

UTILITY AND FRANCHISE REVENUE:
Equitable tax and consistent approach
needed to improve collections

A REPORT FROM THE CITY AUDITOR
May 2009



Office of the City Auditor
Portland, Oregon



CITY OF
PORTLAND, OREGON

OFFICE OF THE CITY AUDITOR
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May 11, 2009

TO: Sam Adams, Mayor
Nick Fish, Commissioner
Amanda Fritz, Commissioner
Randy Leonard, Commissioner
Dan Saltzman, Commissioner
David Olson, Director, Office of Cable Communications and Franchise Management
Sue Klobertanz, Director, Revenue Bureau

SUBJECT: Audit – *Utility and Franchise Revenue: Equitable tax and consistent approach needed to improve collections.* (Report #375)

Attached is Report #375 containing the results of our audit of revenue collection by the Office of Office of Cable Communications and Franchise Management and the Revenue Bureau.

Commissioner Amanda Fritz, Revenue Bureau Director Sue Klobertanz, and Office Cable Communications and Franchise Management Director David Olson have submitted written responses to the audit, and we have included their responses at the back of this published report.

In the report we make two recommendations, and we ask the Director of the Office of Cable Communications and Franchise Management, through the Commissioner-in-Charge, to provide us with a status report within one year detailing actions taken to implement the recommendations.

We appreciate the cooperation and assistance we received from staff in the Revenue Bureau and the Office of Cable Communications and Franchise Management as we conducted this audit.


GARY BLACKMER
City Auditor

Audit Team: Drummond Kahn
Kari Guy
Kristine Adams-Wannberg
Alexandra Fercak

Attachment

UTILITY AND FRANCHISE REVENUE:

Equitable tax and consistent approach needed to improve collections

Summary Business license fees and utility/franchise fees are substantial sources of revenue to the City's General Fund. We audited the revenue collection practices at both the Revenue Bureau and the Office of Cable Communication and Franchise Management to determine whether systems and processes were in place to accurately collect business license and utility/franchise fee revenue.

Our review of the Revenue Bureau followed earlier audits in 2004 and 2006. We found that the Revenue Bureau has continued to improve revenue collection processes by automating the collection process, clarifying and simplifying the business license code, and documenting the policy and process for tax receivable write-offs and civil penalties.

At the Office of Cable Communication and Franchise Management, we found that they have collected substantial compliance revenue through payment monitoring, audit, and litigation. We also found that the Office of Cable Communication and Franchise Management staff negotiate each franchise agreement, payment, audit and settlement on a case-by-case basis. The Office of Cable Communication and Franchise Management staff told us this approach allows them to maximize benefits to the City from each franchise or settlement. However, we believe this has led to inconsistent application of some utility and franchise requirements. For example, businesses such as pipelines and power companies pay a fee to use the City right-of-way, while other entities, such as railroads, do not. In addition, while some underpayments discovered as the result of an audit are paid in full, other similar audit findings may be significantly reduced. The inconsistent application of franchise and utility fee requirements creates an unclear regulatory environment and a potential loss of revenue for the City.

We also found that the City Code has not kept pace with changes in technology, and businesses providing similar services may pay different taxes. For example, City Code requires a fee on telecommunications, but does not explicitly address technology such as wireless or internet service. As a result, traditional landline phone companies pay a utility fee, but wireless phone companies do not. This may put some companies doing business in the City at a competitive disadvantage with other companies providing similar services.

The Office of Cable Communication and Franchise Management has recommended improvements to the City Council in the past to resolve some of the inconsistencies in City Code, but the proposals did not move forward. We recognize that the complex legal environment, and the overlay of state and federal regulatory requirements, makes utility administration difficult. However, the inequity in the City Code and the inconsistent approach by Office of Cable Communication and Franchise Management may erode businesses' willingness to pay, decrease revenues to the City, and create a less equitable competitive environment for businesses. We recommend:

1. The Commissioner-in-Charge direct the Office of Cable Communication and Franchise Management to develop consistent, written procedures for the following:
 - a. A process for determining and documenting when franchising is required;
 - b. A policy defining the process, criteria, and documentation required for settlement decisions;
 - c. Payment documentation and reporting requirements for businesses; and
 - d. Standard franchise requirements, including records retention and audit schedules.
2. The City Council and the Office of Cable Communication and Franchise Management review and update the utility codes to ensure equitable treatment of all businesses. The update should also eliminate obsolete provisions and ensure consistency between utility, franchise, and privilege tax code provisions.

Background

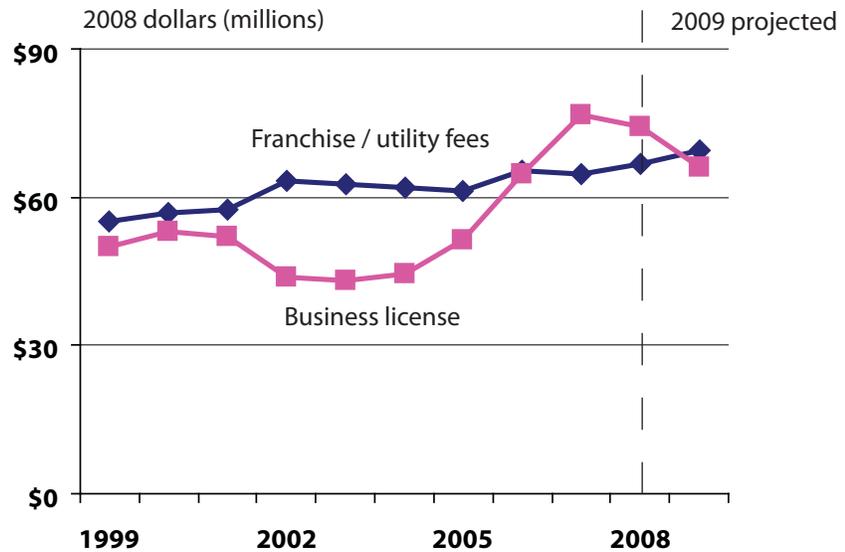
The two largest revenue sources to the City's General Fund after property taxes are business license revenues and utility and franchise fees. Business license revenues are collected by the Revenue Bureau. The Revenue Bureau also collects transient lodging taxes, and issues permits and collects fees for regulatory programs including those for taxicabs, towing, and payday lenders.

Franchise and utility fees are collected by the Office of Cable Communication and Franchise Management (OCCFM). In addition to revenue collection, the OCCFM is charged with staffing the inter-jurisdictional Mt. Hood Cable Regulatory Commission, which regulates the provision of cable services in Multnomah County on behalf of the City of Portland and five other jurisdictions. The OCCFM also has jurisdiction over all public or private utilities seeking to use the City rights-of-way. This regulatory role involves coordinating franchise and utility issues among multiple City bureaus, and advocating for the City at both the state and national levels.

While the regulatory responsibilities of the Revenue Bureau and OCCFM are specialized, the bureaus have similar functions of revenue collection and compliance. Revenues subject to utility fees are exempt from business license fees, but businesses with diverse revenue streams may pay a net revenue business license fee to the Revenue Bureau on some revenue streams, and a gross revenue utility fee to the OCCFM on others. In 2005 there was discussion of transferring the functions of the Office of Cable Communications and Franchise Management to the Regulatory Division of the Revenue Bureau. The move was opposed by stakeholders of the Mt. Hood Cable Regulatory Commission, who argued that the regulatory functions and interjurisdictional cooperation of the OCCFM would be jeopardized by the move. The change was not included in the final plan to create the Revenue Bureau.

Both business license fees and utility/franchise fees have increased over the last ten years, but business license revenues tend to fluctuate more with the economy, as shown in Figure 1.

Figure 1 Utility License/Franchise Fee and Business License Revenue
(Fiscal years 1999-2008 actual, 2009 projected)



Source: Office of Management and Finance

In Fiscal Year 2007-08 the Revenue Bureau collected over \$76 million in business license fees. We audited the Revenue Bureau’s revenue collection practices in 2004, and conducted follow-up work in 2006. The Revenue Bureau has continued to improve revenue collection by automating the collection process, clarifying and simplifying the business license code, and documenting the policy and process for tax receivable write-offs and civil penalties. While business license revenues are projected to decrease in the current fiscal year, we believe the Revenue Bureau has the collection processes in place to maximize revenue collection to the City.

In Fiscal Year 2007-08 the OCCFM collected over \$68 million from franchise fees, utility fees, and privilege taxes. The franchise and utility revenue collection is based on three different code provisions:

- The City’s charter permits the Council to grant **franchises** to any entity utilizing City rights-of-way. The Council establishes the term of the franchise and the amount and manner of compensation.

-
- The **utility code** requires any entity operating a public utility within the City to obtain a license and pay a fee based on gross revenues. The rate varies from 5 percent to 7 percent based on utility type. Any fees paid under a franchise may be deducted from the utility license fee.
 - If certain utilities use a right-of-way without a franchise, they must pay a **privilege tax** based on gross revenues. When a franchise is granted, the privilege tax requirements cease.

In 1985 our office issued *Review of Public Utility License Fees*. The report found fragmented administrative responsibilities among City bureaus, infrequent license fee audits, and a need to better communicate between the City and utility companies. The report recommended clarifying the commissioner liaison responsibility for all public utility franchise matters; assigning responsibility for collection, audit and monitoring of fees to the then- Bureau of Licenses; and updating certain franchise agreements.

In response to the audit, in 1986 the Office of Cable Communications was assigned the utility collections and franchise management functions. In 1988 the City Council revised the City Code governing the Office of Cable Communications to reflect this change, updating the office name and officially granting the Office of Cable Communication and Franchise Management jurisdiction over all franchisees, utilities using City rights-of-way, and all cable communication matters. The Office was charged with coordinating all franchise processes, monitoring franchise compliance, and overseeing franchise and utility audits and revenue.

While the responsibility for franchise and utility matters was shifted to OCCFM in 1988, the underlying code sections dealing with franchise reporting and privilege tax (City Code 7.12), and utility fees (City Code 7.14) were not updated. Those sections still referred to the City Auditor's Office and Bureau of Licenses. In January 2009 administrative updates were adopted to City Code Chapter 7.14 to correct outdated references to obsolete utilities and the Bureau of Licenses. The update also added rule-making authority for the Director, and procedures for revenue collection, review of records, and appeals. No changes were made to the code governing privilege tax or franchise requirements, which have numerous provisions that are outdated and do not reflect current administrative practices.

