

JOINT STUDY COMMITTEE ON FRANCHISE FEES

AND CONDITIONS, RIGHTS OF WAY &

TAX IMPLICATIONS OF COMPETITIVE MARKETS

TO: The Governor, Lieutenant Governor, Speaker of the House of Representatives, Members of the General Assembly, and Other Interested Parties

Prepared by the Offices of House and Senate Research

The Committee

Senator Terrell Starr, Chair

Representative Newt Hudson, Chair

| | |
|---------------------|-----------------------|
| Sen. Charles Walker | Rep. Jimmy Skipper |
| Ms. Nancy Horne | Hon. Bob Knox |
| Mr. Bill Archer | Dr. H. Edwin Overcast |
| Mr. Bill Croker | Mr. Bobby Rowan |
| Mr. Bill Verner | Mr. Jim R. Newman |

I. Introduction

SR 544/Act 105 creates a study committee to examine municipal and county franchising authority and the impact of fees assessed for use of the public rights-of-way on the development of competition. In an effort to better understand franchise fees and the impact such fees have on local entities in Georgia, this joint study committee commissioned the School of Policy Studies at Georgia State University to help research and define these impacts. Once the committee received this background information, meetings began to discuss the various issues that were involved. The committee held five meetings in Atlanta in order to give all participants a chance to discuss their concerns regarding franchise fees.

In a report issued to the committee, Bruce Seaman of the School of Policy Studies explained the importance of studying these tax implications:

Firms providing electricity, natural gas, and the various telecommunications services are subject to a variety of state and local taxes and fees that differ substantially across states. Franchise fees are typically implemented as part of an agreement executed between local governments and a utility company, or other enterprises such as cable companies which utilize public rights-of-way.

Currently in Georgia, where franchise fees are required, telephone companies pay a 3% franchise fee to municipalities; cable companies pay between 3 and 5% to counties and municipalities; electric companies pay 4% to municipalities; and natural gas companies pay 3% to municipals. In total, approximately \$188 million dollars is paid to municipalities and counties each year. Cities receive 91% of these fees and counties receive 8% of these fees.

The relative importance of such franchise fee revenues to specific local government jurisdictions varies very widely. When calculated as a percentage of what the Department of Community Affairs identifies as "Tax Revenue", franchise fees represent an average of only .021% of total tax revenues for the counties in Georgia. Using a combination of the DCA data and the reported payments of franchise fees by the companies themselves, it is clear that franchise fees are much more important sources of revenue to municipalities. For the 525 such governmental units in the DCA data, franchise fees represented an average of 6.66% of total tax revenues.

Dr. Seaman explained that for the following reasons, a re-evaluation of the role and structure of franchise fees is timely:

- Section 253 of the 1996 Telecommunications Reform Act restricts barriers to entry and mandates local governments to manage rights of way on a "competitively neutral and nondiscriminatory basis."
- Ongoing technological developments in addition to the movement toward de-regulation.
- Financial and tax audits in Georgia cities are generating increased pressure among local governments to re-evaluate the justification for limiting the base for the assessment of franchise fees.
- Such potential local governmental variations in the structuring of franchise fee agreements threaten to create even larger administrative burdens on companies paying such fees.
- The pending natural gas deregulation in Georgia raises similar issues of how to apply sales or use taxation and design franchise fees for potential new competitors and/or their customers.

- Similar de-regulatory developments in the electricity industry, while not as immediately pending, will raise similar issues of how to apply state and local taxes and fees to non- Georgia firms generating electricity to local customers.
- All of these issues raise the specter of potential revenue loss from all gross receipts based taxes and fees as a result of a reduction of price for these services and a possible resulting reductions in total revenues, and a further potential loss of a portion of these taxable revenues to the extent that customers switch to non-Georgia companies for whom tax nexus cannot be established.

II. What other states are doing

A. In **Pennsylvania**, out-of-state as well as in-state generators and marketers of electricity must obtain a license from the Pennsylvania Public Utility Commission prior to being allowed to sell electricity within the state; before a license is granted the marketer must certify that it will pay the franchise fee, as well as collect and remit all sales and use taxes imposed by the state.

B. In **North Carolina**, attempts are being made to change the definition of a "utility" to include out-of-state marketers and generators in the natural gas industry by including as a utility "a business entity that sells piped natural gas," which would include non-North Carolina companies using the local distribution company's pipelines. Such companies would then pay the 3% franchise fee.

