# AUDIT REPORT

CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
BUREAU OF FINANCIAL AUDIT
**WILLIAM C. THOMPSON, JR., COMPTROLLER**

## Audit Report on the Compliance of Telebeam Telecommunications Corporation with Section 4 of Its City Franchise Agreement

*FL05-089A*

**December 2, 2005**

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, N.Y. 10007-2341

WILLIAM C. THOMPSON, JR.
COMPTROLLER

**To the Citizens of the City of New York**

Ladies and Gentlemen:

Pursuant to Chapter 5, Section 93 of the New York City Charter, we have examined the compliance of Telebeam Telecommunications Corporation, (Telebeam) with its franchise agreement with the New York City Department of Information, Technology, and Telecommunications (DoITT). Under the terms of the agreement, Telebeam was granted the right to install, operate, repair, maintain, upgrade, remove, and replace public pay telephones (PPTs). Section 4 of this agreement gives Telebeam the right and consent to place advertising, through a media representative, on the exterior rear and side panels of PPT kiosks; and requires Telebeam pay the City 26 percent of its net commission advertising revenue. The results of our audit, which are presented in this report, have been discussed with officials from DoITT, Telebeam and its two media representatives—Van Wagner Kiosk Advertising, L.L.C. and Vector Media Street Furniture and their comments have been considered in preparing this report.

Audits such as this provide a means of ensuring that private concerns conducting business on City property are complying with the terms of their agreements, properly reporting revenues, and paying the City all fees due.

I trust that this report contains information that is of interest to you. If you have any questions concerning this report, please contact my audit bureau at 212-669-3747 or e-mail us at audit@Comptroller.nyc.gov .

Very truly yours,

William C. Thompson, Jr.

WCT/fh

**Report:** **FL05-89A**

**Filed:** **December 2, 2005**

## *Table of Contents*

*The City of New York*
*Office of the Comptroller*
*Bureau of Financial Audit*

# Audit Report on the Compliance of Telebeam Telecommunications Corporation with Section 4 of Its City Franchise Agreement

**FL05-089A**

## AUDIT REPORT IN BRIEF

On September 30, 1999, the City of New York entered into a franchise agreement with Telebeam Telecommunications Corporation (Telebeam) to install, operate, repair, maintain, upgrade, remove, and replace public pay telephones (PPTs). Section 4 of this agreement gives Telebeam the right and consent to place advertising, through a media representative, on the exterior rear and side panels of PPT kiosks; and requires that Telebeam pay the City 26 percent of its net commission advertising revenue. The audit determined whether Telebeam or its agents properly reported total net commission advertising revenue; correctly calculated and paid fees owed to the City; and complied with the public service announcement requirements in according with Section 4 of the Franchise Agreement.

**Audit Findings and Conclusions**

In accordance with Section 4.9 of the Franchise Agreement, Telebeam, through its media representatives, provided the required public service advertising. However, Telebeam did not ensure that its media representatives complied with Section 4.8 in that they did not properly report their total net commission advertising revenue, nor did they correctly calculate and pay fees owed to the City. Telebeam's media representatives underreported $4,781,564 on behalf of Telebeam—$4,764,117 related to bonus free kiosk advertising (the rate card value was used to calculate the fair market value of the bonus free kiosk advertising) and $17,447 related to excessive deductions for agency commissions, advertising exchanged for non-cash items not reported; and, revenue for production of advertising not reported. Also, Telebeam's media representatives underreported an additional $11,436,768 on behalf of another 14 PPT operators that they represent—$11,402,929 related to bonus free kiosk advertising based on calculations using the rate card, and $33,839 related to excessive deductions for agency commissions, advertising exchanged for non-cash items not reported; and, revenue for production of advertising not reported. Consequently, the 15 PPTs owe the City $5,250,707 of which Telebeam owes $1,547,456 in fees and related interest--$1,541,886 related to bonus free kiosk advertising and $5,569 related to excessive deductions for agency commissions, the value of advertising exchanged for non-cash items not reported; and, the revenue for production of advertising not reported.

## Audit Recommendations

Telebeam should:

- Pay the City $1,541,886 in additional franchise fees and related interest based on the rate card value of bonus free kiosk advertising or establish the fair market value of the bonus free kiosk advertising using an alternate methodology, and pay the City the franchise fees due including related interest;

- Pay the City $5,569 in additional franchise fees and related interest associated with; the excessive deductions for agency commissions; the value of advertising exchanged for non-cash items not reported; and, the revenue for production of advertising not reported.

- Ensure that its media representatives are properly reporting their total net commission advertising revenue and correctly calculating and paying fees owed to the City according to their franchise agreements.

The Department of Information, Technology and Telecommunications (DoITT) should:

- Ensure that Telebeam either pays the City $1,541,886 in additional franchise fees based on rate card or pays additional fees and related interest based on an alternate methodology. In that regard, if Telebeam establishes the fair market value, DoITT should review Telebeam's analysis and all supporting documentation to determine the validity of Telebeam's methodology;

- Ensure that Telebeam pays the City $5,569 in additional franchise fees and related interest associated with; the excessive deductions for agency commissions; the value of advertising exchanged for non-cash items not reported; and, the revenue for production of advertising not reported;

- Pursue the collection of either the franchise fees and related interest based on the fair market value determined above from the 14 other companies that Van Wagner and Vector represent or the $3,692,449 calculated by using rate card information;

- Pursue the collection of the $10,802 in additional franchise fees and related interest associated with; the excessive deductions for agency commissions; the value of advertising exchanged for non-cash items not reported; and, the revenue for production of advertising not reported from the 14 other companies that Van Wagner and Vector represent;

- Establish a system to monitor the discounting and bonusing of kiosk panels to ensure that the City is receiving its share of franchise fees in accordance with the franchise agreement.