The charter franchise provisions, utility license code, and privilege tax code may apply to any utility using City rights-of-way. No specific tax rate is required for franchises, and utility and privilege tax payments vary by utility type. In 2008, OCCFM records show 47 businesses had franchises and did not pay a separate utility or privilege tax, and four entities paid the utility fee and had no franchise. One entity paid only the privilege tax, and one paid both privilege and utility taxes. OCCFM management notes that payments under the privilege tax are insubstantial.

In 2008, 93 percent of the franchise and utility revenue was provided by payments from seven providers of basic utility services – cable, landline telephone, gas, electric, and City water and sewer. But the total number of entities paying franchise and utility fees has more than doubled in the past ten years. This increase reflects major changes in the telecommunications industry, as new providers of wireless services, competitive phone service and mobile internet enter the market.

As the number and types of businesses grew, the OCCFM negotiated new franchises and established payment terms on a case-by-case basis. Once one franchise was negotiated, the OCCFM used that case as a beginning template for negotiations with the next entity. Thus each franchise is a unique listing of terms and conditions for occupying the City's right-of-way.

According to the City Attorney, both franchise and utility license fees have been extremely contentious, with numerous lawsuits over utility and franchise requirements. In each case to date the City has generally prevailed, protecting the City's authority to regulate use of the rights-of-way and to collect utility and franchise fees.

Objectives, scope and methodology

The objective of this audit was to determine whether the City has the systems and procedures in place to accurately collect business license and utility/ franchise fees.

To assess the Revenue Bureau collection practices, we reviewed prior audits issued in 2004 and 2006. We interviewed management and staff from the Revenue Bureau's License and Tax and Operations

Division, and reviewed current policies and procedures on collection, audit selection, and tax receivable write-offs. We also reviewed program documentation provided by staff. After verifying implementation of prior audit recommendations, and receiving updates on current program administration, we did not conduct further tests of Revenue Bureau collections.

To review collection practices at the Office of Cable Communication and Franchise Management we interviewed management and staff and reviewed current policies and procedures and program documentation provided by staff. We also reviewed a selection of OCCFM written and electronic files for entities paying franchise or utility fees.

We used data from the Office of Management and Finance and the City Analysis and Reporting System for revenue and payment history. In addition, we reviewed reports on best practices for tax collection, and research on telecommunications taxation. We also surveyed six comparison cities on their telecommunication taxes: Charlotte, Cincinnati, Denver, Kansas City, Sacramento and Seattle.

It was outside the scope of this audit to review the program costs associated with maintaining revenue collection functions at both the Revenue Bureau and OCCFM. However, we believe this issue merits further review as the City considers methods to improve the consistency of utility and franchise revenue collection.

We conducted this audit in accordance with generally accepted government auditing standards. These 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit results

OCCFM has implemented compliance programs to increase revenue collection

In our discussions with OCCFM management and review of program documents we noted many areas where they have implemented compliance programs to increase utility and franchise revenue col-

lection. OCCFM has documented almost \$15 million in compliance revenue from FY 1999-00 to FY 2008-09 that can be attributed to the following activities:

- The OCCFM staff monitor quarterly payments from all payers to identify late payments, substantial changes in payment amounts, or other anomalies. They also work with the Bureau of Transportation and Oregon Public Utilities Commission to identify all potential payers. They have routinely collected unpaid franchise fees and late fees.
- The OCCFM contracts for external audits of major tax payers as funding is available. These audits have yielded substantial settlement amounts for the City both as one-time payments, and in ongoing increases in base payments.
- The OCCFM has both initiated and defended lawsuits over payment of franchise and utility fees. To date the City has generally prevailed in those lawsuits.

The OCCFM management attributes part of their success in collecting compliance revenues to an entrepreneurial approach that allows them to be responsive to a changing environment.

Not all businesses using City rights-of-way are required to get franchises or pay utility fees

It is the policy of the City of Portland that entities seeking rights to use City rights-of-way should be subject to franchise agreements with the City. The OCCFM works to identify all utilities and entities using City streets by coordinating with the Portland Bureau of Transportation, the Oregon Public Utility Commission, and the Oregon Utility Location Center. The number of entities paying utility or franchise fees has more than doubled in the past ten years.

However, when there is uncertainty about whether a franchise or utility fee is required, we found that decisions were deferred, resulting in inconsistent application of franchise and utility fee requirements in some cases. The OCCFM does not have written criteria for determining when a franchise is required, a process for making that determination, or a method of documenting decisions. The OCCFM

estimates potential revenue from entities using the rights-of-way without franchises or utility fee payments at over \$400,000 per year. In our review of OCCFM files we noted various discrepancies in franchise and utility fee requirements. Some examples of discrepancies include the following:

Railroads: Franchise requirements for railroads are specifically described in City Charter, and historically railroads were required to agree to franchises with the City. As the franchises expired, they were not renewed. OCCFM staff indicate that they believe the cost of negotiating a franchise would exceed any potential franchise revenue, so they have opted not to require the franchises. The OCCFM has not documented this decision.

Universities: Two universities within the city have franchises for their placement of telecommunication lines in City rights-of-way, and each pays annual franchise fees of approximately \$15,500. A third university placed similar lines in a City right-of-way for a development in the South Waterfront neighborhood. The university applied for a franchise in 2004, but the OCCFM did not complete negotiations with the university. Although the work was completed, no franchise or payment was required.

Telephone Resellers: Telephone resellers buy excess phone line capacity from the traditional landline phone companies. In 2003 the OCCFM staff sent a request to resellers to begin paying a fee on gross telephone revenues. Some resellers began to pay; some did not. Some paid at a rate of 5 percent of gross revenue; some paid at 7 percent. OCCFM staff told us that after the initial payments, they decided the code was not clear on whether payment was required. Since that time OCCFM has accepted payment from those resellers choosing to send payment, but they did not pursue payment from other resellers or clarify the payment rate.

Power companies: Major power utilities have also been treated differently. Two City utilities claim historic franchises pre-dating the City's franchise requirements. The City Council directed OCCFM to negotiate franchises with one electrical company, but negotiations stalled two years ago and have not resumed.

Negotiations with the gas company led to a modern franchise, in exchange for a significant reduction in past due utility payments.

In each of these cases there may be valid reasons for treating payers differently. The OCCFM staff indicate that some differences result from internal priority-setting – they prioritize available staff and attorney resources to the most pressing and imminent utility negotiations. They also note that in each case decisions are based on an analysis of City costs and benefits developed in consultation with the City Attorney and the Commissioner-in-charge. But without written criteria for determining when a franchise is required, a consistent approach (and timeline) for making that determination, and documentation of the decision, it is difficult to evaluate the reasonableness of the decision. Both to maximize revenue collection, and to treat similar businesses equitably, we believe that written criteria, a consistent approach, and improved documentation would better support franchise decisions.

Settlement decisions lack clear written criteria and consistent approach

There is a similar lack of criteria, consistent approach, and documentation of decisions to settle outstanding payments based on legal judgments or audit findings. The utility and privilege tax codes are silent on the authority or process for settlement decisions. According to documentation provided by OCCFM staff, since 2000 the City has foregone over \$4.7 million in revenue through settlements. We reviewed the files for four settlement decisions made between 2000 and 2008. In each case the settlement process was different.

In one case, OCCFM recommended settlement of a lawsuit, forgiving \$900,000 of a legal judgment in exchange for an end to litigation. The settlement was documented in a memo to Council that included a thorough discussion of the lawsuit, the original judgment amount, the legal and precedent issues, and immediate, ongoing, and indirect financial impacts of the settlement.

In another case, an audit of a utility found that the utility had not paid utility fees on revenues received from federal and other miscellaneous accounts. The OCCFM recommended the amount be

reduced from an estimate of \$2.3 million to \$900,000 in exchange for adoption of a current franchise. The settlement amount was then reduced to \$350,000 in subsequent negotiations with the Commissioner-in-Charge. The settlement was approved by City Council, but documentation submitted to Council included only the one-time, positive revenue impact of \$350,000. The documentation provided to Council did not explain the rationale for the settlement, foregone revenue, or any precedent or policy implications. In contrast, similar audit findings for another utility resulted in full payment of the outstanding amount.

In all of the settlement decisions we reviewed, the OCCFM staff did consult with the City Attorney, and in three of the cases the final settlement amount was submitted to Council for approval. The OCCFM management told us that in each settlement they attempt to maximize both fiscal and non-fiscal benefits to the City. In each case the settlement decision may be reasonable, but in only one case was the record sufficient to explain the factors considered in making the decision, and the trade-offs involved. Written criteria, consistent approach, and improved documentation would better support settlement decisions and ensure Council is able to consider the full impact of decisions.

Compliance efforts are hampered by poor payment documentation, infrequent audit, and inconsistent franchise terms

The OCCFM staff routinely monitors smaller payments and conducts some audits of smaller payers. They also attempt to audit major payers every three to five years by contracting with external consultants. In documenting the benefit of the audit function, OCCFM has found that both compliance efforts have more than recovered costs.

We found that the effectiveness of the compliance function is limited, however, by inconsistent payment documentation, infrequent audits, and inconsistent franchise terms.

Both the utility and franchise codes have specific requirements for documentation and reports to be submitted with payments, and the OCCFM has written procedures for payment processing. However, in practice the documentation submitted varies, with some businesses

submitting detailed revenue reports, and some businesses sending no documentation. The OCCFM staff tells us that the problem has been worsened by the shift to electronic payments, as more payments are received with no documentation. We noted discrepancies in the payment amounts recorded in the City's accounting system and the OCCFM records. Without documentation it is difficult to verify the accuracy of payments, and may create a challenge for future audits and enforcement action.

As franchise agreements are negotiated on a case-by-case basis, franchise terms may differ between franchisees. We reviewed one element of franchise agreements – the time period for record retention and audit. We looked at franchises for competitive local phone companies, and found time periods of two years, five years, or no limit at all. The January 2009 revisions to the utility code require utilities to maintain records for three years, different than the business license code requirement of seven years. Currently, the OCCFM attempts to audit major utilities every three to five years, and smaller payers are audited less frequently, if at all. The inconsistent records retention and audit time-limits in franchises and code, combined with infrequent audits, may reduce the City's ability to audit and to recover revenues.

