

CABLE TELEVISION DIVISION
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
STATE OF HAWAII

In the Matter of)
)
TIME WARNER ENTERTAINMENT) **NOTICE OF FINDINGS OF FACT AND**
COMPANY, L.P.,) **INTENT TO ISSUE A DECISION AND**
) **ORDER**
) **CATV-06-03**
Under-Collected Franchise Fees from)
Subscribers in the West Hawaii)
Franchise Area on the Island of Hawaii)
for the Period of July 1, 1995 to)
December 31, 2003.)
_____)

NOTICE OF FINDINGS OF FACT AND
INTENT TO ISSUE A DECISION AND ORDER

I. FINDINGS OF FACT

- A. The State of Hawaii (“**State**”) Department of Commerce and Consumer Affairs (“**Department**”) retained Merina & Company, LLP and Public Knowledge (collectively referred to as “**Merina**”), as a financial consultant to review the cable television franchise fee collection and payment process performed by Time Warner Entertainment Company, L.P. (“**TWE**”), doing business as Sun Cablevision (Kona), for the West Hawaii (including Kona and Kohala) cable television franchise area on the island of Hawaii, during the period of July 1, 1995 to December 31, 2003.
- B. In addition, Merina was directed to compare the cable television franchise fee calculation, assessment, collection, and payment process with the

requirements in Decision and Order Nos. 173 (dated June 30, 1995) and 261 (dated August 11, 2000).

- C. The State received a report from Merina on those issues dated October 29, 2004.
- D. Decision and Orders Nos. 173 and 261, and Hawaii Administrative Rules chapter 16-132, specify that the franchise fee consists of three elements: (1) an “Access Operating Fee,” to support public, educational and governmental (**PEG**) access programming,¹ (2) a Hawaii Public Broadcasting Authority (“**HPBA**”) Fee,² and (3) an “Administrative Fee.”³
- E. In general, the Merina Report determined that during the period of July 1, 1995 to December 31, 2003, TWE collected amounts of franchise fees from West Hawaii cable television subscribers that differed from what it was required to pay to the following designated recipients: Na Leo ‘O Hawaii, (“**Na Leo**”), the designated PEG access organization for the West Hawaii Franchise area; Hawaii Public Television Foundation (“**HPTF**”), dba PBS HAWAII (“**PBS**”), formerly known as HPBA; and the Department. This resulted in the following cumulative net over-collected and under-collected amounts:

¹ By Decision and Order No. 261, TWE pays the Director or the Director’s designee an amount equal to three percent (3%) of TWE’s annual gross revenues from TWE’s West Hawaii System.

² Decision and Order No. 261 directs TWE to pay Hawaii Public Broadcasting Authority or its designee an amount equal to one percent (1%) of TWE’s West Hawaii System annual gross revenues.

³ Pursuant to Hawaii Administrative Rule §16-132-2, TWE pays an administrative fee to the Department. During the time period in question here, the fee was one percent of the income received from subscribers during the preceding calendar year. The rule was subsequently modified.

<u>Franchise Fee Element</u>	<u>Accrual basis over/ (under) collected balances</u>
Access Operating Fees	\$ (154,296.00)
HPBA Fees ⁴	\$ 143,548.00
Administrative Fees	\$ (74,915.00)
Total	\$ (85,663.00)

- F. The Merina Report further found that the over- and/or under-collected amounts were largely a result of TWE's internal accounting practices. TWE itemized franchise fees on a flat fee basis, as opposed to charging subscribers a percentage of the amount of the cable television services on each individual subscriber's bill. Over time, the amount TWE collected in itemized franchise fees differed from the percentage amounts remitted to Na Leo, PBS, and the Department. The Merina Report also determined that this difference was attributable to the timing of the collection of the franchise fees from subscribers and the later remittance to Na Leo, PBS, and the Department, and also to the subscriber bill itemization methodology.
- G. The Merina Report also concluded that in its franchise fee computation, TWE did not utilize bad debt write-offs in the revenue reported to the Department. TWE did not also include launch fees, marketing support credits, and/or co-op advertising in its gross revenue calculation.

⁴ Adjusted to an accrual basis which was due and paid in January 2004.

