Report to the County Executive

Regarding the Proposed Grant

of a Cable Television Franchise Renewal

to

Comcast of Potomac, LLC

by

The Office of Cable and Broadband Services,

Montgomery County Department

Of Technology Services

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I. EXECUTIVE SUMMARY

This report addresses the proposed Renewal Franchise Agreement ("Franchise Agreement") between Montgomery County and Comcast of Potomac, LLC. ("Comcast"), and two related proposed agreements between the County and Comcast: a Settlement Agreement, and an Agreement for Indefeasible Right of Use of Certain Facilities, and Provision of Cable Modem Services ("IRU").

Comcast submitted the proposed Franchise Agreement and related agreements to the County pursuant to Section 8A-22(f) of the Montgomery County Code. The proposed agreements are the products of extended negotiations with the County through the Office of Cable and Broadband Services, Montgomery County Department Of Technology Services ("Cable Office"). The Franchise Agreement renews Comcast's cable franchise, which authorizes Comcast to use County rights-of-way to provide cable services. The Settlement resolves certain issues with respect to Comcast's past performance. The IRU effectively preserves the County's right to continue to use portions of Comcast's system which comprise part of the existing "institutional network" or "I-Net" connecting major County facilities for video and data communications. The Cable Office recommends that the County Executive approve the proposed Franchise Agreement and related agreements because the proposed agreements will serve the interests of cable subscribers and the County.

II. THE PROPOSED FRANCHISE AGREEMENT.

A. Overview.

The Cable Office, with the assistance of the Office of the County Attorney negotiated the terms of the proposed Franchise Agreement with representatives of Comcast. The Cable Office has considered the interests of all the affected parties - including County residents, cable subscribers, the municipalities within the County, the Montgomery County Public Schools, Montgomery College, County government, and outside agencies - in an effort to achieve an equitable balance among all of those interests. We have also considered the effects of the proposed Franchise Agreement on the County's agreements with other cable operators, Verizon Maryland Inc. and RCN.

B. Summary of the Proposed Franchise Agreement.

The proposed Franchise Agreement requires Comcast to serve all parts of the County, although customers may be required to share in the cost of system extension where population density is below certain levels. The Franchise Agreement also provides the County and participating municipalities with capital grants for PEG uses of the system (which include the I-Net). The value of these commitments is enhanced by the separate Settlement Agreement and IRU. Through the Settlement Agreement, the County and participating municipalities will be able to use PEG grants for operating support. Through the separate IRU agreement, the County secures the availability of the Comcast facilities which are part of the I-Net for at least 15 years, and obtains a right to purchase the Comcast facilities which are part of the I-Net at the end of the IRU term. In addition, the Franchise Agreement and the Settlement Agreement continue the current obligations of Comcast with respect to the provision of courtesy services to schools and other public institutions.

The general terms of the proposed Franchise Agreement related to police powers, use of rights of way, bonding and the like are modeled on the existing Verizon franchise except where differences between the systems justified a different treatment. Many of the terms, including the customer service provisions, are either identical to, or virtually identical to the Verizon franchise terms.

The principle terms of the proposed Franchise Agreement are as follows:

1). *Term.* The Franchise Agreement expires in 2021, the same year as the Verizon franchise. Having both franchises expire at the same time should permit the County to address renewal for both franchisees more cost-effectively.

2). *Service Territory.* Comcast must serve all residences in the County where the density is equal or greater than 15 occupied dwelling units per mile. In addition, and unlike the Verizon franchise, the Franchise Agreement requires Comcast to extend service where density is less than 15 occupied dwelling units per mile if the customers requesting service share the costs. The cost sharing formula is designed to lower costs if neighbors order service together.

3). *Franchise Fee.* Comcast must pay a 5% franchise fee on gross revenues derived from the operation of the cable system to provide cable service. This is the same as the fee Verizon has been paying, and the same as Comcast is paying under its existing franchise.

4). *PEG Support.*

(a). Comcast will pay 3% of its gross revenues to the County for PEG capital grants. These funds can be used for the PEG access channels and for the I-Net (see discussion below). Verizon also pays 3%. Under its existing franchise, Comcast makes lump sum payments which were once *less* than 3% of gross revenues but today are more than 3% (due to declines in customers and revenues). The Cable Office believes it makes sense to move Comcast to a gross revenues-based PEG fee.

(b). Comcast will provide courtesy cable service to the same number of buildings to which it now provides courtesy service and must extend service to up to three new public buildings per year. Comcast will also provide, maintain and replace converters needed to receive service in place now, and provide up to three additional converters for each new site. The County would pay for additional equipment if needed. Combined with obligations in franchises or proposed franchises with other providers related to courtesy cable services, this should satisfy the County's needs for the renewal term.

5). *PEG Channels.*

(a). Comcast now provides 11 PEG channels in standard definition, or SD. Under the proposed Franchise Agreement, Comcast will provide up to 14 PEG channels, of which 5 may be high definition or HD. Up to four HD channels may be activated within the first three years of the renewal franchise. In order to activate all four HD channels, the County will need to drop one or combine existing SD channels. The four HD channels can have original content, or "simulcast" other PEG channels programming (just as broadcast channels simulcast today in HD and SD). After the third year of the Agreement, the County can convert one other SD PEG channel into a fifth HD channel.

(b). The proposed Franchise Agreement requires Comcast to treat the PEG channels the same way it treats the most popular commercial channels it carries. The channels must be accessible from program guides, recordable in the same way, and be equivalent in quality from the perspective of the viewer.