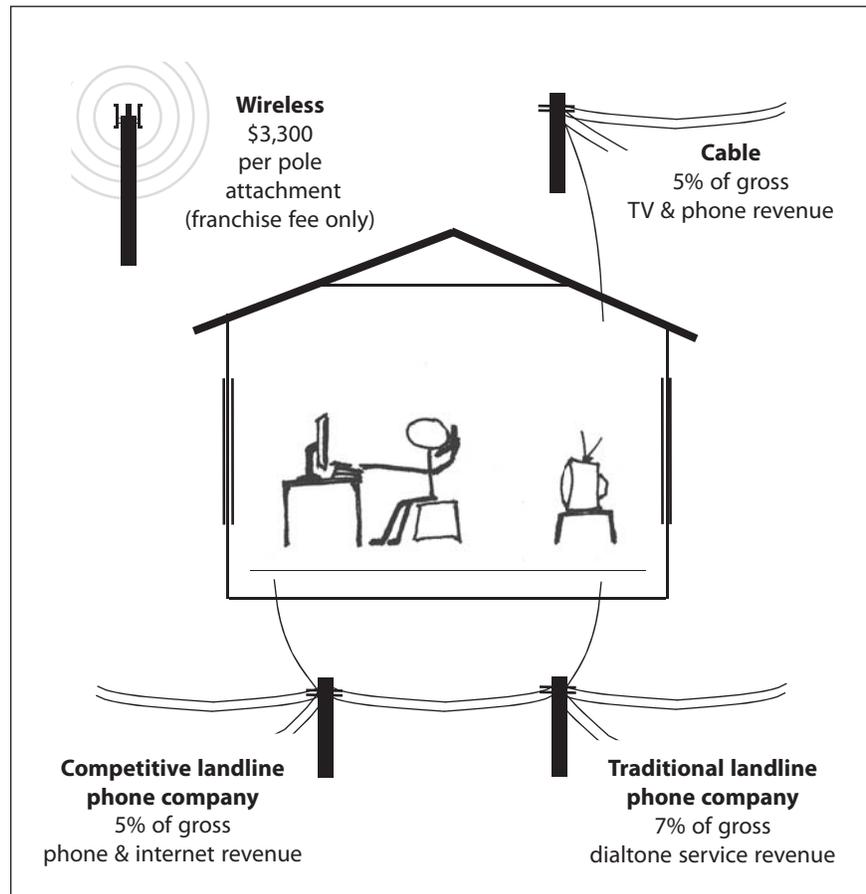
Other franchise terms are also subject to negotiation and change. The OCCFM has attempted to standardize one portion of franchise agreements by working with the Bureau of Transportation to create rules governing utility work in streets. OCCFM does not have any written standards or rules for other franchise terms such as compensation, auditing, insurance, or payments. OCCFM management told us this approach allows them to be entrepreneurial and responsive in a rapidly changing environment, while maximizing the benefits to the City from each franchise. However, we believe that adopting standard franchise terms would be both easier to administer and to ensure fairness and consistency among franchisees.

Businesses providing similar services pay different tax rates

Over the past 25 years the telecommunications industry has changed, with a shift to wireless technology and an increase in single companies providing a variety of services (or "bundling"). The City's tax code has not kept pace, with the result that businesses providing similar services are taxed at different rates.

For example, traditional landline phone companies pay a 7 percent fee based on the gross revenues from providing dialtone service. Newer competitive landline phone companies, however, pay a 5 percent fee on a broader base that includes the revenue from internet services. Cable companies pay a 5 percent fee on cable television service, and an additional 3 percent for other public benefits. As of January 2009, cable companies will also pay a 5 percent fee on the phone service they provide. Most wireless phone and internet providers do not pay any fee on gross revenues, but pay only a franchise fee for each utility pole attachment. See Figure 2 for an illustration of the current franchise and utility fee payment rates.

Figure 2 Annual utility and franchise fees by telecommunications provider type



Source: Audit Services Division illustration from data provided by OCCFM

Notes: Cable companies also pay 3% of gross TV revenue for other public benefits.

See glossary on Page 19 for explanation of terms.

Any income that is subject to a franchise or utility fee is exempt from the City’s business license fee. Telecommunications income that is not subject to the utility or franchise fee of 5 to 7 percent of gross revenue, such as wireless phone revenue, is subject to the business license tax of 2.2 percent of adjusted net income. The OCCFM staff estimate that this is a significantly lower tax payment, as illustrated in Figure 3.

Figure 3 Potential wireless revenue comparison - business license tax and utility fee

If Portland wireless companies paid under this authority:	The annual revenue to the City is estimated at:
Business License Fee (2.2% of net revenues)	\$250,000
Utility Fee (5% of gross revenues)	\$11,500,000

Source: OCCFM and Office of Management and Finance estimates

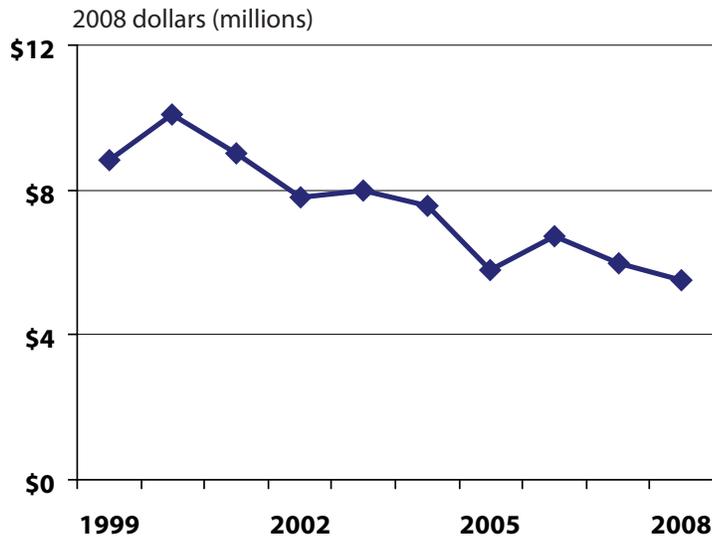
Telecommunications companies that provide a variety of services may pay both a business license fee to the Revenue Bureau and a utility or franchise fee to the Office of Cable Communication and Franchise Management, on the separate lines of revenue.

The City’s utility fee and franchising is further complicated by an overlay of federal and state laws that constrain the City’s discretion. In Oregon, only three cities (Eugene, Creswell, and Oakridge) have a consistent utility fee on all telecommunication services. Three other cities that proposed consistent utility taxes (Springfield, Corvallis, and North Plains) faced referendum and proposals were withdrawn or defeated. We reviewed the telecommunication taxes of six comparison cities in other states, and found similar inconsistencies in telecommunication taxation – each of the cities we reviewed taxed wireless and landline phone service at the same rate, but no city was also consistent in taxes for cable or internet services.

In 2004 the Office of Cable Communication and Franchise Management proposed updates to the utility code to ensure consistent tax rates for all utilities and to address changes in technology and law. The OCCFM held work sessions with Council on the proposed amendments in 2004 and 2005, but the proposal was not adopted. In 2008 the OCCFM proposed housekeeping amendments to the utility code, to update administrative provisions. These changes were approved by Council, but did not address the tax inequities.

The impact of this inequity is a loss of revenue to the City, as more City residents shift from traditional landline phone service to alternatives such as wireless. A recent study by the Nielson Company estimated that between 2003 and 2007, the percentage of households nationwide that were wireless-only increased from 4.2 percent to 16.4 percent. The shift is evident in the decline of City telecommunication revenues as shown in Figure 4. Adjusted for inflation, telecommunication revenues to the City decreased 38 percent from 1999 to 2008, despite new franchise revenues generated by competitive local phone companies and wireless providers.

Figure 4 Total telecommunication revenue Fiscal Years 1999-2008



Source: City Analysis and Reporting System, Office of Management and Finance

To make the utility and franchise payments equitable across telecommunication utilities, Council could choose to extend the utility fees to all service providers, or reduce or eliminate the fees for existing payers. OCCFM staff estimate the potential revenue from expanding the utility tax to cover all telecommunications providers at a consistent rate would be approximately \$13 million per year. A decision to decrease utility taxes on existing tax payers, rather than expand the base, could result in a decrease in revenues (see Figure 4 for current telecommunication revenues). We believe that not having an equitable utility and franchise fee system may decrease businesses' willingness to pay, make the City more vulnerable to lawsuits, and create a less equitable competitive environment for businesses providing services to City residents.

Recommendations

Utility and franchise fees are a significant source of revenue to the City's General Fund. We recognize that the complex legal environment, the overlay of state and federal regulatory requirements, and the changes in the telecommunications industry make utility administration more difficult. However, we believe that the inequity in the City Code and inconsistent approach by Office of Cable Communication and Franchise Management may erode businesses' willingness to pay, decrease revenues to the City, and create a less equitable competitive environment for entities doing business in the City.

We recommend:

- 1. The Commissioner-in-Charge direct the Office of Cable Communication and Franchise management to develop consistent, written procedures for the following:**
 - a. A process for determining and documenting when franchising is required
 - b. A policy defining the process, criteria, and documentation required for settlement decisions
 - c. Payment documentation and reporting requirements for businesses

d. Standard franchise requirements, including records retention and audit schedules

2. City Council and the OCCFM review and update the utility codes to ensure equitable treatment of all businesses.

The update should also eliminate obsolete provisions and ensure consistency between utility, franchise, and privilege tax code provisions.

GLOSSARY

Cable provider: Companies with rights-of-way franchises to provide cable services. Cable providers may also offer internet and phone service. Currently only Comcast provides cable services in Portland.

Competitive landline phones: Providers of local phone services. Some may own facilities in the right-of-way and some may lease capacity from another carrier. Examples in Portland include Electric Lightwave Inc, MCI, and Time Warner.

Reseller: Companies that may or may not own telecommunications facilities, but pay compensation to a facility-based provider for use of their systems to deliver wholesale or resale telecommunication services to an end user.

Traditional landline phones: Telephone companies providing service in territories allocated by the Public Utility Commission in accordance with the Telecommunications Act of 1996. In Portland, this includes Qwest and Verizon.

Wireless service provider: Companies that provide telecommunications services primarily through wireless technologies. In addition to phone services, some wireless companies provide connection to the internet. In Portland, wireless providers include T-Mobile, Clear, and AT&T.

Source: League of Oregon Cities and OCCFM records.

RESPONSES TO THE AUDIT



CITY OF
PORTLAND, OREGON

Amanda Fritz, Commissioner
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May 1, 2009

Mr. Gary Blackmer, City Auditor
1221 SW 4th Avenue, Room 140
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Dear Auditor Blackmer:

Thank you for the opportunity to review and comment on the Utility and Franchise Revenue Audit (Report #375).