# INTRODUCTION

## Background

On September 30, 1999, the City of New York entered into a franchise agreement with Telebeam Telecommunications Corporation (Telebeam) to install, operate, repair, maintain, upgrade, remove, and replace public pay telephones (PPTs). Section 4 of this agreement gives Telebeam the right and consent to place advertising, through a media representative,[1] on the exterior rear and side panels of PPT kiosks; and requires that Telebeam pay the City 26 percent of its net commission advertising revenue.[2] In addition, the agreement requires that Telebeam provide free public service advertising on two percent of the advertising panels. The Department of Information Technology and Telecommunications (DoITT) is the City agency that is responsible for monitoring compliance with the agreement.

During calendar year 2003, Telebeam contracted with two media representatives, Van Wagner Kiosk Advertising, L.L.C. (Van Wagner) and Vector Media Street Furniture (Vector), to: sell advertising; bill and collect advertising fees from advertisers; and compute and pay the City the fees due. (It should be noted that Van Wagner represented six other PPT providers, and Vector represented eight other providers during calendar year 2003—the scope period of this audit.)

Van Wagner and Vector collect advertising revenues from each PPT provider they represent, which they combine on a quarterly statement, and they pay the City 26 percent of the total revenue collected. For calendar year 2003, Van Wagner and Vector reported a total of $28,166,568 in net commission advertising revenue and paid the City $7,323,308 in franchise fees. Of these amounts, Van Wagner and Vector allocated $8,250,646 in net commission advertising revenue to Telebeam and paid the City $2,145,168 on its behalf. Van Wagner and Vector do not individually sell each PPT's advertising space. Rather, space sold to advertisers usually covers more than one PPT's telephone booths. Since payment is received in total, Van Wagner and Vector allocate the amount of revenue they receive to the PPT operators based on each operator's percentage of the total advertising space available from all PPT operators.

## Objective

Our audit objective was to determine whether Telebeam complied with Section 4 of its franchise agreement with the City. Specifically, we determined whether Telebeam or its agents properly reported total net commission advertising revenue; correctly calculated and paid fees owed to the City; and complied with the public service announcement requirements.

---

[1] Section 4.2 of the agreement defines a Media Representative as "entity (ies) qualified by the City and selected by the PPT Franchise to represent, organize and manage the advertising space available on all PPT's subject to this Agreement."

[2] Section 4.8 of the agreement defines net advertising revenue as "the total revenues derived by the Company, or any subsidiary, affiliate, agent, assignee, contractor, licensee, transferee or lessee of the Company (including the Media Representative(s) with which the Company has contracted), from the display of advertising material on PPT's pursuant to this Agreement (whether such revenues are received in the form of cash or in the form of materials, services, or other benefits, tangible or intangible, in which event such revenues shall be deemed to include the fair market value of such materials, services or other benefits, whether actually received by the Company, an account receivable or otherwise)."

## Scope and Methodology

The scope period of this audit was calendar year 2003. To achieve our audit objective, we reviewed the terms and conditions of Section 4 of Telebeam's franchise agreement. We also reviewed the agreements between Telebeam and its media representatives—Van Wagner and Vector. We analyzed the books and records of both media representatives, and recalculated the amounts reported and paid to the City. We also evaluated the adequacy of the internal controls over the revenue processing to determine the nature and extent of substantive testing to be performed. In that regard, we obtained an understanding of the internal controls in relation to the recording and reporting of advertising revenue by interviewing officials of both media representatives, conducting walk-throughs of their operations, and familiarizing ourselves with their record-keeping processes. In addition, we interviewed DoITT officials responsible for monitoring compliance with the agreement and reviewed correspondence, revenue reports, and other relevant documents.

We reviewed each advertising contract entered into by Van Wagner and Vector—the 444 Van Wagner contracts and the 15 Vector contracts account for 100 percent of the advertising revenue collected for calendar year 2003 on behalf of Telebeam and the 14 other PPT operators. We traced the total revenue amount collected from advertisers to the amount reported to the City. We then traced the total revenue to the general ledger, cash receipts journal, and bank accounts. For each contract, we compared the amount charged according to the contract to the amount recorded on the customer invoice and collection reports. We traced the individual amounts on the collection reports to the cash receipts journal.

During our review of the contracts, we noted that more than 46 percent of the agreements contained provisions for "bonus" advertising panels—free kiosk advertising. Consequently, we reviewed "Completion Reports" prepared by Van Wagner and Vector to determine the amount of bonus space where advertising was posted. We noted that Van Wagner and Vector did not report advertising revenue from the bonus panels and therefore did not pay the City franchise fees for these panels. Using the rate card value for the bonus panel revenue, we calculated the amounts by which Van Wagner and Vector understated revenue for all 15 PPT operators, including Telebeam. We allocated the understated revenue to each PPT operator and calculated the additional fees and interest owed.

Finally, we reviewed reports provided by Van Wagner and Vector, which detailed the amount, location, and dates posted of all public service advertising to determine compliance with Section 4.9, Public Service Advertising, of the franchise agreement.

This audit was conducted in accordance with generally accepted government auditing standards (GAGAS) and included tests of the records and other auditing procedures considered necessary. This audit was performed in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

## Discussion of Audit Results

The matters covered in this report were discussed with Telebeam at the conclusion of this audit. A preliminary draft report was sent to Telebeam on April 22, 2005, and was discussed at an exit conference. On June 2, 2005, we submitted a draft report to Telebeam officials with a request for comments. On June 16, 2005, we received responses from Telebeam, Van Wagner, Vector and DoITT. We have made changes to the draft report as deemed appropriate based on the submitted responses.