6). *I-Net.* The County relies on an I-Net for critical data and video communications. Comcast proposes to move its I-Net obligations from the franchise into a separate agreement – the IRU agreement. The Cable Office agreed with this approach. Having a separate agreement can be advantageous for the County: where franchising has shifted from localities to the state level, companies have continued to provide I-Nets required by separate agreements. Placing obligations in a separate agreement also resolves an argument raised by Comcast in negotiations – that when the local franchise terminates, the I-Net obligations also terminate. The proposed Franchise Agreement permits PEG grants to be used for I-Net purposes, and a failure to comply with the IRU is a material franchise violation.

7). *Competitive Equity.* The proposed Franchise Agreement includes a "competitive equity" clause not included in the Verizon franchise and unlike the one in the current Comcast franchise. Under the proposed clause, if County Council grants a franchise that contains material terms and conditions that differ from Comcast's material obligations under the Franchise Agreement to an entity that provides competitive video programming services to County residences, at Comcast's request, the County and Comcast must enter into negotiations to ensure regulatory and financial burdens on each franchisee are materially equivalent. If no agreement is reached, Comcast may shorten the franchise term and require the County to commence renewal proceedings. The clause does not apply to entities occupying the County right of way as of the effective date of the proposed Franchise Agreement. I-Net obligations were omitted from the list of obligations that trigger the "equity" clause.

III. THE SETTLEMENT AGREEMENT AND IRU.

A. Summary of the Proposed Settlement Agreement.

The proposed Settlement Agreement resolves certain disputes regarding Comcast's performance under its existing franchise, provides a release to Comcast in connection with the settlement of those disputes and relieves Comcast of certain obligations the County believes could otherwise be imposed upon Comcast through the renewal process (primarily, the I-Net obligations discussed above). In return, Comcast agrees:

1). to pay the County $200,000;

2). to release claims it may have against the County for reimbursement of certain I-Net expenses, or for the provision of courtesy drops under the existing franchise, and to provide courtesy drops without offset during the Franchise Agreement term;

3). to enter into the IRU and to allow the County to use PEG grants for the IRU facilities, and for expansion of the I-Net by the County; and

4). to permit the County to use the PEG grants for non-capital purposes under a matching formula. One third of the PEG support Comcast provides (1% of gross revenues) can be used for non-capital purposes. For each dollar the County, the participating municipalities, or the schools and colleges spend on PEG in a fiscal year, an additional dollar of the Comcast PEG grant may be used for non-capital purposes in the following fiscal year. Thus, if those entities spent $200,000 for PEG in FY 2015, in FY 2016 an additional $200,000 of the Comcast PEG grant could be used for non-capital support. With enough matching funds, the entire 3% Comcast PEG grant could be used for non-capital support.

B. <u>Summary of the Agreement for Indefeasible Right of Use (IRU).</u>

1). *Overview.* What the County calls the I-Net is comprised of fiber (including associated facilities) built, paid for, and owned by the County (FiberNet); fiber installed, paid for and owned by Comcast (the Comcast-Paid C-Net); and fiber installed by Comcast and paid for by the County (the County-Paid C-Net). The proposed IRU is a separate agreement that replaces the Comcast I-Net obligations under the existing franchise. Under the IRU, Comcast will no longer have any obligation to build any additions to the I-Net. It effectively delegates that responsibility to the County (as described in the Settlement Agreement). The IRU requires Comcast to allow the County to access and use Comcast fiber (both the Comcast-Paid C-Net and the County-Paid C-Net), and requires Comcast to maintain this fiber to certain specified standards. In most other respects, the IRU simply preserves the status quo. As under the current arrangement, there is no charge for use of the fibers, but Attachment 1 to the IRU agreement requires the County to pay Comcast's actual costs for maintaining facilities provided under the IRU.

2). *Term.* The IRU terminates if the proposed Franchise Agreement terminates, and if Comcast no longer has authority to maintain its facilities in the rights of way. If Comcast maintains its authority to occupy the rights of way (whether under a new franchise or some other authorization), the IRU remains in effect through October 1, 2030, although Comcast may extend the IRU to October 1, 2035.

3). *Right to Purchase/Reversion.* When the IRU expires, title to the County-Paid C-Net will revert to the County automatically. The County will have the right to purchase the Comcast-Paid C-Net at original cost less depreciation. A similar purchase arrangement is in the existing franchise.

4). *Use Restrictions*. Like the existing Comcast franchise, the IRU prohibits sale, lease sublease, bartering or giving away capacity on the Comcast-Paid C-Net or the County-Paid C-Net to a private entity to use to provide a competing cable service or an Internet access service offered on a paid commercial basis that competes with any Internet access service Comcast may be authorized to provide. The limitations would cease to apply if the County purchases the facilities. The restrictions do not apply to the FiberNet.

5). *Other.* Because Comcast will no longer be required to build out the I-Net to new or moved locations, Comcast agreed to continue to provide cable modem service to certain locations that are not served now by the I-Net on a paid basis.

IV. RECOMMENDATION.

Overall, the Cable Office believes that the agreements in combination represent a reasonable compromise that serves what were the County's major goals going into renewal, including preservation of PEG channels and grants, preservation of the I-Net, and development of an agreed formula for cost-sharing in low-density areas. There could be substantial risks associated with rejecting the proposed Franchise Agreement, and a loss of the significant benefits provided under the Settlement Agreement with respect to use of grants for non-capital support, and under the IRU with respect to the I-Net. Therefore, the Cable Office recommends approval of all three agreements.