While this was a joint audit of the Office of Cable Communications and Franchise Management (OCCFM) and the Revenue Bureau, I agree the audit's primary focus on OCCFM was appropriate since two recent prior audits have focused on the Revenue Bureau and OCCFM has not been audited since being assigned the Utility Franchise Management program in 1986. As the new Commissioner in Charge, the Audit has provided me a welcome opportunity to read your expert review of current practices and assessment of areas of potential improvement.

As evidenced in the audit, it is clear that OCCFM's expertise, diligence and collection efforts have resulted in substantial revenue generation for the City. I agree with the recommendations to formalize OCCFM's practices. This will ensure transparency and consistency and allow us to document OCCFM's immense institutional knowledge.

Thank you also for identifying the City's ongoing tax equity issue. Although I agree with OCCFM that this is a Council-wide issue, I also believe the City must first demonstrate that it is spending existing revenues wisely, prior to addressing this issue. I will discuss this issue thoroughly with my Council colleagues.

Your audit has validated OCCFM's direction and Council's recent action to update applicable code provisions. I commend OCCFM for proposing actions on an ambitious timeline that in many respects go beyond your office's recommendations. I also look forward to working with OCCFM and your office to monitor implementation of the Audit recommendations and continually improve the City's practices.

Again, thank you for your work on this audit. Let me add historical thanks for the Auditor's original 1985 audit of this area, which first identified the need to consolidate utility franchise management functions at the City and led to the assignment of those functions to OCCFM. Those original Audit recommendations have yielded great benefits to the City for nearly a quarter century.

Sincerely,

Commissioner Amanda Fritz

cc: Mayor & City Council

AUDIT RESPONSE



CITY OF PORTLAND
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Kenneth L. Rust, Chief Administrative Officer

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M E M O R A N D U M

TO: Gary Blackmer, City Auditor
FROM: Sue Klobertanz, Director, Revenue Bureau
SUBJECT: FINAL DRAFT OF REPORT ON REVENUE COLLECTION (REPORT #375)
DATE: April 22, 2009
CC: Ken Rust, Chief Administrative Officer

Thank you for the opportunity to comment on your audit of revenue collection at the Revenue Bureau and Office of Cable Communication and Franchise Management (OCCFM).

The Revenue Bureau appreciates your recognition of the ongoing improvements in automating the collection process, clarifying and simplifying the business license code and documenting the related policies and processes. Staff is committed to the mission of collecting revenues to fund essential city services.

Currently, the Revenue Bureau is working with the OCCFM to provide audit services in FY 2009-10 for two scheduled non-intergovernmental audits. Following successful conclusion of these audits, the bureaus will discuss the possible continuation and/or expansion of an interagency agreement for the provision of OCCFM audits in future fiscal years, and will jointly discuss related issues raised in the FY 09-10 budget process, such as a possible utility audit revolving fund.

The Revenue Bureau is pleased to enter into this cooperative relationship and believe we can use our existing expertise to complete the work in an efficient and effective manner. The Revenue Bureau will also continue to support partnerships with other bureaus and consolidation of functions where appropriate.

We appreciate the opportunity to participate in these discussions.

An Equal Opportunity Employer

To help ensure equal access to programs, services and activities, the Office of Management & Finance will reasonably modify policies/procedures and provide auxiliary aids/services to persons with disabilities upon request.

www.portlandonline.com/omf/revenue



CITY OF PORTLAND, OREGON

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May 1, 2009

TO: Gary Blackmer, City Auditor

SUBJ: OCCFM response to Audit of Utility and Franchise Revenue (May 2009)

I. Executive Summary of OCCFM Response

The Office of Cable Communications and Franchise Management (OCCFM) thanks the Audit Services Division for conducting an audit of our collections of utility/franchise fees. We believe it is important at the outset to note that this is the first-ever audit of the OCCFM utility program in the nearly 25-years that have elapsed since the City Auditor first identified (in 1985) the need for a centralized (not fragmented) Utility Franchise Management program at the City, and the subsequent assignment of that program (in 1986) to our agency (which was previously entitled the Office of Cable Communications)¹. We are pleased to offer an initial executive summary of our response, followed by a more detailed analysis, which includes OCCFM's commitment to promptly complete (within a year) administrative actions going forward in those areas where OCCFM agrees with the recommendations contained in the Audit. Our summary is as follows:

1. *Useful administrative improvements suggested by the Audit in OCCFM collections and auditing should not obscure the need for action by the Council as a whole to create equity in the City's longstanding telephone tax (under PCC 7.14). Such action, if taken, could potentially add \$13-15 million in new, recurring revenue to the City's General Fund. OCCFM has previously requested such action by the Council on multiple prior occasions. OCCFM once again stands ready to work with the Council as a whole in this regard.*

¹ The Office of Cable Communications ("OCC") was created by the City Council in May, 1980. The City Auditor's "Review of Public Utility License Fees" IAR 2-85 (1985) among other things pointed out the problems which arose from the City's then-fragmented administration of private utility matters (which had previously been scattered among multiple bureaus for many years) and recommended that a single and primary City bureau point of contact be established with responsibility for overseeing and helping coordinate multiple and ongoing City contacts with private utilities (including payment of fees, right-of-way use, franchising and re-franchising, collections, legal and policy matters, state and federal legislative relations, litigation, & etc.). OCC was assigned this function in 1986, and the "Office of Cable Communications and Franchise Management" (OCCFM) was re-born as the resultant entity (subsequent City Code amendments to PCC 3.114 formally recognized the change in 1988).

2. *OCCFM welcomes and is committed to promptly implementing the constructive administrative improvements recommended in connection with OCCFM utility revenue collections and auditing practices; OCCFM wishes to emphasize that a number of these improvements are similar, in many respects, to those recommended by the Auditor in previous audits (2004 and 2006) of the Revenue Bureau and its predecessor the Bureau of Licenses; OCCFM moreover is pleased to commit to aggressively implementing these administrative improvements (over matters within OCCFM's control) within the next fiscal year.*
3. *At the same time, OCCFM remains perplexed that the final version of the Audit retains several references (discussed more specifically below) regarding OCCFM programmatic matters (including alleged program inconsistencies) which cannot be substantiated on the record, or else are not material in terms of fiscal impact on the City, or which may be based on a faulty or incomplete understanding of the environment in which we work. These elements of the Audit in our view may not reflect adequate analysis or understanding of the complex, legally constrained and highly litigious legal environment in which OCCFM's substantive work is accomplished, including the negotiated, 2-party nature of franchise agreements (where—unlike City Code--- the City cannot dictate terms, but can only reach agreement with potential franchisees through negotiations); the degree to which OCCFM's work is dependent on negotiations, legal strategies, and cooperation from existing and potential franchisees, as well as substantive cooperation from other bureaus (e.g. PDOT, City Attorney's Office, Government Relations); well-settled differences among various categories of franchisees (which have been consistent for many years); decision-making on regulatory matters by OCCFM based on cost/benefit criteria for the City applied in a straightforward and consistent manner over many years; and finally the fact that OCCFM only very recently and for the first time received authority under City Code (as of January 15, 2009)² to engage in formal rulemaking enabling us to implement a number of recommendations of the Audit;*
4. *With respect to other City Code updates suggested by the Audit, OCCFM is willing to cooperate on an inter-bureau basis in bringing these forward, but respectfully submits that none of the other Code revisions identified in the Audit involve outdated Code sections with any demonstrable or substantial adverse fiscal impact to the City, nor can any of the referenced Code updates be accomplished by OCCFM alone, but instead will depend on cooperation by other City bureaus and offices (e.g. cooperation from the City Auditor's office itself, as well as the Revenue Bureau, and the City Attorney's office in connection with updating PCC 7.12; and continued cooperation with PDOT in completing the already-launched update of the transportation and Right-of-way provisions of Title 17 of the City Code).*
5. *Finally, OCCFM acknowledges and appreciates the recognition afforded by the Audit that OCCFM should be credited with collection of substantial compliance revenue on the City's behalf over many years, through, e.g. payment auditing, monitoring, and litigation. However, in light of the Audit's concurrent assertion*

² By means of Council-approved amendments to Portland City Code Chapter 7.14 (which is the primary City Code section governing OCCFM's collections under the City Utility License fee program).

that potential (but not always specified) losses of revenue may be implicated in certain instances (in amounts which when specified are not commensurate with the new and recurring revenue successfully obtained by the City through OCCFM's work) OCCFM believes that it is important in our formal response to specifically document the scope and substance of City revenue gains achieved (or projected) directly or primarily owing to OCCFM's work for more than a decade, while at the same time taking pains to clarify that the current fiscal shortfall facing the City is NOT a result of failure to implement any of the particularized OCCFM administrative improvements identified in the Audit, but rather are primarily a result of shortfalls in City Business License fee collections due to the current severe economic recession³.

II. OCCFM FORMAL RESPONSE TO AUDIT

Preliminary comment & organization of OCCFM formal response. Once again we appreciate the opportunity provided to the Office of Cable Communications and Franchise Management (OCCFM) to respond and comment on the Utility and Franchise Revenue Audit (May 2009). This memorandum is for the purpose of clarifying those areas where we agree that OCCFM administrative action and improvements are appropriate and necessary, committing to take such actions promptly on a going-forward basis, and finally providing more detailed comment and background, particularly addressed to our concerns regarding certain interpretive and factual matters included in the Audit. We have organized our response in terms of:

- (1) administrative actions going forward where OCCFM substantially agrees with a number of the recommendations contained in the Working Draft, and commits to an aggressive timeline for implementation, with completion contemplated before fiscal year end FY 2009-10; and
- (2) addressing and/or responding to certain factual and interpretive items and statements in the Audit where we believe correction or clarification is warranted.

A. OCCFM Going-Forward Commitments (to be completed FY 2009-10)

Based on the constructive elements of the Audit recommendations, on or before June 30, 2010, OCCFM commits to accomplishing the following:

1. Administrative Rules (under authority of PCC 7.14 effective January 15, 2009)

- promulgating an administrative Rule regarding audit settlement documentation and the process to be used when Council approves any audit settlement recommended by OCCFM or with substantial OCCFM participation⁴;
- promulgating an administrative Rule regarding the documentation, format and information that must accompany all Utility License Fee (“ULF”) payments, franchise fee and other payments received by OCCFM⁵; and

³ See OCCFM Figure 2, below.

⁴ This responds to Audit recommendation 1.b.

⁵ This responds to Audit recommendation 1.c.