In their responses, Telebeam, and its media representatives, Van Wagner and Vector Media, strongly disputed the report's principal findings regarding imputed revenue on bonused advertising panels and stated that they should not have to pay additional franchise fees and related interest. In addition, with regard to the value of advertising exchanged for non cash items, Van Wagner disputed our finding for two of four contracts that it did not report the fair market value of this free advertising space. Moreover, Van Wagner disputed our finding about reporting revenue it received from advertisers for the cost of producing advertising. However, Van Wagner did not provide any documentation or evidence that was sufficient to support its position on these matters.

With regard to the bonused panels, we maintain that it is appropriate under the franchise agreement to impute value to the free advertising provided by Telebeam's media representatives since bonusing provided the vendors with significant benefits that the City did not share and in which it is entitled to share under the plain language of the franchise agreement. The comments received in regard to this issue from Telebeam, Van Wagner, Vector, and DoITT and our rebuttals are presented at end of this report.

The full texts of the responses received are included as addenda to this report.

# FINDINGS

In accordance with Section 4.9, of the Franchise Agreement, Telebeam, through its media representatives, provided the required public service advertising. However, Telebeam did not ensure that its media representatives complied with Section 4.8 in that they did not properly report their total net commission advertising revenue, nor did they correctly calculate and pay fees owed to the City. Telebeam's media representatives underreported $4,781,564 on behalf of Telebeam. Of this amount, $4,764,117 related to bonus free kiosk advertising based on calculations using the rate card. We used the rate card value to calculate the fair market value of the bonus free kiosk advertising because the rate card, which was established by the media representative, is a readily ascertainable and objective standard. The additional $17,447 is related to excessive deductions for agency commissions, advertising exchanged for non-cash items not reported, and revenue for production of advertising not reported. Also, Telebeam's media representatives underreported an additional $11,436,768 on behalf of another 14 PPT operators that they represent—$11,402,929 related to bonus free kiosk advertising based on calculations using the rate card, and $33,839 related to excessive deductions for agency commissions, advertising exchanged for non-cash items not reported; and, revenue for production of advertising not reported. Consequently, the 15 PPTs owe the City $5,250,707 of which Telebeam owes $1,547,456 in fees and related interest--$1,541,886 related to bonus free kiosk advertising and $5,569 related to excessive deductions for agency commissions, the value of advertising exchanged for non-cash items not reported, and the revenue for production of advertising not reported. (See Appendices I and II).

These issues are discussed in detail in the following sections of this report.

## Unreported Advertising Revenue

As previously stated, for calendar year 2003, Van Wagner and Vector reported a total of $28,166,568 in net commission advertising revenue and paid the City $7,323,308 in franchise fees. Of these amounts, Van Wagner and Vector allocated $8,250,646 in net commission advertising revenue to Telebeam and paid the City $2,145,168 on its behalf. Our review of Van Wagner and Vector's books and records disclosed that, using the rate card methodology, the net commissions advertising revenue reported to the City was understated by $16,218,332 for all 15 PPT operators—$4,781,564 of which was allocated to Telebeam (see Appendix I). As a result, the 15 PPTs owe the City $5,250,707, of which Telebeam owes $1,547,456 in fees and related interest. We used the rate card value to calculate the fair market value of the bonus free kiosk advertising because rate card is a readily ascertainable and objective value established by the media representatives.

The details of the underreporting are as follows:

### Value of Bonus Free Kiosk Advertising Not Reported

Van Wagner and Vector provided bonus free kiosk advertising to their clients as an incentive to enter into advertising agreements. However, Van Wagner and Vector did not report the fair market value of these bonuses—$16,167,046 using the rate card—in Telebeam's net commission advertising revenue to the City, as required by the franchise agreement. The franchise agreement states:

> " 'Net commissions advertising revenues' shall mean the total revenues (i.e., total receipts without reduction for any costs or expenses except as expressly set forth in this definition) derived by the Company, or any subsidiary, affiliate, agent, assignee, contractor, licensee, transferee or lessee of the Company (including the Media Representative(s) with which the Company has contracted), from the display of advertising material on PPTs pursuant to this Agreement (whether such revenues are received in the form of cash or in the form of materials, services, **or other benefits, tangible or intangible,** in which event such revenues shall be deemed to include the fair market value of such materials, services or other benefits, whether actually received by the Company, an account receivable or otherwise)." [Emphasis added.]

Consequently, Van Wagner and Vector understated net advertising revenue by $16,167,046 using rate card, of which Telebeam's portion amounted to $4,764,117.[3]

**Excessive Deductions for Agency Commissions**

Vector deducted more in agency commissions than are allowed by Telebeam's franchise agreement. The franchise agreement states:

> "'Net commissions advertising revenues' shall mean total revenues . . . less any advertising agency commission paid or deducted from such amount, but in no event shall such deduction for advertising agency commissions exceed fifteen percent (15%)."

Overall, we found that Vector deducted 16.35 percent for advertising commissions. As a result, net commission advertising revenue was understated by $11,901, of which Telebeam's share amounted to $6,148.

**Value of Advertising Exchanged for Non-Cash Items Not Reported**

Van Wagner provided free kiosk advertising space to clients in exchange for such non-cash items as heath spa and ballet memberships and gift certificates. However, Van Wagner did not report the fair market value of this free advertising space to the City as required by the franchise agreement. The PPTs represented by Van Wagner understated net commission advertising revenue by $22,100, of which $6,340 was attributable to Telebeam.

**Revenue for Production of Advertising Not Reported**

Van Wagner did not report to the City $17,285 of revenue it received from advertisers, of which $4,959 was attributable to Telebeam. These revenues were payments to Van Wagner for the cost of producing the advertising for calendar year 2003. Telebeam's franchise agreement states:

> "'Net commissions advertising revenues' shall mean total revenues . . . derived by the Company, or any subsidiary, affiliate, agent, assignee, contractor, licensee, transferee or lessee of the Company (including the Media Representative(s) with which the Company has contracted), from the display of advertising material on PPT's pursuant to this Agreement."

* * * *

[3] We used the rate cards from each company to determine the fair market value of the free kiosk advertising posted.

