassee, Florida, Rice Associates, December 31, 1987, at II-18.

¹⁹ MUNICIPAL OWNERSHIP OF CABLE TELEVISION IN CAMBRIDGE, How Much Will It Cost And How Will It Operate? ("Cambridge Report") Communication Strategies Incorporated, Executive Summary, February, 1893, at 22.

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financing without securing it with tax increases or bonds.

C. Capacity and Disruption in Rights-of-Way and Private Property

The City of *Tacoma* must carefully study the use and capacity of easements and rights-of-way in the City. The City of *Tacoma* must address how the additional installation of cables and construction of the City-owned system will affect the utilities -- electric, telephone and water companies -- serving the City of *Tacoma*. The City of *Tacoma* will need information from the utilities concerning capacity on existing poles, projected uses of poles, whether poles would have to be changed, cost of such change, use of underground easements and the capacity of such easements. Finally, the City of *Tacoma* should determine how much of its proposed system will be installed underground since such installation is not only much more costly, see Rice reports, but also causes the greatest disruption to public and private property.

The potential disruption makes it imperative that the City of Tacoma conduct such an overbuild study²⁰ prior to deciding to go forward with the construction of a second system. One consultant has stated that cable television is a disruptive force at installation and causes inconvenience to the County's citizens.²¹ The disruptive impact in an overbuild cannot be minimized. "Because overbuilds represent a more dense and complex use of rights-of-way and may require new digging in areas dug up previously they are likely to cause somewhat more disruption than a 'new build'."²² For example, in its report to Dade County, Florida, Touche Ross reported that to install cable underground, the second operator would have to lift and replace sidewalks, acquire new easements from private owners, retrench and repair the road service, or in some instances, build on the opposite side of the road of the present operator. Touche Ross found the following possible additional disruptions:

In both aerial and underground construction (assuming

²⁰ For example, when Hillsborough County, Florida, was considering granting additional cable television franchises which would have resulted in an overbuild situation, the County hired Telecommunications Management Corporation ("TMC") as its consultant to advise the County on whether to grant such additional franchises and to review the applications submitted by those seeking the franchises.

²¹ TMC Report ("TMC Report"), at 97, 121.

²² TMC Report at 123.

coexistence in the right-of-way or easements) the additional CATV cable is to be placed close to the existing CATV cable, thereby leaving it vulnerable to be damaged or cut.

The similarities between the physical properties of the existing CATV plant and the new CATV plant may cause confusion to the cable construction crews unless the two systems are marked correctly.²³

The City of *Tacoma* has a duty to insure that its citizens do not needlessly bear this inconvenience. If the City of *Tacoma* did not have a cable operator already providing service, but was about to seek an initial installation, the competing duty to provide cable service might override the interest in avoiding disruption. This is not the case, however, because the City of *Tacoma* already has a cable operator whose franchise insures that all of the City's residents have cable service available to them.

Not only must the City of Tacoma be concerned with physical disruption during an overbuild, it must also be wary of exhausting the utilities' capacity for accommodating additional cable television systems. One county was cautioned to avoid exhausting this capacity in order that the capacity will be available for future use.²⁴ In addition, it was reported to the county that to install just one additional cable system, at least 50% of all of the poles in the county would have to be changed.²⁵ The Jefferson City task force made a similar observation when it found that "[t]he ability to attach additional wire to the poles [within Jefferson City] is limited by regulation on spacing. If a pole is not available, the cost to place a taller pole at the same location is approximately \$500.00 per pole. Given the number of poles that are at capacity, this would be significant cost to the new competitor.²⁶

D. Other Problems

In addition to the disruption discussed above, Touche Ross reported to Dade County that there are day-to-day operation problems with second cable system,

²³ Touch Ross Report to Dade County, Florida at 19.

²⁴ TMC Report at 121.

²⁵ Id at 51.

²⁶ Task Force Report at 4.

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including:

Customer confusion -- Not knowing whom to call for installation and trying to understand the rate and tiering structures of two different companies can be difficult for some new subscribers.

Drops and Installations -- . . . The entire subscriber tap to back-of-set is subject to incorrect hook-ups, theft of facilities, etc., and therefore can be a source of customer confusion and frustration.

Service -- Customers not familiar with the cable TV provider can call the wrong cable company for service. If it is caught before a truck is dispatched, the inconvenience is that of the clerk's time and the phone traffic. However, if the truck is dispatched, the customer is inconvenienced as they wait for a repairman that is not authorized to work on their system and then wait further for the proper repairman to arrive.²⁷

Other problems identified by Touche Ross include:

The side effects of construction, such as traffic detours, trenching and lawn/garden restoration, cable crews in backyards, etc., are in themselves a nuisance, and are compounded by the fact that the residents will have to go through this process again with a second operator.

A review of the County's complaint log over the past five years indicated that underground cable trenching and pedestal placement issues are common complaints among Dade County residents. Placements of a second pedestal can cause additional objections in many areas.

After an additional CATV company is in operation, it is likely that some subscribers will have switched service to the second operator.