- promulgating an administrative Rule regarding telephone resellers, including clarifying the extent to which resellers are legally included under current ULF definitions.⁶

2. Process & Policy Matters

- *Franchise template and Franchise Application process*: OCCFM will revisit, review and revise where necessary our existing Franchise template and Franchise Application process, update model Franchise provisions (for each type of franchisee where applicable), and re-launch this material on the OCCFM website and as an OCCFM Administrative Policy (this must be accomplished in consultation with the City Attorney, the Auditor, and OCCFM's Commissioner in charge)⁷
- *Franchising Applicability Checklist*: In conjunction with revisiting and revising our existing application process & template, OCCFM will also develop and finalize, in consultation with the City Attorney and Auditor's office, a Franchising Applicability Checklist designed to clarify and specify exactly when a franchise is required, provide examples of situations where a franchise may not be required, and clarify what City Code sections apply to any entity that either may not agree to a franchise (since a franchise is a contract requiring both parties to agree) or else to entities not required to obtain a franchise but who may fall under other sections of Code (e.g. PCC 7.12, PCC 7.14) where OCCFM has administrative responsibilities; OCCFM proposes that this clarification be included (with the update to the Franchise template and application process) as an overall adopted OCCFM Administrative Policy, adopted by the Bureau, approved by the Commissioner in Charge and published on the OCCFM office website;⁸
- *Revisions to PCC 7.12*: Subject to agreement with and participation by other bureaus listed in Portland City Code Section 7.12, OCCFM will launch a Code Review and Update process for review and revision of Portland City Code Section 7.12 (Privilege Tax), in consultation with the Auditor, the Revenue Bureau, and the City Attorney's office, with a view toward presenting an updated, corrected and modernized PCC 7.12 to the City Council before the end of FY 2009-10; we recommend this Code Review process be mapped out and begun no later than September 1, 2009⁹;
- *Records Retention requirements: documentation of basis for differing requirements, and clarification/update where necessary*: As discussed below, OCCFM commits to documenting the legitimate accounting reasons for the different records retention requirements (3 years) under the revised ULF (PCC 7.14) versus the records retention requirement in Business Licenses (7 years)¹⁰.

⁶ This responds to Audit recommendation 1.c. and 2.

⁷ This responds to Audit recommendation 1.a.

⁸ This responds to Audit recommendation 1.a. and 2.

⁹ This responds to Audit recommendation 2. and a portion of Audit recommendation 1.d.

¹⁰ As referenced elsewhere in this response, there are wholly legitimate accounting reasons for these distinctions, having to do with underlying legal requirements governing retention of certain records for tax purposes (7 years) versus retention of general ledger (gross income) records (generally 3 years), but OCCFM will document the legitimate and longstanding accounting reasons for these distinctions.

OCCFM commits in its franchising processes going forward, and in its updated model franchise provisions (on the OCCFM website and as Administrative Policy) to provide for such consistent records retention in new, renewed, or renegotiated franchises that accord with the existing records retention requirements of either the ULF or the Business License provisions as applicable, or else clearly document and justify any different provision which may be arrived at in individual instances as a result of negotiations. OCCFM documentation in this area will take the form of a published Administrative Policy or a Rule but we will make a determination on the final form by which this issue is addressed through consultation with the City Attorney's office, the Auditor's office, and our Commissioner in charge¹¹.

- Utility & franchisee audit process & schedules, going forward: OCCFM has an existing schedule for utility and franchisee audits and processes, which depends on budget resources annually allocated by Council for this function, as well as OCCFM's professional judgment about the order of magnitude of the revenues or issues at stake in an individual case, and/or possible litigation and strategic issues. However, recognizing that an underlying theme of the Audit is that such processes be routinized and documented, and that process efficiencies be explored and captured whenever possible, OCCFM commits to going beyond the specific recommendations of the Audit and looking for additional efficiencies by, among other things:
 - exploring creation of a possible Revolving Audit fund, to be replenished annually with monies collected in ongoing audits;
 - publishing and revising when necessary a planned audit schedule for all existing categories of franchisees, licensees and other OCCFM payers;
 - developing an interagency agreement with the Revenue Bureau for conducting certain utility or franchisee audits on subjects or in areas where OCCFM can cost-effectively utilize Revenue Bureau staff and processes at less expense than hiring outside auditors; if successful, such an interagency agreement can be renewed and continued on an annual basis, subject to planned audit schedules and ongoing audit needs and circumstances;¹²
- Documenting OCCFM criteria for franchising and audit settlements - OCCFM commits to publishing in the form of a formal Administrative Policy OCCFM's longstanding "cost/benefit" criteria for franchising and audit settlements: our cost/benefit criteria for many years have been predicated on ascertaining (in consultation and cooperation with the City Attorney, our Commissioner in Charge and other interested or affected City bureaus) whether any given franchising activity or process undertaken by OCCFM, including negotiations, settlement, or litigation, will result in a net fiscal, legal or policy benefit to the City that exceeds

¹¹ This responds to Audit recommendation 1.d.

¹² This responds to Audit recommendation 1.d. and portions of the Audit narrative, but exceeds Audit recommendations in a number of respects. At this writing an interagency agreement by OCCFM with the Revenue Bureau for certain audits has already been informally discussed and agreed on for FY 09-10.

or is demonstrably greater than the cost to the City itself (including staff, consultant and litigation costs) of engaging in such activity or process.¹³

B. OCCFM summary of key issues & responses on interpretive and factual matters

Having set forth OCCFM’s going-forward commitments in response to each of the specific recommendations of the Audit, OCCFM also wishes to use this opportunity to comment on, clarify, provide context or in some instances correct certain interpretive and factual statements, opinions, or illustrations referenced or utilized in the Audit. In lieu of providing comments on a section-by-section basis, we believe it is more effective to provide such comments on an issue-by-issue basis based on our views of the key issues (part 1, below), and to provide further clarification and context in connection with specific statements included the Audit, where identified (Part 2, below).

1. Summary of Key Issues.

1. Key fiscal issue. The key fiscal issue facing the City in OCCFM’s program area, as the Audit rightly emphasizes, is the need for *telephone tax equity*. Fundamentally, this means that the City’s current telephone tax structure, which exists as a component of the City’s longstanding Utility License Fee or “ULF” structure under Portland City Code (“PCC”) Chapter 7.14, is inequitable both to the City and affected payers in its current design and application. OCCFM fully agrees with Audit findings in this respect. In essence, under current circumstances, the City in terms of telephone taxation relies on an outdated, eroding and quite limited tax base applicable only to the limited “lifeline” (or dial tone) revenue portion of the ever-diminishing number of traditionally-regulated landline phones in the City. The primary reason for this inequity is that wireless telephone revenues billed in the City are not taxed because the City has not updated its telephone tax base. A secondary reason is that the City’s existing landline telephone tax base itself is outmoded, and is assessed on only a fraction of the revenues generated by traditional landline phones in the City. However, the lack of inclusion of wireless telephone revenue in the City’s outdated ULF telephone tax structure not only has a disproportionate and inequitable impact on landline users (who pay a telephone tax not paid by wireless telephone users), but also means that the City is in essence forgoing \$13-\$15 million per year in recurring General Fund revenue that could be gained simply by taking the necessary steps to reform the City’s longstanding telephone tax to be equitable to all payers by including wireless and at the same time reforming the existing, outmoded landline tax base. This remains a pressing issue for the entire Council but can only be addressed through action at the Council level. This is also an issue that OCCFM has recommended on multiple occasions over the past five years the City should address, but which, as the Audit recognizes, nevertheless remains unaddressed at this writing.
2. OCCFM collections are only one component of a broader, distinct OCCFM mission which has paid dividends to the City for many years. This Audit by its own terms is limited to OCCFM’s utility/franchise revenue collection function

¹³ This responds to Audit recommendation 1.a., 1.b., and 1.d.

and is not by any means a programmatic audit of the structure and overall functions of the bureau. In this respect, although the revenue collection component of OCCFM's mission may appear similar (e.g. to the collection activities of the Revenue Bureau) OCCFM has been charged since 1986 with the broader and more specialized mission of managing on the Council's behalf a high level program which includes oversight, regulation, negotiation and coordination of policy and legal matters arising from the City's multi-level, multi-faceted relationships to its major private utilities. To carry out its mission and duties, OCCFM performs highly complex substantive legal and regulatory functions, maintains a regular and essential direct and ongoing reporting relationship to the City Council, and carries out multiple responsibilities on the Council's behalf requiring OCCFM to maintain a high level of expertise and familiarity with applicable franchisees and industries (including utilities in the telecommunications, cable and energy sectors). OCCFM is recognized as the City's longstanding legal and policy advocate on these matters, and remains the Council's advocate for local authority, benefits, and pro-active public interest policies in our specialized area at both national (e.g. Congress and the FCC) and state (e.g. Oregon PUC) levels. OCCFM's duties frequently require direct engagement with the Mayor and Council in that regard, along with substantive participation by other bureaus as necessary (e.g. on current wireless licensing matters, OCCFM has been deeply engaged with both the Planning and the Development Services bureaus). Therefore, although revenue collection functions of OCCFM and, e.g. the Revenue Bureau may appear similar, the overall core functions of both bureaus are distinct. For example, as a consequence of OCCFM's substantive relationship to regulated telecommunications and cable franchisees, OCCFM has been able to address a wide variety of City needs over and above revenue collections alone - this capability has benefited and continues to benefit the City in numerous ways.¹⁴ When the functions of OCCFM were initially studied by outside consultants advising the City on creation of the Revenue Bureau, the consultants concluded: "*The Office of Cable Communications and Franchise Management operates in a highly specialized area. Because of its unique business operations we do not believe it is practical to combine its limited generic billing and cash receipting functions with other agencies.*"¹⁵ Nevertheless, OCCFM agrees with the Audit's view that under

¹⁴ For example, OCCFM's Utility program was able to create the building blocks of the City's IRNE system through negotiating franchise assets in the 1990s. The Utility Program's relationship to the Cable program in turn enabled OCCFM to integrate the City's IRNE assets with cable franchise assets Countywide. In 2002, OCCFM in cooperation with the MHCRC and many local elected officials was able to use the occasion of an ownership transfer of cable franchises to Comcast to leverage an interconnected, countywide public broadband system that presently serves schools and libraries throughout Multnomah County at substantially greater capacity and substantially lower cost than previously available. Most recently, the relationship between OCCFM's Utility and Cable programs provided leverage and bargaining power enabling OCCFM to include Comcast voice revenues in the City ULF (January 2009) with new, unanticipated revenues of \$600,000+ per year to the City, without litigation or public controversy. These are only a few examples of the critical synergistic relationships of OCCFM's Cable and Utility programs.