C. In **Florida**, steps are being taken to develop franchise fee ordinances that would require electricity providers, whether regulated or unregulated generators or marketers, to first obtain a franchise with the particular city, which in turn requires that the electricity provider agree to pay a franchise fee. In addition, **Florida** commissioned a "Telecommunications Task Force" to review the tax burden on that industry, including the gross receipts tax. The task force recommended a unified tax arrangement similar to a "telecommunications excise tax" as some percentage of gross revenues, including possible expansions of the tax base. There

was some debate regarding the definition of the tax base related to the concept of "taxing capacity," but eventually the Florida legislature failed to enact the proposal due largely to apparent concerns about the change being perceived by the public as a "new tax," as opposed to a relatively revenue neutral change in the tax structure.

D. **South Carolina** has adopted a variation on these approaches that "strengthens" the franchise system by supplementing it in telecommunications with a business

license tax of 3% of gross revenues, payable by all long distance phone service providers and resellers who are not paying franchise fees.

E. **New Jersey** has established a 6% "Energy Consumption Tax," with current utilities paying a transitional assessment for five years to ensure stability of revenue, in state as well as out- of-state paying the same tax burden. The state has "guaranteed": cities that they will receive a total of \$745 million in FY 1998, growing to a stable \$750 million per year by 2002.

F. **California** has substituted a consumption tax on all natural gas and electricity suppliers equal to the previous franchise fee rate.

G. **Kentucky** has passed legislation which amends its utility gross receipts license tax to apply to any Kentucky purchaser of natural gas, electricity, cable, and "other items" when the provider/seller of such services is not subject to that utility gross receipts license tax. This change seems to make the local tax more similar to Kentucky's use tax on such items. Kentucky has also created the electricity Restructuring Task Force, whose goal is to study electricity restructuring in the state, and has also created a related Task Force on Utility Tax Policy.

III. What we are doing in Georgia

The following two tables provide an overview of the current structure (Table 1) and the revenue (Table 2) of franchise fees in the state. [See Footnote 1](#)

Table 1

Overview of Sales and Franchise Fee Structure

| Service | Sales Tax | Sales Tax Base | Franchise Fee | Franchise Fee Base | Identified on Customer Bills |
|---|----------------------|--|----------------------|--|------------------------------|
| Telephone (Wired): BellSouth; Independent Phone | 4%-7% state + county | Basic local + most optional services per | 3% to municipalities | Gross receipts for "recurring local service" only; i.e. not applied to pay | Sales: Yes Franchise: No |

| | | | | | |
|--|----------------------|---|-------------------------------------|---|------------------------------|
| Companies | | customer | | phone , optional service, access etc. | |
| Cellular phone | 4%-7% state + county | Monthly service only; not air time | None | Not applicable NA | Sales: Yes |
| Other telecommunications; paging, PCS, net access; conferencing etc. | None | NA | None | NA | NA |
| Cable TV | 4%-7% state + county | Converter rental fee; not basic service | 3-5% to counties and municipalities | Full basic service + converter rental revenue | Sales: Yes Franchise: Yes |
| Satellite TV* | None | NA | None | NA | NA |
| Electricity: GA Power; EMC's | 4%-7% state + county | Monthly usage per customer | 4% to municipalities | Total electricity sales receipts | Sales: Yes Franchise: No |
| Natural Gas: Atlanta Gas Light; United Cities; ATMOS Energy | 4%-7% state + county | Monthly usage per customer | 3% to municipalities | Total gas sales receipts excluding interruptible, i.e. industrial customers** | Sales: Yes Franchise: No |

* The Telecommunications Reform Act of 1996 (TRA96) permits a state to impose a separate state-wide tax on Direct Broadcast Satellite (DBS) providers and then redistribute such revenues back to local governments. No states have chosen to do this to date.

** The base for establishing franchise fee payments by Atlanta Gas Light Has been changed by a recent agreement negotiated with the Georgia Municipal Authority (GMA), by which a franchise fee to a given municipality shall equal "the product of the Design Day Capacity and the current franchise fee factor", which in turn "shall equal the product of the base year franchise fee factor and one plus the inflation index expressed as a decimal to three significant places (from sample contract provided by Atlanta Gas Light).