Based on the amount of unreported revenue, as previously discussed, the 15 PPTs owe the City $5,250,707, of which Telebeam owes $1,547,456 in fees and related interest.[4]

## RECOMMENDATIONS

**Audit Recommendations**

Telebeam should:

1. Pay the City $1,541,886 in additional franchise fees and related interest based on the rate card value of bonus free kiosk advertising or establish the fair market value of the bonus free kiosk advertising using an alternate methodology, and pay the City the franchise fees due including related interest;

2. Pay the City $5,569 in additional franchise fees and related interest associated with; the excessive deductions for agency commissions; the value of advertising exchanged for non-cash items not reported; and, the revenue for production of advertising not reported.

3. Ensure that its media representatives are properly reporting their total net commission advertising revenue and correctly calculating and paying fees owed to the City according to their franchise agreements.

DoITT should:

4. Ensure that Telebeam either pays the City $1,541,886 in additional franchise fees based on rate card or pays additional fees and related interest based on an alternate methodology. In that regard, if Telebeam establishes the fair market value, DoITT should review Telebeam's analysis and all supporting documentation to determine the validity of Telebeam's methodology;

5. Ensure that Telebeam pays the City $5,569 in additional franchise fees and related interest associated with; the excessive deductions for agency commissions; the value of advertising exchanged for non-cash items not reported; and, the revenue for production of advertising not reported;

6. Pursue the collection of either the franchise fees and related interest based on the fair market

[4] According to the franchise agreement, the interest rate on late payment is equal to "the rate of interest then in effect charged by the City for late payments of real estate taxes." According to a Department of Finance official, the interest rate on delinquent real estate taxes for the year 2003 through 2005 was 18 percent.

value determined above from the 14 other companies that Van Wagner and Vector represent or the $3,692,449 calculated by using rate card information;

7. Pursue the collection of the $10,802 in additional franchise fees and related interest associated with; the excessive deductions for agency commissions; the value of advertising exchanged for non-cash items not reported; and, the revenue for production of advertising not reported from the 14 other companies that Van Wagner and Vector represent;

8. Establish a system to monitor the discounting and bonusing of kiosk panels to ensure that the City is receiving its share of franchise fees in accordance with the franchise agreement.

***Telebeam, Van Wagner, Vector Media Responses*:** Telebeam and its media representatives Van Wagner and Vector Media strongly dispute the draft report's findings regarding imputed revenue on bonused advertising panels and state that they should not have to pay $1,547,456 in additional franchise fees and related interest. Van Wagner states, "The relevant provision of the franchise agreement does not mandate the maintenance of rate card, does not mandate selling techniques, does not prohibit discounting and does not prohibit bonusing." (Van Wagner response, Addendum II, p.3.) The vendors further contend that the draft report's finding on the value of bonus panels is inconsistent with prior audits that examined the same issue and that the report uses an inappropriate "fair market value" test.

***DoITT Response***: DoITT agreed that the "franchisees should be directed to assure that accounting methods should be corrected in the future to avoid the vulnerability to misconstruction that is created by this system of designating groups of panels being sold as 'free.'" DoITT stated that "if further investigation by the auditors produces evidence that actual additional value was received in connection with the free panels, then DoITT would support pursuing payment in full of compensation to the City reflecting that value. DoITT further stated that "absent evidence of other value having been received, a strong argument can be made by the franchisees that the inclusion of 'free' panels in addition to paid panels represents merely a method of characterizing a reduction in per panel prices rather than evidence of additional value received beyond revenue on which the City has also received its percentage-based compensation."

***Auditor Comment*:** We agree that the franchise agreement does not mandate the maintenance of rate card or prohibit discounting or bonusing as selling techniques. Nonetheless, the agreement does require percentage based payments to the City based on "total revenues," including revenue received in the form of cash or in the form of materials, services, or other benefits. We maintain that it is appropriate under the franchise agreement to impute value to the free advertising provided by Telebeam's media representatives. Contrary to the vendors' responses and, as discussed in more detail below, the bonusing provided the vendors with significant benefits that the City did not share and in which it is entitled to share under the plain language of the franchise agreement. Moreover, this position is entirely consistent with prior audits.

Regarding the objection to the audit's "fair market value test," this amount was derived by applying the full rate card to bonused panels. We used this method (as we have in other audits) because the rate card is easily verified and is established by the media representative, presumably with some relation to market value. We recognize that it is common industry practice to offer legitimate discounts off rate card, and to charge premiums above rate card to respond to market conditions. Therefore, the actual value of benefits derived from the free panels may be different from the amount derived by applying rate card amounts (For an example of an alternate calculation, see below at page 12.)

The franchise agreement has a broad definition of "net commission advertising revenues," which includes "total revenues," whether "received in the form of cash or in the form of materials, services or other benefits, tangible or intangible, in which event such revenues shall be deemed to include the fair market value of such materials, services or other benefits." The only explicit exclusions from net commission advertising revenues is advertising agency commission (capped at 15 percent). The franchise agreement prohibits imputing value to any PSAs provided by the franchisee in accordance with the agreement; no such prohibition exists for other free advertising.

Our review of advertising contracts revealed a troubling disparity between revenue received on contracts that included bonuses versus contracts that did not include bonuses. The average weekly price-per-panel for all panels on the non-bonused contracts was $163.56, compared with just $101.25 on the bonused contracts—a loss to the City of over 38 percent on the bonused contracts.

In the most egregious example, Van Wagner sold only ***two*** panels in the highly desirable area near Bloomingdale's, but gave away ***50*** panels, receiving only one percent of rate card. These free panels were provided in mid-May 2003, a time of year that supports strong advertising sales, based on our review of non-bonused contracts entered into during that same period (e.g., a contract with Microsoft entered into on the same date that did not include bonuses yielded 70 percent of rate card). In addition, given that this advertiser requested specific panels, one would have expected the agreement to reflect a premium, not a discount of 99 percent off the rate card.