¹⁵ Report to the Mayor, Revenue Bureau Work Group, AKT Consultant Report, March 1, 2004, page 7.

- current fiscal circumstances any possible efficiencies in the auditing or collections area should be considered and OCCFM is already acting on this (see footnote 12).
3. OCCFM only recently received Code authority to implement necessary improvements. In making recommendations regarding improvements in OCCFM administrative practices, the Audit makes brief mention that OCCFM only recently (in January 2009) received from City Council the necessary Code authority (in PCC 7.14 amendments) to administratively implement (e.g. through promulgating rules) most of the needed improvements, after working for more than a year under Commissioner Saltzman to develop the necessary Code amendments.
 4. Update of Privilege Tax Code not fiscally urgent, but can be accomplished with participation of multiple bureaus. The Audit states that OCCFM has failed to update the Privilege Tax Code (PCC 7.12) but does not highlight that this Code section names multiple bureaus (including the Auditor) along with OCCFM as responsible for administration, and is a Code section seldom used or relied on by the City in collections or legal matters. However, OCCFM agrees with the Audit that such an update would be useful from a legal and policy standpoint, despite not being urgent from a fiscal perspective. Any update of this Code section, however, will need to involve direct participation not just by OCCFM, but also by the other bureaus specifically named in PCC 7.12, including the City Auditor and the Bureau of Licenses (now the Revenue Bureau). But for purposes of this Audit it must be stressed that there is no evidentiary basis that any lag in updating this particular little-used Code section bears any verified or documented relationship to any material revenue loss by the City. OCCFM's position is that there is in fact no demonstrable revenue loss from prior delay in updating the Privilege Tax Code, and the Audit's implication to the contrary is unfortunate.
 5. Any revenue loss from "collections" insubstantial in relation to OCCFM success in securing significant new revenues for the City over the years. OCCFM does not agree that the City has experienced any significant revenue loss from "collections".¹⁶ OCCFM is happy to document this by including OCCFM Figure 1 (below) which sets forth in detail substantial additional, unanticipated City revenues gained by virtue of OCCFM compliance programs for more than a decade (projected through 2012). As Figure 1 demonstrates, OCCFM's compliance work has enabled the City to gain or anticipate more than \$25 million in unanticipated revenues over this period. These revenues are inextricably intertwined with the unique relational function of OCCFM, where work on utility issues is managed in a variety of ways in cooperation with other City bureaus, and where OCCFM's ongoing work is not confined to Code-mandated revenue collection alone. OCCFM Figure 1 (below) documents this otherwise-unanticipated new revenue, broken out over the period of 1999-2012 (projected).

¹⁶ The assertion in the Audit regarding such alleged revenue loss in at least one instance appears based on informal, unpublished unofficial internal OCCFM estimates which were not intended for use outside the bureau and which did not include (nor were designed to include) the legal and regulatory context, caveats and limitations on the projected estimates; moreover, the ability of OCCFM to promulgate rules addressed to this area was strictly limited until passage of the necessary Code change (effective January 15, 2009); as discussed elsewhere in this response.

OCCFM FIGURE 1

OCCFM Compliance Program Revenue Collection Summary, 1999 – 2012 (projected)				
	One-Time Revenues		Ongoing Revenue Impacts	TOTAL
YEAR	Major Actions or Initiatives	REVENUE COLLECTED		
1999-00	Baseline (late fees and fines)	\$155,455	\$0	\$155,455
2000-01	CLEC audit (ELI); LD audit (Phase I)	\$1,302,605	\$0	\$1,302,605
2001-02	Qwest lawsuit win; PGE audit	\$5,310,918	\$37,250	\$5,348,168
2002-03	LD audit (Phase II)	\$605,104	\$209,000	\$814,104
2003-04	Wireless	\$167,879	\$454,000	\$621,879
2004-05	LD adjustments	\$156,588	\$503,000	\$659,588
2005-06	PPL audit; wireless	\$213,183	\$784,000	\$997,183
2006-07	ELI lawsuit settlement	\$4,583,673	\$1,436,617	\$6,020,290
2007-08	360 settlement	\$1,252,894	\$545,230	\$1,798,124
2008-09	NWNG, Comcast Digital Voice, Qwest	\$1,183,287	\$717,382	\$1,900,669
2009-10 (est)	Comcast Digital Voice	\$700,000	\$700,000	\$1,400,000
2010-11 (est)	McLeod CLEC Audits/Lawsuits	\$2,000,000	\$400,000	\$2,400,000
2011-12 (est)	XO, Level 3 CLEC Audits/Lawsuits	\$1,500,000	\$300,000	\$1,800,000
TOTAL (actual + est)		\$19,131,585	\$6,086,479	\$25,218,064

2. OCCFM responses (detailed) to selected Audit statements

Audit Statement: *“The inconsistent application of franchise and utility fee requirements creates an unclear regulatory environment and a potential loss of revenue for the City.”*

OCCFM comment: To the contrary, revenue collections from OCCFM have been a substantial bright spot in the City’s revenue picture for many years. See OCCFM Figure 1 (above) demonstrating otherwise-unanticipated actual and estimated revenues to the City totaling more than \$25 million from 1999 to 2012 (projected).

Audit Statement: *“...the inequity in the City Code and the inconsistent approach by Office of Cable Communications and Franchise Management may erode businesses’ willingness to pay, decrease revenues to the City, and create a less equitable competitive environment for businesses.”*

OCCFM comment: OCCFM does not agree with this summary statement (included at the beginning and repeated at the end of the Audit) except to the extent it refers to the longstanding need for City action on telephone tax equity (as described in Key Issue #1, above). Apart from the issue of telephone tax equity, which OCCFM agrees is a major and significant issue requiring City action, there is simply no objective evidence in the record that businesses are otherwise unwilling to pay or that City revenues have by any measure decreased as a result of delay in updating the little-used Privilege Tax Code (discussed in Key Issue #4, above). Any implication to the contrary is unwarranted, and is at best sheer speculation, devoid of objective evidence or substantiation. The core problem remains this: the City’s telephone tax has not yet been updated and applied to all telephone revenues in the City (i.e. all voice services including wireless). Moreover, the quoted statement (twice-repeated in the Audit) as written is misleadingly generic, appearing to imply that there is or may be an overall problem of differential treatment within the City’s Utility License Fee (ULF) tax, which as written otherwise assesses at uniform rates utility revenues earned by gas, electric, sewer, water, and cable licensees doing business in the City. There are no differential treatment or equity issues with respect to the other categories of ULF payers; it is *only* the telephone portion of the ULF tax that needs attention by the Council, and *only* the telephone portion of the ULF that gives rise to the need for reform as a result of the differential impact of an outdated definition. Thus, the reference in the Audit to potential “decrease(d) revenues to the City” can at best only refer to a loss of POTENTIAL not actual revenue (due to the need to update the telephone tax), and otherwise bears little or no objective relationship to overall collections or administration by OCCFM of the existing ULF tax.

Audit Statement: *“businesses such as pipelines and power companies pay a fee to use the City right-of-way, while other entities, such as railroads, do not.”*

OCCFM comment: OCCFM is disappointed that the Audit continues to utilize this comparison, which we believe, based on order of fiscal magnitude to the City, is not a fair analogy. As documented in OCCFM’s initial reply to the Working Draft of the Audit (and as discussed more extensively, below), the recommendation by OCCFM in the 1990s, accepted at the time by both the City Attorney’s office and our then-Commissioner in Charge, was that the City not invest extraordinary staff and legal time to renew the City’s antique but expiring railroad franchises. The actual revenue to the

City implicated by these historic but fiscally insignificant railroad franchises amounted to \$600 per franchise per year (3 railroad franchises, or a total \$1,800 per year), an amount little changed since Portlanders wore button shoes in the 19th century. In the meantime, the estimated cost in staff time to negotiate renewals of the expiring railroad franchises (negotiations which in and of themselves presented a substantial risk that any agreement to renew these franchises on the same or similar terms might severely undercut the City's other recent franchising compensation reforms); along with potential (and very likely) litigation expenses would easily have exceeded ten to one hundred times the amount of revenue forgone by the City (\$1,800/year). This situation is further discussed in greater detail (below). Therefore, any comparison of antique railroad franchises to other entities such as power companies (where franchise/utility fees paid to the City are more than \$15 million/year) or pipeline companies (involving revenues to the City of more than \$100,000/year) is not warranted based on the magnitude of revenues involved, and is at best a distraction. In this situation and others, OCCFM relies on a straightforward cost/benefit analysis as to whether any given OCCFM franchising activity or process, including negotiations, settlement, or litigation, will result in a net fiscal, legal or policy benefit to the City that exceeds or is demonstrably greater than the cost of the activity or process to the City itself (including staff, consultant and litigation costs). However, as indicated in our Going Forward commitments, OCCFM agrees that the rationale for these and similar OCCFM decisions, primarily arising from a rational cost/benefit analysis as described, can and should be better documented in the record and OCCFM commits to improved documentation of such cost/benefit analyses going-forward (as set forth in OCCFM's going-forward commitments, *see* Section A, above).

Audit Statement: “According to documentation provided by OCCFM staff, since 2000 the City has foregone (sic) over \$4.7 million in revenue through settlements.”