Table 2

Total Franchise Fees Paid to Municipalities and Counties

| Source of Payment | Time Period | Amount Paid | % of Total Franchise Fees Paid |
|----------------------------------|---------------------------|--|--------------------------------|
| Georgia Power | Net paid in 1998 for 1997 | \$85,845,941 | 49.80% |
| GEMC | 1997 | \$5,943,291 | 3.45% |
| BellSouth | 1997 | \$22,009,272 | 12.76% |
| Other Telecom | 1997 | \$9,015,000 * est. by BellSouth; estimate of GMA = \$5 million | 5.23% |
| Atlanta Gas Light | Calendar 1996 | \$13,097,223 | 7.60% |
| United Cities Gas | 1997 | \$1,000,000** est. by GMA | .58% |
| Cable Companies | 1997 | \$35,520,000 | 20.60% |
| Total Municipality | 1996-1997 | \$ 172,430,727 | 100.00% |
| Cable Companies paid to Counties | 1996 | \$15,750,000 | 100.00% of county fees |
| Total All Franchise Fees | | \$188,180,727 | 91.63% paid to cities |

The revenue generated by franchise fees varies widely between cities and counties. According to the Department of Community Affairs (DCA), franchise fees are an average of .021% of total tax revenue for the 159 counties in Georgia, and no county reports franchise fees as high as 1% of tax revenue. This is mainly due to the fact that counties only assess franchise fees on cable companies.

Franchise fees are a much higher source of revenue for the municipalities of the state. According to the DCA, these fees were an average of 6.66% of the 525 municipalities total tax revenue. A closer look at this data by Dr. Bruce Seamans of Georgia State University has indicated that among cities the fees relationship to total revenue varies widely. It ranges from 0% for 11 cities to a reported 100% for the town of Between. The following table represents the break down of certain percentages as reported by Dr. Seaman.

Table 3

Franchise Fees as a Percentage of Total Revenue

| Percentage of 525 Municipalities | Percentage of Total Revenue |
|----------------------------------|-----------------------------|
| 1.14% | Over 80% |
| 4.95% | At least 25% |
| 17.7% | Over 10% |
| 66.29% | Less than 4.0% |
| 47.05% | Less than 2.0% |

The deregulation of natural gas in Georgia raised questions with regard to the collection of these franchise fees from gas marketers. This has led to a new agreement between the Georgia Municipal Association and Atlanta Gas Light. The agreement seems to have created a remedy for the collection of franchise fees in this newly unregulated sector. The eventual deregulation of the

electricity industry could pose similar questions, however it does not appear that this will occur in the immediate future.

The most pressing area for re-examination lies in the telecommunications area. Section 253 of the Telecommunications Reform Act of 1996, restricts the imposition of barriers to entry in this sector. Compensation for the management of right-of-ways is left to state and local governments to be carried out in a competitively neutral manner. BellSouth and the GMA have been in negotiations with regard to the franchise fee issue and will continue to negotiate following the present legislative session.

Industry representatives on the committee have not indicated a pressing need for legislative action, and neither have representatives of the consumer. Furthermore, there appears to be a high level of communication between the major parties involved with the franchise fee issue. For these reasons, the committee calls for

no legislative recommendations at this time. However, the General Assembly will continue to look at this issue in Georgia as markets and technology change.

IV. Conclusion

As a result of the Joint Study Committee on Franchise Fees and Conditions, Rights of Way, and Tax Implications of Competitive Markets, the State of Georgia has enabled all of these entities to come together to work out their differences. As stated previously in this report, the natural gas industry has already established an agreement with municipalities. The electric companies do not foresee their situation as yet something that needs changing, and all other entities involved are currently in negotiations to work out their differences.

While the counties still have some disagreement about the amount of franchise fees they get, the committee feels that anything that would change their current status would be viewed as a tax increase to Georgia's citizens. This is something that members of the committee, particularly legislative members, are adamantly opposed.

It is the agreement of the committee that there is not a need for legislation at this time. Legislative members of this committee, however, plan to keep a close watch on the negotiations between all entities involved, in a effort to make sure that the end result is something in which local citizens in Georgia benefit. It is the responsibility of these members to carefully negotiate their terms and conditions in a way that provides full and complete services at the lowest possible cost to Georgia's taxpayers.

Respectfully Submitted,

Senator Terrell Starr, Chairman

Rep. Newt Hudson, Chairman

Senator Charles Walker

Rep. Jimmy Skipper

Ms. Nancy Horne

Honorable Bob Knox

Mr. Bill Archer

Dr. H. Edwin Overcast

Mr. Bill Croker

Mr. Bobby Rowan

Mr. Bill Verner

Mr. Jim R. Newman

Footnote: 1

Tables 1 and 2 are from a report by Dr. Bruce A. Seaman, entitled An Analysis of Franchise Fees in Georgia: Preliminary Report, Fiscal Research Program, School of Policy Studies, Georgia State University. August 1998.