There are numerous other examples where the City received less than 25 percent of rate card, even for prime Manhattan space and during times of the year when the media representatives were able to negotiate substantially higher rates with other advertisers. That Van Wagner's written response wrongly claims a loss of "only" twenty percent on the bonused contracts is further reason to question the vendors' arguments that this practice maximized the cash revenues for all parties. Although Van Wagner's response goes on at length on bonusing as an acceptable marketing practice, these points are not relevant to the question of whether the practice resulted in "revenues" as defined in the franchise agreement, and in no way explain the pricing disparities.

In addition, it is clear that bonusing results in additional benefits to the vendors, whether tangible or intangible, which are not being shared with the City. At a minimum, bonusing would earn the vendors valuable goodwill with the advertisers to whom they gave free use of the City's panel assets. This is a very significant benefit to Van Wagner and Vector because they then have a better chance to earn future profits on those same advertisers' purchases of space in the vendors' other media, such as walls and billboards. The advertising panels also typically identify the media firm and thus essentially serve as free advertising. This advertising benefits the firm not only with respect to sale of telephone kiosk panels, but also with respect to their other lines of business. The franchise agreement itself acknowledges that goodwill is generated with free advertising in that it explicitly prohibits imputed value for PSAs.

These benefits belie Vector Media's contention that "the only benefit to Vector Media from the use of bonus panels is to make sales of phone kiosk advertising." (Vector Media response, Addendum III, p. 4.) Both Van Wagner and Vector Media actively sell wall and billboard space. For example, Vector Media's Web site, vectornyc.com, states that "Vector Media has high profile locations positioned on major expressways and throughout the ethnically diverse neighborhoods of New York City" and "with an extensive inventory Vector Media can provide custom advertising packages including bulletins, wallscapes, telephone kiosks, interactive kiosks as well as coffee cups." Film clips on that same Web site show that Vector Media may sell the same advertisers space on both telephone panels and walls or billboards. Similarly, vanwagner.com/newyork.htm states, "The same team that developed most of Times Square's spectacular signage now offers unique locations and excellent coverage throughout New York City. . . . Van Wagner offers many outdoor advertising opportunities in a variety of formats including bulletins, walls, construction wraps, spectaculars and those eye-catching telephone kiosks."

We believe the foregoing is sufficient to support DoITT's pursuing payment of additional franchise fees. We disagree with DoITT's apparent position that the City must document specific instances in which the vendors used the free panels to obtain tangible, non-cash benefits such as the health spa and ballet memberships or where the free advertising was bundled with other non-city advertising space to induce advertisers to buy space from them in other media. First, it may not be possible for the City, in the normal course of business, to investigate years of Van Wagner's and Vector Media's transactions in multiple, different advertising media. Second, the combination of the 38 percent revenue loss to the City together with the inevitable and valuable goodwill gained by the vendors from giving away the panels is sufficient to raise a strong inference that the bonusing of panels was done to benefit the vendors, not the City.

Under those circumstances, it is legally appropriate under the franchise agreement to recover from the vendors an imputed amount for the benefits they accrued from giving away the City's assets. See, e.g., *Rochester Telephone Corp. v. Public Service Commission*, 87 N.Y. 2d 17, 29-33 (1995) (holding that PSC, in setting utility rates, could properly impute financial value to subsidiaries' "free" use of parents' name and reputation in advertising). That benefit is a "revenue" under the franchise agreement, which the vendors may not appropriate for themselves; rather the City is entitled to a recovery of its value.

That recovery should make good the detriment the City suffered. For the Van Wagner contracts alone, if the City had been paid for all panels (both purchased and bonused) on the bonus contracts what it earned per panel on the non-bonus contracts ($163.56 per panel per week), total revenue would have increased by $12,241,496, and the City's share of that increased revenue would have been $3,182,789, not including interest. Alternatively, the City may be entitled to recover a greater amount to account for the profits the vendors earned through the enhanced sale of wall and billboard advertising space to the same advertisers to whom they gave free telephone panels.

Contrary to the vendors' assertion, the Comptroller's position in this audit is entirely consistent with its prior audit of Viacom, dated June 28, 2004, to which the vendors refer. Viacom holds a City franchise that includes the sale of advertising space on City-owned bus shelters. The audit determined that Viacom provided free bus-shelter advertising to 10 vendors as an incentive for them to enter into agreements on Viacom billboards (for which the City receives no revenue) and applied a fair market value of $486,000 for that free space based on the lowest bus-shelter advertising fee on Viacom's rate card. (Comptroller's audit entitled *"Audit Report on the Compliance of Viacom Outdoor With Its Franchise Agreement #FM03-139A, issued June 28, 2004"*, p.5.) In fact, Viacom remitted to the City the full requested payment based on the rate-card calculation. (Viacom Audit, p.7.)

Finally, because the franchise agreement does not prohibit the practices of discounting and bonusing, it is incumbent on DoITT to monitor this program aggressively and to establish better controls to ensure that the City is receiving appropriate compensation. This is particularly true in light of the inherent conflict of interest presented by the media representatives' multiple lines of business. DoITT has been lax in its monitoring of this program. That alone sends a message that the City's assets can be freely leveraged at the City's expense.