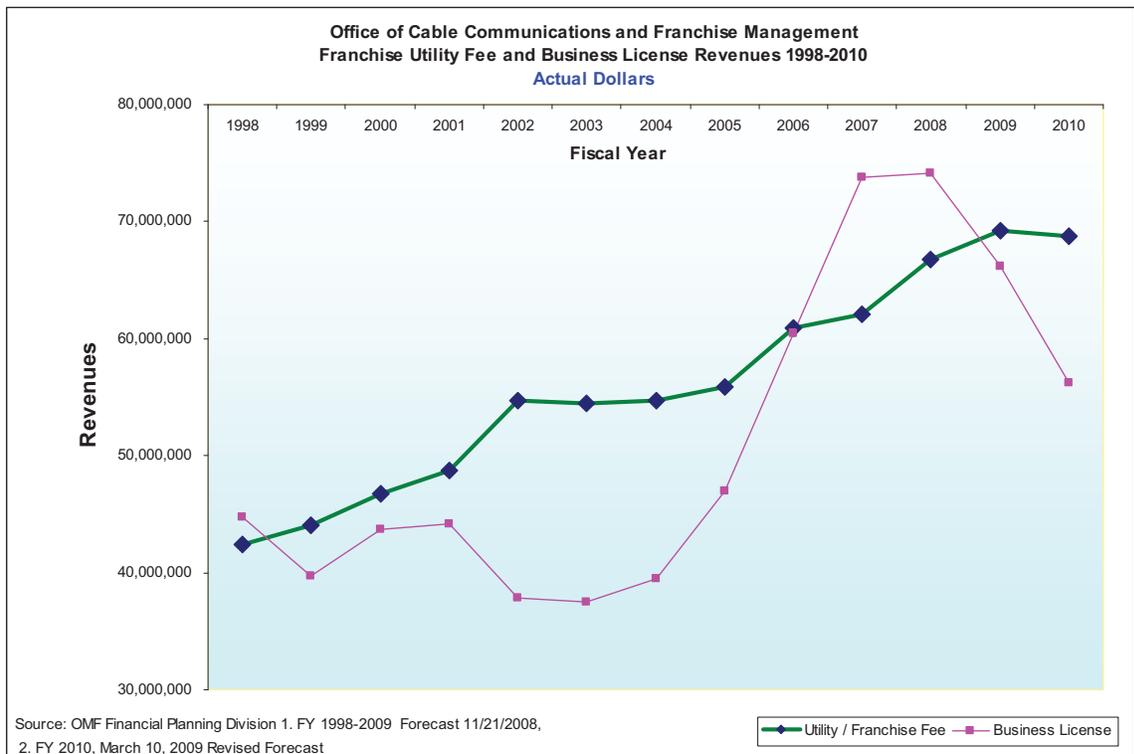
OCCFM comment: As mentioned elsewhere in this response (both above and below), OCCFM did not have specific City Code authority to audit or settle audits at the bureau level until PCC 7.14 Code amendments were approved by the City Council and went into effect on January 15, 2009. Moreover, as the Audit itself references, a number of audit settlements involve legitimate and significant non-fiscal benefits to the City which in some cases clearly outweigh direct fiscal benefits. Moreover, certain settlements (as with NW Natural) sometimes arise in situations where non-OCCFM City entities or agencies (e.g. the City Attorney's office or the Commissioner in Charge) take the lead and make a primary settlement recommendation. Thus, it is not clear that any “forgone revenue” specified by the Audit in this instance would outweigh countervailing, non-fiscal benefits to the City in any given instance¹⁷. Moreover, inasmuch as this Audit by its own terms addresses “revenue collection practices at both the Revenue Bureau and the Office of Cable Communications and Franchise Management”, then at a minimum and in order to provide sufficient and meaningful comparative context, any references in the Audit to “forgone revenue” from OCCFM audit settlements since 2000 should also include (after examination of appropriate documentation) a parallel reference to “forgone revenue”

¹⁷ In the case of NW Natural, the City as a result of the audit settlement was able to enter into the first modern franchise agreement with NW Natural in the City's history, as NW Natural for the first time in 150 years agreed to withdraw from a prior claimed franchise issued to NW Natural's legal predecessor by the Government of Oregon Territory during an era when buckskins were *de rigueur*.

over the same period arising from Revenue Bureau audit settlements (including settlements initiated or recommended by the Revenue Bureau’s predecessor the Bureau of Licenses). Only in this way can the total amount of revenue “forgone by the City” as a result of both Bureau of Revenue and OCCFM audit settlements be sufficiently and appropriately compared, under this methodology, on an “apples to apples” basis.

Audit Figure 1: Figure 1 utilized in the Audit displays recent trends in reduced City Business License fee collections resulting from the current severe economic recession. This situation is a primary factor in the difficult and continuing negative fiscal and budgeting circumstances facing the City Council at this writing and in OCCFM’s view adds a strong element of urgency to what OCCFM regards as the key fiscal issue of the audit (telephone tax equity, Key Issue #1, as discussed above). OCCFM has separately graphed these circumstances and attaches an alternate version (below) of Audit Figure 1, which we hope is also constructive and helpful in graphically depicting the current City fiscal picture:

OCCFM FIGURE 2



Audit Statement: “In FY 2007-2008 the OCCFM collected over \$68 million from franchise fees, utility fees and **privilege taxes.**” (emphasis supplied)

OCCFM comment: As mentioned above, amounts collected by OCCFM from “privilege taxes” under PCC 7.12 are *de minimus* and cannot fairly be equated with amounts collected under franchise fees or the Utility License Fee under PCC 7.14. References to the Privilege Tax Code here and elsewhere in the Audit, along with any implication that collections or liabilities under PCC 7.12 represent anything other than an insubstantial (at

best) proportion of past, ongoing or potential revenues to the City, should in OCCFM's view be considered accordingly.

Audit Figure 2: This figure compares franchise and ULF collections from cable, landline and competitive telephone companies (all based on gross revenues) with revenue from a small number of wireless right of way attachments (fees paid on a per-attachment basis only).

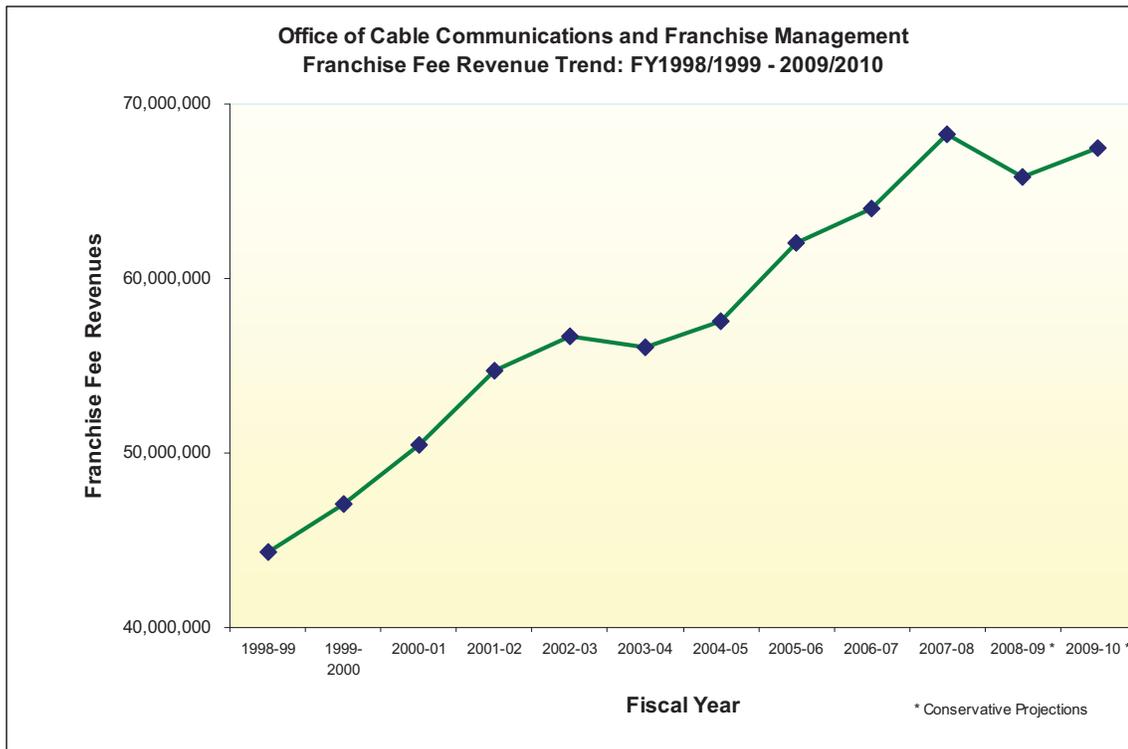
OCCFM comment: The illustration used as Figure 2 of the Audit compares "apples" with "oranges". One of the main issues arising from this Audit (Key fiscal issue #1, discussed above) is that the City has not yet taken collective action to include wireless gross revenues (at 5%) in the ULF telephone tax calculation, nor has the City implemented needed reforms to the existing but outdated ULF landline tax, and that continuing to postpone action on this is potentially costing the City \$13-\$15 million annually in forgone revenue (as detailed in Audit Figure 3)¹⁸. Audit Figure 2, however, in OCCFM's view is potentially confusing (and also distracting in terms of the main issues of the Audit) by comparing wireless per-attachment revenue (based on an entirely different and unrelated formula) to the three other mainstream, and longstanding utility/franchise revenue categories (all involving revenues to the City of a high order of magnitude, and all based on annual gross revenues of the provider, earned within the City). The illustration as used thus appears to equate very modest revenue received by the City with respect to a very limited number of wireless attachments on existing or replacement utility poles in the streets (where compensation is based on a very different methodology) to the City's longstanding and substantial ULF/franchise revenues (all based on gross revenues). Therefore, OCCFM does not believe this illustration is constructive, particularly with regard to the extent to which it might tend to undercut one of the key issues of the Audit.

Audit Figure 4: This illustration in the Audit shows erosion of the City's telecommunications revenue tax base over the past 10 years, which is primarily due to the continued erosion in the City's existing and limited ULF landline telephone tax (discussed above).

OCCFM comment: OCCFM agrees that inclusion of this figure is appropriate, however OCCFM also believes that helpful additional context can be provided by including the Franchise Fee Revenue Trend Chart, 1999-2010 (below, next page, shown as OCCFM Figure 3) prepared by OCCFM's Senior Financial Analyst based on data from OMF's Financial Planning division.

¹⁸ Audit Figure 3 lists annual wireless revenue standing alone as \$11,500,000, but this does not include recent strong wireless growth in the City, nor the fiscal benefits to the City of the additional needed reform to the very limited current ULF telephone landline tax,. The net result of both needed reforms, according to OCCFM's recent updated estimates, would be total additional, recurring annual collections to the City in the \$13 million to \$15 million range.

OCCFM FIGURE 3



Audit Statement: “when there is uncertainty about whether a franchise or utility fee is required, we found that decisions were deferred, resulting in inconsistent application of franchise and utility fee requirements.”

OCCFM comment: OCCFM does not agree that there is any substantial degree of uncertainty involved in the majority of OCCFM franchise/utility fee decisions. Nor does OCCFM agree that occasional, justified application of differential requirements creates undue risk to the City or unfairness to applicants or payers in most instances; rather, decisions made in individual instances to defer action have been based on settled and rational cost/benefit analyses developed in consultation with the City Attorney and the Commissioner in charge (e.g.. potential cost to the City versus revenue to be gained); however, OCCFM agrees with the Audit that the cost/benefit criteria and analysis relied on by OCCFM in given instances can and should be better documented in the record; and OCCFM commits to better documentation of our standard cost/benefit analysis (as stated in OCCFM’s Going-forward recommendations, discussed above).

