

Statement of Tom Adams
Revenue Laws Study Committee
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My name is Tom Adams. I am President of the Raleigh Division of Time Warner Cable. I'm also currently the President of the North Carolina Cable Telecommunications Association and, in that capacity, I am speaking today.

As my colleague, Randy Fraser, explained, our goal with respect to tax and regulatory treatment is simple. Treat like services alike. We don't mind competition—in fact our industry has benefited in a number of respects from competition—but we strongly believe that in a competitive environment there must be a level playing field.

I'd like to spend the time that I have today by digging a little deeper into the issue of treating like services alike and explain what it means in terms of two critical issues currently facing the cable industry.

The first is the treatment of cable and satellite service taxes. The second is the issue of increased competition—in particular competition from the telephone companies.

Satellite Tax Issue

As to the tax issue, I want to applaud your work over the years to equalize the sales tax treatment between satellite and cable. You have had the challenging task of closing tax loopholes, plus the issue of bringing North Carolina's sales tax system into compliance with the Streamlined Sales Tax Initiative. You took the time to study the issues, hear from all parties, and make sure that cable and satellite service providers, and their customers, were treated fairly.

As you are aware, cable companies have historically paid up to five percent of their gross receipts in franchise taxes to local governments, in addition to the other state and local taxes identified by Randy.

By contrast, you may be surprised to know that, until 2001, satellite providers paid no gross receipts tax to the State or to local governments. The reason that the satellite companies have not been subject to local tax is that Federal law prohibits it. However, Congress did not prevent states from imposing taxes on satellite. To the contrary, Congress envisioned that states could, and would, impose taxes on satellite service at the state level. So, in North Carolina, prior to 2001, satellite enjoyed a classic tax loophole.

In 2001, acting upon the recommendation of the Governor's Tax Loophole Closing Commission, North Carolina closed this loophole by approving a five percent state sales tax on satellite providers. With the enactment of this tax, the overall tax burden on cable and satellite subscribers was equalized. Subscribers of both services were subject to a five percent gross receipts tax—cable at the local level and satellite at the state level.

Last year, in response to the Streamlined Sales Tax Initiative—which requires the equalization of gross receipts taxes—the General Assembly adopted a seven percent state gross receipts tax applicable to both satellite and cable companies. To preserve tax equity, the legislature allowed cable companies to take a credit against this state tax for the franchise taxes paid to local governments. As is shown on the slide before you, the credit has the effect of equalizing the overall tax burden on cable and satellite subscribers. Under this provision, cable subscribers pay an overall tax of seven percent and satellite subscribers pay the same. Like services are treated alike.

Regrettably, the satellite companies have gone to federal court to try and overturn the General Assembly's fair-minded decision to treat satellite and cable customers alike. They claim the General Assembly's tax treatment of cable and satellite violates the Constitution because it treats the state and local taxes on gross receipts equally. The satellite companies actually lost this very same argument in the state courts last year when they challenged the old law. They have now brought this same challenge against the new tax, this time in federal court. We certainly believe that the federal court will come to the same conclusion that the state court did—that the tax is an entirely rational and permissible measure well within the legislature's prerogative.

In their arguments for change, you will probably hear from the satellite companies about state sales tax and local franchise taxes serving different purposes. Satellite companies will argue that the tax paid by cable companies is actually a “fee” for use of the rights-of-way. This simply is not so. It's a tax, pure and simple.

In fact, the statutes authorizing this tax call it just that—a “tax.” If the General Assembly had intended for it to be a “fee,” it would have called it that.

And the tax has, in substance, all the characteristics of a tax. Unlike a “fee” which is used to recover specific costs, the proceeds of the five percent franchise tax are used by local governments for general welfare purposes. If the tax was just a “fee” for use of the rights-of-way—then North Carolina counties would not be permitted to impose the five percent levy because counties do not own rights-of-way in North Carolina.

Finally, it is telling that other companies using rights-of-way do not pay a five percent tax to the local governments. Telephone, electric, and gas companies all use rights-of-way, yet they are not subject to a five percent franchise tax. If the tax was merely a “fee” for use of the rights-of-way, these other companies would also pay the fee.