**Appendix I**

## Telebeam Telecommunications Corporation
## Audit Number FL05-089A
### *Allocation of Additional Franchise Fees and Interest Owed*

| Allocations | Unreported Revenue | Allocation Percentage | Revenue per Company | Additional Fees at 26% | Interest Allocation | Total Additional Fees and Interest |
|---|---|---|---|---|---|---|
| | | | | | | |
| **Vector** | **$ 559,533** | | | | **$ 33,139** | |
| **Phone Mgt.** | | 16.29% | $ 91,148 | $ 23,698 | $ 5,398 | **$ 29,097** |
| **Payco** | | 21.11% | 118,117 | 30,711 | 6,996 | **37,706** |
| **R&B** | | 1.62% | 9,064 | 2,357 | 537 | **2,894** |
| **NY Telephone** | | 0.81% | 4,532 | 1,178 | 268 | **1,447** |
| **One Touch** | | 2.53% | 14,156 | 3,681 | 838 | **4,519** |
| **Universal** | | 1.62% | 9,064 | 2,357 | 537 | **2,894** |
| **BAS Comm.** | | 2.52% | 14,100 | 3,666 | 835 | **4,501** |
| **American Payphone** | | 1.84% | 10,295 | 2,677 | 610 | **3,287** |
| **SUBTOTAL** | | 48.34% | $ 270,478 | $ 70,324 | $ 16,019 | **$ 86,344** |
| | | | | | | |
| **Telebeam** | | 51.66% | $ 289,055 | $ 75,154 | $ 17,120 | $ 92,274 |
| **TOTAL** | | **100.00%** | **$ 559,533** | **$ 145,479** | **$ 33,139** | **$ 178,618** |
| | | | | | | |
| **Van Wagner** | **$ 15,658,799** | | | | **$ 1,000,802** | |
| **Costal** | | 15.81% | $ 2,475,656 | $ 643,671 | $ 158,227 | **$ 801,897** |
| **Noble** | | 0.32% | 50,108 | 13,028 | 3,203 | **16,231** |
| **Comet** | | 0.31% | 48,542 | 12,621 | 3,102 | **15,723** |
| **Teleplex** | | 8.78% | 1,374,843 | 357,459 | 87,870 | **445,329** |
| **Verizon** | | 45.91% | 7,188,955 | 1,869,128 | 459,468 | **2,328,596** |
| **Northeast** | | 0.18% | 28,186 | 7,328 | 1,801 | **9,130** |
| **SUBTOTAL** | | 71.31% | $ 11,166,290 | $ 2,903,235 | $ 713,672 | **$ 3,616,907** |
| | | | | | | |
| **Telebeam** | | 28.69% | $ 4,492,509 | $ 1,168,052 | $ 287,130 | **$ 1,455,183** |
| **TOTAL** | | **100.00%** | **$ 15,658,799** | **$ 4,071,288** | **$ 1,000,802** | **$ 5,072,090** |
| | | | | | | |
| **Telebeam Total Fees and Interest** | | | **$ 4,781,564** | **$ 1,243,207** | **$ 304,250** | **$ 1,547,456** |
| | | | | | | |
| **Total Other Companies Fees and Interest** | | | **$ 11,436,768** | **$ 2,973,560** | **$ 729,691** | **$ 3,703,251** |
| | | | | | | |
| **Totals per Audit** | | | **$ 16,218,332** | **$ 4,216,766** | **$ 1,033,941** | **$ 5,250,707** |
| | | | | | | |

## Telebeam Telecommunications Corporation
## Audit Number FL05-089A
### *Allocation of Additional Interest Owed*

### Interest Due
### Van Wagner

| Date | Franchise Fee Due | Accumulated Balance Due | Due Date | Cover Period From | Cover Period To | Days Overdue | Interest Rate | Interest Due |
|---|---|---|---|---|---|---|---|---|
| **2003** | | | | | | | | |
| **1st Quarter** | **$ 331,462** | $ 331,462 | 1/30/2003 | 1/31/2003 | 4/30/2003 | 90 | 18.00% | $ 14,711 |
| **2nd Quarter** | | 346,173 | 4/30/2003 | 5/1/2003 | 7/31/2003 | 92 | 18.00% | 15,706 |
| **3rd Quarter** | | 361,879 | 7/31/2003 | 8/1/2003 | 10/31/2003 | 92 | 18.00% | 16,418 |
| **4th Quarter** | | 378,298 | 1/31/2004 | 11/1/2003 | 1/31/2004 | 92 | 18.00% | 17,163 |
| **2004** | | | | | | | | |
| **1st Quarter** | **3,640,283** | 4,035,744 | 1/30/2003 | 2/1/2004 | 4/30/2004 | 90 | 18.00% | 179,121 |
| **2nd Quarter** | **99,543** | 4,314,408 | 4/30/2003 | 5/1/2004 | 7/31/2004 | 92 | 18.00% | 195,744 |
| **3rd Quarter** | | 4,510,152 | 7/31/2004 | 8/1/2004 | 10/31/2004 | 92 | 18.00% | 204,625 |
| **4th Quarter** | | 4,714,777 | 1/31/2005 | 11/1/2004 | 1/31/2005 | 92 | 18.00% | 213,909 |
| **2005** | | | | | | | | |
| **1st Quarter** | | $ 4,928,686 | 1/30/2005 | 2/1/2005 | 3/31/2005 | 59 | 18.00% | $ 143,404 |
| | **$ 4,071,288** | | | | | | | |
| **Total Interest** | | | | | | | | **$ 1,000,802** |