Audit Statement: “OCCFM estimates potential revenue from entities using the rights of way without franchises or utility payments at over \$400,000 per year.”

OCCFM comment: This estimate, which appears to be extrapolated from internal, unpublished documents, is a very soft number at best and cannot be properly understood without the inclusion of appropriate context.¹⁹ First of all, a substantial

¹⁹ See footnote 16, above.

component of this particular estimate appears to be derived from projected revenues from telephone resellers (discussed more fully, below). The critical point, mentioned elsewhere in this response in numerous instances, is that OCCFM only received authority to address and resolve ambiguities with respect to telephone resellers with the PCC 7.14 Code amendments, effective January 15, 2009. Therefore, any implication that OCCFM (and thus the City) have willingly forgone revenue that was otherwise due or collectible without considerable legal risk or challenge before adoption of the PCC 7.14 Code amendments is not sustainable from a factual standpoint. Further amplification, by issue, is as follows:

Railroads: As discussed briefly (above) the City's three previous railroad franchises expired in the 1990s. Each of these historic railroad franchises paid the City approximately \$600 per year apiece (or a total \$1,800 per year). Upon expiration in the 1990s, OCCFM in consultation with the City Attorney attempted to engage in a renewal discussion with the railroad entities, and proposed to increase compensation under these franchises to a modern, per-lineal foot basis (a methodology OCCFM had established by means of then-recent and successfully-concluded franchises with several point-to-point telecommunications companies wishing to construct new facilities in the City). Attorneys for the railroads at the time made it absolutely clear to OCCFM's negotiating team that the railroads would willingly litigate with the City any degree of increase in proposed compensation in renewed franchises, and also potentially might challenge any substantial change in franchise terms that differed in material respects from historic terms originally agreed to by the City during a period when the Mayor and Council commuted to City Hall via horse and buggy. After discussion with the City Attorney's office, OCCFM recommended that the City not invest extraordinary staff and legal time to negotiate renewal of these antique franchises at a higher rate that was probably not attainable without considerable and unjustifiable cost, time and expense. At the same time OCCFM concluded internally that the City's overall franchising interests would doubtless not be served by putting the Council in the position of appearing to re-ratify 19th century franchise terms written in another era. Moreover, in consultation with the City Attorney's office we estimated that staff time and potential litigation expenses to the City in such an event could easily exceed 10-100 times the amount of any revenue to be gained under the expiring railroad franchises in comparison with potential expenses to the City. Finally, the railroads themselves, as successors in interest to railroads which enjoyed substantial legal and fiscal clout in early Portland history, continued to enjoy the benefit of a considerable body of historical franchise claims, potentially adverse to the City, based on facilities in place for many years, as well as the unknown but possibly adverse impact on the City (in the event of litigation) of a body of longstanding and often preemptive federal and state laws which, collectively, tended to favor railroads.²⁰ OCCFM's recommendation to allow

²⁰ See, in general. *The Robber Barons* by Matthew Josephson, Harvest/ Harcourt Brace & Co 1995. Originally published in 1934. ISBN 0-15-676790-2. With reference to Portland, see also *Merchants, Money & Power: The Portland Establishment 1843-1913*, by E. Kimbark MacColl (published 1988) ISBN 0-9603408-4-X ("MacColl"). In MacColl (page 406) it is noted that "By 1913...they (the Southern Pacific and Union Pacific railroads) held a total of 56 franchises within Portland, all received without payment of compensation."

the railroad franchises to expire was accepted without further comment by the City Attorney's office and the Commissioner in charge at the time. As stated above, however, OCCFM agrees with the Audit that the rationale for these and similar decisions, primarily arising from a consistent cost/benefit analysis (potential cost to the City versus revenue to be gained) could be better documented in the record and OCCFM is committing to better documentation in this area (see Going-forward recommendations, above);

OHSU – the Audit statement that “*a third university placed similar lines in a City right-of-way for development in the South Waterfront neighborhood*” refers to OHSU's South Waterfront development. However, the statement that OCCFM “did not complete negotiations” is not correct. This situation involved at most two perpendicular street crossings, and remains pending subject to formal advice from PDOT as to whether in this particular set of circumstances an encroachment permit approach would be preferable to a franchising approach. OCCFM staff has been of the opinion that the best approach, ultimately, would be for PDOT to conclude its Title 17 Code revisions, which have been supported by OCCFM financially, and which may best address this question on an ongoing basis. Once PDOT's final and formal opinion is obtained, OCCFM is prepared to conclude the process with OHSU, as previously committed. Thus, this is an active and pending franchising/Code situation which has not concluded and should not appropriately be compared to franchises already agreed on and concluded with other institutions. Moreover, compensation potentially forgone by the City due to this situation being somewhat prolonged is minimal.

Telephone resellers – as explained above, the primary pre-condition enabling OCCFM to address and resolve this issue was the January, 2009 effective date of the PCC 7.14 Code amendments providing OCCFM with the formal authority to promulgate a rule making the necessary clarification. Now that OCCFM has formal authority to promulgate rules in this area, OCCFM is committed to doing so in our going-forward actions (set forth above). Under the circumstances, it is neither appropriate nor accurate for the Audit to state that OCCFM “did not pursue payment or clarify the payment rate” when we had been actively seeking authority from the City Council to do exactly that – authority which OCCFM finally received only at the beginning of the current year.

Power companies – OCCFM appears to be criticized here for not yet resuming franchise negotiations with PGE, although those negotiations were recessed only temporarily so as to allow for audit negotiations leading to an eventual settlement and a first-ever modern franchise with NW Natural²¹. OCCFM has every intention of resuming and completing successful franchise negotiations with PGE so long as PGE remains a willing negotiation partner. OCCFM intends to resume work on this issue in FY 2009-10, assuming the cooperation of PGE is confirmed. The temporary hiatus in PGE negotiations was and is based on a rational cost/benefit analysis for the City, but the actions criticized here appear also to criticize not only OCCFM but also the City Attorney's office and our Commissioner in charge at the time, who were consulted and involved throughout the process, including when franchise negotiations were recessed. However, OCCFM agrees with the Audit that improved

²¹ See footnote 17, above.

documentation will better support the circumstances involved in this and similar decisions, and OCCFM agrees that Audit recommendations in that regard are helpful and constructive.

Audit Statement: *“Compliance efforts are hampered by poor payment documentation, infrequent audit and inconsistent franchise terms.”*

OCCFM comments:

(1) Reporting formats: To repeat, OCCFM did not have clear authority to promulgate rules to establish reporting formats and proper documentation until the January, 2009 PCC 7.14 Code changes. OCCFM fully intends to address this issue in the coming year through promulgating the necessary rule (see Going-forward actions, above). There is no evidence showing the City has lost or forgone any revenue in the absence of this administrative improvement;

(2) Records retention and audits: OCCFM does not agree with the substance of the quoted statement regarding infrequent audits, and it is unfortunate that the Audit does not clearly point out that many inconsistencies in OCCFM franchise terms, on an individual basis, are negotiated in order to benefit the City or else to update outdated franchise terms (franchise terms tend to become dated quickly, particularly with respect to rapidly evolving industry segments such as telecommunications). In the area of audits, Utility revenues subject to audit among OCCFM payers are as defined in negotiated franchise agreements we administer, or under PCC 7.14 (Utility License Fee). There are fixed and longstanding categories of payers, including franchisees and licensees who pay on revenues and other franchisees who pay on a linear foot basis (i.e. point-to-point telecommunication carriers and pipelines). OCCFM auditing practices follow a planned cycle, and from an administrative standpoint OCCFM either contracts for specific outside audits, or at other times conducts joint audits in cooperation with other cities. For example, OCCFM has a recent substantial and successful history of cooperating on joint utility audits with other cities in Oregon who share the same provider e.g. PP&L, Qwest, Verizon and NW Natural). These joint audits have created efficiencies for all concerned, and have also served the goal of building relationships with other cities. Joint audits also create efficiencies for the audited utility, where the company benefits from undergoing one audit instead of, e.g. 50 individual audits from individual cities. With respect to records management and retention, there are distinct differences between records audited under OCCFM’s utility program and records under the Business Law. As OCCFM understands it, the records that the Business License Law requires be maintained are net income records of non-utility businesses. They are not "utility revenues" subject to PCC 7.14 or our franchises, owing to the exclusion of such revenues from the calculation of business license fees. The City Attorney's office has previously advised us that under PCC 7.02.400, "[i]ncomes subject to Chapters 7.12 or 7.14" of the City Code (where OCCFM has Code responsibilities) are wholly exempt from the requirements of the Business License Law. Therefore, the City's business license law generally exempts the utilities that OCC/FM regulates from the record keeping requirements of the Revenue Bureau, at least insofar as their gross revenues are concerned. Yet it is precisely the gross revenues of such utilities, from their general ledgers, that are the records which in most cases are subject to audit under OCC/FM's audit programs. This is the underlying context which helps explain, among other things, the legitimate accounting reasons for

different records retention requirements (3 years) under the revised ULF (PCC 7.14) versus the records retention requirement in Business Licenses (7 years). However, as set forth in the Going-forward commitments (above) OCCFM commits in its future franchising and utility management processes to document these distinctions, and provide for consistent records retention requirements in new, renewed, or renegotiated franchises that satisfactorily accord with existing records retention requirements of either the ULF or Business License provisions as applicable, OCCFM also commits to documenting and justifying any different provisions that may be arrived at through negotiations. Finally, OCCFM wishes to again stress that there is no evidence showing the City has lost or forgone any revenue in the absence of these administrative improvements.

In conclusion, OCCFM wishes to extend its thanks to Audit Services staff and request careful consideration of these comments on the part of the Auditor, the City Council, and all interested stakeholders and members of the public. OCCFM remains very proud of a program which for nearly 25 years has delivered excellent value to the City and the public in managing the City's multi-level, multi-faceted utility relationships, and defending the public interest. We appreciate the Auditor's continuing cooperation and support in helping move the City beyond a period when the public interest was not well-served or well-represented in private utility franchise matters (such as the period depicted in the attached 1906 Oregonian cartoon).²²

Respectfully,



David C. Olson, Director

Office of Cable Communications and Franchise Management

²² From MacColl, page 426.



20.8 Oregonian anti-franchise cartoon, 1906

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Utility and Franchise Revenue: Equitable tax and consistent approach needed to improve collections

Report #375, May 2009

Audit Team Members: Kari Guy,
Kristine Adams-Wannberg, Alexandra Fercak

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Gary Blackmer, City Auditor
Drummond Kahn, Director of Audit Services

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