All these arguments aside, all you really need to do is look at the effect of the taxes in question on the consumers of the services. The slide in front of you shows what the satellite companies are proposing—what you have already rejected twice. If you were to accept the satellite companies' argument that the local franchise tax should not be treated as a tax, the effect would be to put an additional five percent tax on the 1.8 million North Carolina households that elect to receive their television by cable rather than satellite. Cable customers would then be taxed at the rate of 12 percent—paying five percent at the local level and seven percent at the state level. Yet satellite customers would pay only the seven percent state sales tax. That is unfair by any

measure. Cable subscribers should not be penalized for choosing to receive their television service by cable.

At the end of the day, what the satellite companies really want is their loophole back. I can't say I blame them. But I do want to applaud you for the decisions you have already made to adopt a tax-neutral policy for competition between cable and satellite providers, and I would urge you to reject any further efforts by the satellite industry to tilt this level playing field in their direction.

Video Franchise Issue

The second issue that I want to address today, is the issue of telephone companies entering the video marketplace and the potential impact this will have on consumers and on state tax and regulatory issues.

In other states across the country, telephone companies are seeking authority to enter the video service market, but under a different set of rules. We anticipate the same attempts will occur in North Carolina. As we have indicated previously, we welcome competition, as long as everyone is playing by the same rules.

In North Carolina, some telephone companies are already providing video under local franchise agreements, the same rules that apply to cable companies. There are at least five telephone companies that currently offer video services under local franchises and have been doing so for quite some time. In other states, Verizon has been actively obtaining cable franchises from local governments in states like Virginia. BellSouth currently has at least 20 cable franchises in other states serving some 1.4 million subscribers in areas like Atlanta and Miami.

Nonetheless, some of the phone companies have said that they want to bend the rules in their favor. They advocate a change in the local franchise process to give them a competitive advantage. Many of you are aware that during the final hours of last year's legislative session, attempts were made to add a provision to the technical corrections bill that would have exempted telephone companies—but not cable companies—from the local franchise process completely. We are grateful for the successful efforts of leadership in the General Assembly, including many of you in this room, to block this effort.

The cable industry is not opposed to a re-examination of the manner in which franchises are awarded. Again, we only ask that you regulate like services alike. That's why we will strenuously oppose any effort to carve out special regulatory treatment for telephone companies that would free them from regulatory requirements to which the cable industry is subject.

There are few points here that I want to bring to your particular attention.

First, the debate over how telephone and cable companies should be regulated is not occurring in a vacuum. It is occurring in many states across the nation. It is also being debated in Congress, and at the Federal Communications Commission. There are several bills pending in Congress that would overhaul the manner in which video franchises are awarded, and the FCC itself has opened a rulemaking proceeding to consider adopting new rules to more tightly regulate the local

franchise process. Any regulation by North Carolina must, of course, be consistent with these federal laws and rules as they presently exist and as they may change in the near future.

Second, one of the principles that is particularly important under federal law is that local governments should be permitted to ensure that their citizens are not left behind as new services are made available. This is referred to as “build-out.” Cable operators have traditionally been required to build out their networks. Sound public policy should not require one competitor—in this instance, cable—to construct facilities throughout a community and then allow another competitor—the phone companies—to pick and choose where they want to build and which customers they want to serve. Such “cream-skimming” would artificially increase the cost of cable service and, by regulatory fiat, effectively subsidize the telephone companies’ networks.

More fundamentally, the public policy of this State has been that all citizens should have access to the latest technologies and services. Such technologies are an engine of economic growth in North Carolina, and are an essential part of community development and opportunity in today’s economy. It is the policy of the State to promote broadband deployment in rural and underdeveloped areas. This is what the “digital divide” is all about. And as we all know, it is something that is still prevalent in our rural areas. Ensuring that the phone companies build-out like cable companies have done—and not be permitted to serve only affluent customers or only customers in densely populated areas—will be consistent with this policy and will help ensure high-speed broadband facilities are widely available.

In summary, as shown on the slide in front of you, the basic policy position of the cable association on these important tax and regulatory issues is straightforward:

- * Tax and regulate like services alike;
- * Don’t discriminate against television viewers who subscribe to cable; and
- * Don’t bend or change the rules for any particular competitor.

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As always, we appreciate, very much, the opportunity to work with you on these and other issues impacting our industry.

Again, thank you for the opportunity to speak with you today.