### Interest Due
### Vector

| Date | Franchise Fee Due | Accumulated Balance Due | Due Date | Cover Period From | Cover Period To | # of Days Overdue | Interest Rate | Interest Due |
|---|---|---|---|---|---|---|---|---|
| **2004** | | | | | | | | |
| **1st Quarter** | **$ 145,479** | $ 145,479 | 1/30/2003 | 2/1/2004 | 4/30/2004 | 90 | 18.00% | $ 6,457 |
| **2nd Quarter** | | 151,936 | 4/30/2003 | 5/1/2004 | 7/31/2004 | 92 | 18.00% | 6,893 |
| **3rd Quarter** | | 158,829 | 7/31/2004 | 8/1/2004 | 10/31/2004 | 92 | 18.00% | 7,206 |
| **4th Quarter** | | 166,035 | 1/31/2005 | 11/1/2004 | 1/31/2005 | 92 | 18.00% | 7,533 |
| **2005** | | | | | | | | |
| **1st Quarter** | | $ 173,568 | 1/30/2005 | 2/1/2005 | 3/31/2005 | 59 | 18.00% | $ 5,050 |
| | **$ 145,479** | | | | | | | |
| **Total Interest Due** | | | | | | | | **$ 33,139** |

| **Total Interest Due** | **$1,033,941** |
|---|---|

Appendix III

**Telebeam Telecommunications Corporation**
**Audit Number FL05-089A**
***Summary Schedule of Findings***

**Van Wagner**

| | *Franchisee* | *Telebeam* | *Coastal* | *Noble* | *Comet* | *Teleplex* | *Verizon* | *Northeast* | *Total* |
|---|---|---|---|---|---|---|---|---|---|
| | *Revenue Allocation Rate* | *28.69%* | *15.81%* | *0.32%* | *0.31%* | *8.78%* | *45.91%* | *0.18%* | *100%* |
| 1) | *Bonus Revnue 2003* | *$3,643,828* | *$2,007,979* | *$40,642* | *$39,372* | *$1,115,121* | *$5,830,887* | *$22,861* | *$12,700,691* |
| | *Franchise fee @ 26%* | ***$947,395*** | ***$522,075*** | ***$10,567*** | ***$10,237*** | ***$289,931*** | ***$1,516,031*** | ***$5,944*** | ***$3,302,180*** |
| 2) | *Bonus Revenue 2002- 2003* | *$837,382* | *$461,450* | *$9,340* | *$9,048* | *$256,264* | *$1,339,986* | *$5,254* | *$2,918,723* |
| | *Franchise fee @ 26%* | ***$217,719*** | ***$119,977*** | ***$2,428*** | ***$2,352*** | ***$66,629*** | ***$348,396*** | ***$1,366*** | ***$758,868*** |
| 2a) | *as of 12/31/01* | *$13,928* | *$7,675* | *$155* | *$150* | *$4,263* | *$22,288* | *$87* | *$48,548* |
| | *Franchise fee @ 26%* | ***$3,621*** | ***$1,996*** | ***$40*** | ***$39*** | ***$1,108*** | ***$5,795*** | ***$23*** | ***$12,623*** |
| 2b) | *as of 12/31/02* | *$351,827* | *$193,879* | *$3,924* | *$3,802* | *$107,670* | *$562,997* | *$2,207* | *$1,226,305* |
| | *Franchise fee @ 26%* | ***$91,475*** | ***$50,408*** | ***$1,020*** | ***$988*** | ***$27,994*** | ***$146,379*** | ***$574*** | ***$318,839*** |
| 2c) | *as of 12/31/03* | *$361,785* | *$199,366* | *$4,035* | *$3,909* | *$110,717* | *$578,931* | *$2,270* | *$1,261,013* |
| | *Franchise fee @ 26%* | ***$94,064*** | ***$51,835*** | ***$1,049*** | ***$1,016*** | ***$28,786*** | ***$150,522*** | ***$590*** | ***$327,863*** |
| 2d) | *as of Q1 of year 2004* | *$109,842* | *$60,530* | *$1,225* | *$1,187* | *$33,615* | *$175,770* | *$689* | *$382,857* |
| | *Franchise fee @ 26%* | ***$28,559*** | ***$15,738*** | ***$319*** | ***$309*** | ***$8,740*** | ***$45,700*** | ***$179*** | ***$99,543*** |
| | **Total Bonus** | **$4,481,210** | **$2,469,429** | **$49,982** | **$48,420** | **$1,371,385** | **$7,170,873** | **$28,115** | **$15,619,414** |
| | ***Allocated 26% to the City*** | ***$1,165,115*** | ***$642,052*** | ***$12,995*** | ***$12,589*** | ***$356,560*** | ***$1,864,427*** | ***$7,310*** | ***$4,061,048*** |
| 3) | ***Barter Revenue*** | $6,340 | $3,494 | $71 | $69 | $1,940 | $10,146 | $40 | $22,100 |
| | *Franchise fee @ 26%* | ***$1,649*** | ***$908*** | ***$18*** | ***$18*** | ***$504*** | ***$2,638*** | ***$10*** | ***$5,746*** |
| 4) | ***Production Sales*** | $4,959 | $2,733 | $55 | $54 | $1,518 | $7,936 | $31 | $17,285 |
| | *Franchise fee @ 26%* | ***$1,289*** | ***$711*** | ***$14*** | ***$14*** | ***$395*** | ***$2,063*** | ***$8*** | ***$4,494*** |
| | ***Subtotal - Van Wagner*** | ***$4,492,509*** | ***$2,475,656*** | ***$50,108*** | ***$48,542*** | ***$1,374,843*** | ***$7,188,955*** | ***$28,186*** | ***$15,658,799*** |
| | *Franchise fee @ 26%* | ***$1,168,052*** | ***$643,671*** | ***$13,028*** | ***$12,621*** | ***$357,459*** | ***$1,869,128*** | ***$7,328*** | ***$4,071,288*** |