- H. The Merina Report also evaluated whether TWE paid Na Leo, PBS, and the Department the franchise fee amounts that they were due during the period of July 1, 1995 to December 31, 2003. The Merina Report concluded that there were no instances in which Na Leo, PBS, and/or the Department did not receive the proper amount of franchise fees. Each entity received the correct amount due to it.
- I. Notwithstanding the fact that franchise fee payments were made correctly during the period from July 1, 1995 to December 31, 2003, TWE did not attempt to correct any differences between the amounts collected from subscribers and the amounts remitted to beneficiaries at the end of each calendar year. Had it done so, TWE could have increased the amount assessed and collected from subscribers to adjust for the undercollection of projected franchise fees.
- J. As directed in a letter order dated August 11, 2000, TWE agreed to implement a new procedure, beginning January 1, 2001, under which the franchise fee assessment for each subscriber would be based upon a percentage of the subscriber's monthly bill. This was a change from the past practice of a flat fee assessment under which all subscribers were assessed the same amount of franchise fees irrespective of whether a subscriber subscribed to basic service only or subscribed to basic service and other cable programming. This new procedure should eliminate future re-occurrences of over-and/or under-collections caused by the circumstances set forth in Paragraph F herein.

- K. During the period from July 1, 1995 to December 31, 2003, many different customers connected to and/or disconnected from TWE's cable system. At this point, it would be difficult and not cost beneficial to reconstruct which subscribers may have underpaid during the more than eight (8) year period in question.
- L. Based on the amount of fees at issue, the Department finds it would not be cost-effective to reconstruct the over- and under-collections from July 1, 1995 to December 31, 2003 on a customer-by-customer basis.
- M. The Department finds that the amount collected from subscribers in TWE's West Hawaii cable television franchise area on the island of Hawaii did not equal the amount paid out to designated recipients, and TWE under-collected from subscribers in TWE's West Hawaii cable television franchise area on the island of Hawaii, the net amount of EIGHTY-FIVE THOUSAND SIX HUNDRED SIXTY-THREE AND NO/100 DOLLARS (\$85,663.00), during the period of July 1, 1995 to December 31, 2003.

II. PROPOSED DECISION AND ORDER

- A. The Department must decide whether to allow TWE to recover the undercollected amounts. Because the cost of determining which individual subscribers underpaid is prohibitive, and because of the length of time which has elapsed since the underpayments, the Department does not believe it is appropriate to allow TWE to collect those amounts now from past subscribers.
- B. An alternative approach would be to authorize TWE to collect from current

subscribers the amount that was underpaid. However, the Department does not believe that approach is appropriate either. Not every current subscriber was a subscriber during the period from July 1, 1995 to December 31, 2003, when the net undercollections occurred. TWE could have attempted to recover undercollections from subscribers on a timely basis when they were occurring, but did not do so. In these circumstances, the Department does not believe it is appropriate to authorize TWE to recover the undercollections from current subscribers.

- C. The Department notes that a related issue arose with regard to overcollection of cable fees in other franchise areas, such as the City and County of Honolulu. See Decision and Order No. 316, issued February 2, 2005. In that case the Department determined that the overcollected amounts should be refunded to current subscribers.
- D. The Department believes that circumstances of the overcollections and undercollections are distinguishable. In both situations, TWE was in control of the billing process, and thus appropriately should bear the consequences of the decisions it made in administering that process. If it overcollected fees, it should not be allowed to retain them. However, if it undercollected fees and did not attempt to address that shortfall in a timely manner, then current subscribers should not be required to make up the undercollected amounts.
- E. Accordingly, the Department intends to issue a Decision and Order providing that TWE may not assess and collect the under-collected

franchise fees in the amount of **EIGHTY-FIVE THOUSAND SIX HUNDRED SIXTY-THREE AND NO/100 DOLLARS (\$85,663.00)** from current or past cable television subscribers in TWE's West Hawaii cable television franchise area on the island of Hawaii.

- F. However, prior to the issuing of a Decision and Order, the Department will allow interested persons to submit comments on the above Findings of Fact for thirty (30) calendar days from the date of this Notice. The Department will consider comments timely submitted and issue its Decision and Order thereafter.

Dated: Honolulu, Hawaii, February 17, 2006.



MARK E. RECKTENWALD
Director of Commerce and
Consumer Affairs