When this occurs, their homes may have multiple aerial drops installed which could result in a negative aesthetic effect.

²⁷

Touche Ross Report to Dade County, Florida at 20.

Each attachee to a utility pole is required to place a separate anchor and guy wire at specified locations as opposed to attaching to existing Telco or CATV anchors. The additional anchor will be placed and may be an eyesore.²⁸

All of these problems create public irritation and therefore have political consequences. Given the dismal success of overbuilds generally, the City of Tacoma would be well advised to reevaluate any plans for an overbuild.

IV. LEGAL CONSIDERATIONS

The City of Tacoma, like the City of Paragould, Arkansas, must face the fact that "a number of legal questions must be resolved in any government owned and operated system. The legality of competing, questions of antitrust, anticompetitive behavior by the City must be guarded against."²⁹ Although a municipality may own and operate a cable system, that is only the beginning -- not the end -- of the inquiry.

For Example, some of the potential legal issues include:

1. Violation of Constitutional Due Process and Equal Protection Rights

How can you regulate us and compete with us at the same time? This simple and fundamental question raises a host of constitutional issues.

The City of Tacoma is going to face the twin pressures of still competition and the enormous financial and other challenges which face any overbuilder. At the same time, the City of Tacoma is the authority which regulates us. There will be a strong temptation for the City of Tacoma to overcome its disadvantages by increasing our regulatory burden. Because of the conflict arising from the City of Tacoma's dual role as our regulator and competitor, all regulatory actions taken by the City of Tacoma which may fall with a heavier hand on us than on the City of Tacoma, are open to a constitutional due process claim. This claim can be asserted regardless of the procedures used to take such actions.

Next, the City of Tacoma cannot give itself an unfair advantage

²⁸ Id. at 19-20.

²⁹ Jefferson city Task Force Report at 11.

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over Company. Any franchise granted to the City of *Tacoma* must ensure that the City is treated equally with the private cable operator. The City of *Tacoma* cannot franchise itself on terms and conditions more favorable, or less burdensome, than those required by *TCI of Tacoma's* franchise. There must, at all times, be a "level playing field" for competition. This principle requires the City of *Tacoma* to go through the exact same franchise application process, including, if applicable, competitive bidding.

If the City of *Tacoma* is obligated to give itself a franchise under state or local laws, the provisions of that franchise agreement must be at least the same as those of *TCI of Tacoma, Inc.'s* franchise. This may include the following: the same channel capacity; the same service area; construction, installation, maintenance of the system in the same manner as *TCI of Tacoma, Inc.*, consistent with all laws, ordinances, construction, safety, and FCC technical standards; the same requirements as to location and maintenance of poles, wires and appurtenances so as to cause minimal interference with the proper use of the streets and public ways; equal treatment as to payment and use of the poles with other utilities and cable operators; the same responsibilities for restoring all sidewalks, driveways, landscaping and street surfaces; the same operational standards, including provision of customer services, repair services and maintenance of the technical and quality standards which *TCI of Tacoma, Inc.* is required to maintain; some mechanism for maintaining the fees which *TCI of Tacoma, Inc.* is obligated to pay; and the same required services, including at least the same special access channels, production facilities for local origination programming and the like.

As you can see, this is quite a list.

2. Control Over Content Under the U.S. Constitution and the Federal Cable Act

A city-owned cable system makes an inviting target for political abuse on two levels. First, incumbent elected officials would be tempted to use their access to the system to gain a "free" advertising edge over challengers. Second, politicians may be tempted to control the content of programming on the system (i.e. nudity in R-rated movies or restrictions on politically unpopular groups on ideas having access to the system) to advance their personal political agendas.

In order to avoid challenges by citizens or public interest groups under both constitutional and federal law, accompanied by cries of "censorship" in the media, the City of *Tacoma* must ensure that it will not exercise control over the cable system's

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4. Federal and State Antitrust Violations

The City of *Tacoma* may not, of course, compete unfairly with TCI of *Tacoma, Inc.* and use its regulatory authority with a heavier hand upon TCI of *Tacoma, Inc.* so as to threaten to drive TCI of *Tacoma, Inc.* out of business. In such circumstances, the City of *Tacoma* may not be immune from federal or state antitrust claims and may be subject to pay treble damages, attorneys' fees and other costs. The City of *Tacoma* also can be enjoined from any unfair competition by the court order.

The issues outlined above are but a brief summary of the possible legal pitfalls facing a City planning to build and operate a cable system in order to compete with private cable operators. These legal factors and possibly many others, must be considered along with the economic, managerial and political factors raised earlier before any decision is made by the City of *Tacoma* to enter into the cable television business.

In short, the City of *Tacoma* has a lot to think about before it decides to embark on this course. TCI of *Tacoma, Inc.* hopes that this letter will give the City of *Tacoma* a chance to pause and let the euphoria of the benefits you may now expect to be replaced by a realistic appreciation of the pitfalls and risks associated with municipal ownership of what is traditionally an entertainment service provided by private enterprise.

Sincerely,

Barbara J. Wyatt
General Manager

BJW/lkb