***Vector Media***

| | *Franchisees* | *Telebeam* | *Phone Management* | *Payco* | *R & B* | *NY Telephone* | *One Touch* | *Universal* | *BAS Communication* | *American Payphone* | *Total* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | *Allocation* | *51.66%* | *16.29%* | *21.11%* | *1.62%* | *0.81%* | *2.53%* | *1.62%* | *2.52%* | *1.84%* | *100.00%* |
| | Bonus allocated for Year 2003 | $244,682 | $77,156 | $99,985 | $7,673 | $3,836 | $11,983 | $7,673 | $11,936 | $8,715 | $473,639 |
| | Bonus allocated for Other Years | $38,225 | $12,053 | $15,620 | $1,199 | $599 | $1,872 | $1,199 | $1,865 | $1,361 | $73,993 |
| 1) | **Total Bonus** | **$282,907** | **$89,209** | **$115,605** | **$8,872** | **$4,436** | **$13,855** | **$8,872** | **$13,800** | **$10,076** | **$547,632** |
| | ***Allocated 26% to the City*** | ***$73,556*** | ***$23,194*** | ***$30,057*** | ***$2,307*** | ***$1,153*** | ***$3,602*** | ***$2,307*** | ***$3,588*** | ***$2,620*** | ***$142,384*** |
| 2) | Agency Commissions | $6,148 | $1,939 | $2,512 | $193 | $96 | $301 | $193 | $300 | $219 | $11,901 |
| | *Franchise fee @ 26%* | ***$1,598*** | ***$504*** | ***$653*** | ***$50*** | ***$25*** | ***$78*** | ***$50*** | ***$78*** | ***$57*** | ***$3,094*** |
| | **Subtotal - Vector** | **$289,055** | **$91,148** | **$118,117** | **$9,064** | **$4,532** | **$14,156** | **$9,064** | **$14,100** | **$10,295** | **$559,533** |
| | *Franchise fee @ 26%* | ***$75,154*** | ***$23,698*** | ***$30,711*** | ***$2,357*** | ***$1,178*** | ***$3,681*** | ***$2,357*** | ***$3,666*** | ***$2,677*** | ***$145,479*** |

| | |
|---|---|
| **Grand Total** | **$ 16,218,332.08** |
| ***Franchise fee @ 26%*** | ***$ 4,216,766.34*** |
| **Grand Total for Telebeam** | **$ 4,781,564.26** |
| ***Franchise fee @ 26%*** | ***$ 1,243,206.71*** |

| **Franchise Fee Due by Year:** | | | |
|---|---|---|---|
| **Year 2001** | **$ 12,623** | **Year 2001** | **$ -** |
| **Year 2002** | **$ 318,839** | **Year 2002** | **$ -** |
| **Year 2003** | **$ 3,640,283** | **Year 2003** | **$ 145,479** |
| **Year 2004, 1st. Quarter** | **$ 99,543** | **Year 2004** | **$ -** |
| **Van Wagner** | **$ 4,071,288** | **Vector** | **$ 145,479** |
| ***Allocation*** | ***28.69%*** | | ***51.66%*** |
| **Telebeam** | **$ 1,168,052** | | ***$ 75,154*** |

T E L E B E A M

June 16, 2005

The City of New York
Office of the Comptroller
Attention: Greg Brooks, Deputy Comptroller
1 Centre Street
New York, New York 10007-2341

RE: Audit Report on the Compliance of Telebeam Telecommunications Corporation ("Telebeam") with Section 4 of its City Franchise Agreement FL05-089A ("Draft Audit Report")

Dear Mr. Brooks:

This letter responds to the recommendations and findings in the referenced Draft Audit Report dated June 2, 2005. Telebeam's Franchise Agreement with the City of New York ("City") allows Telebeam to place advertising on the outer panels of its public pay telephone enclosures only through the services of a designated media representative. Telebeam's designated media representatives are Van Wagner Kiosk Advertising, LLC ("Van Wagner") and Vector Media Street Furniture, LLC ("Vector"). The Franchise Agreement requires that the media representatives be responsible for the " ... billing and collection of all advertising revenues, [and] the periodic payment of compensation due to the City, ..." *See, Franchise Agreement, page 18.* Necessarily, the Comptroller's audit in reality was an audit of the books and records of Van Wagner and Vector. Consequently, Telebeam has requested that Van Wagner and Vector also respond to the Draft Audit Report, and Telebeam incorporates those submissions as part of Telebeam's response to this Draft Audit Report. <u>Telebeam's response, which it understands will be incorporated into any final audit report, shall include the responses submitted by Van Wagner and Vector</u>.

## <u>RESPONSE IN BRIEF</u>

Telebeam strongly disagrees with the findings of the Comptroller. Given that the findings are just plain wrong, no recommendation should be followed. The Comptroller's findings are not only arbitrary and capricious, but also clearly erroneous. The plain language of the Franchise Agreement does not support the Comptroller's findings. In fact, to support the Comptroller's position, the words of the Franchise Agreement are taken out of context and their meanings are tortured and distorted.

36-40 37 STREET
LONG ISLAND CITY, N.Y. 11101
718.706.1111 FAX 718.706.1234

Assuming *arguendo* that the Comptroller could demonstrate that the pertinent contract language is ambiguous, and therefore, that the intention of the parties would be relevant, it is not now and never was the intention of Telebeam, the Media Representatives, or the Department of Information, Technology and Telecommunications ("DoITT"), to assign arbitrary values to bonus panels to manufacture revenues upon which the Media Representatives could be obligated to pay a commission to the City.

While you need not look beyond the four corners of the Franchise Agreement to discern the meaning of the pertinent provision, if the Comptroller did, it still could find no rational basis for its findings. The Comptroller's findings and methodology are not supported by any audit precedence and in fact, are contradicted by a recent audit of another outdoor media company. Moreover, the Comptroller's determination of "net commission advertising revenue" is contrary to generally accepted accounting principles ("GAAP").

Finally, implementation of the Comptroller's recommendations is just poor public policy. Implementation of those recommendations in effect would mandate that the Media Representatives could no longer offer bonus panels, notwithstanding their uncontroverted demonstration that bonus panels are effective tools for the sale of advertising, the maximization of revenues, and in turn, compensation to the City. Essentially, the Comptroller will have substituted his judgment for the business judgment of those entities, which DoITT determined possessed the necessary expertise and skills to manage advertising on public pay telephones.

**BACKGROUND**

The New York City Council passed Authorizing Resolution 2248 in March, 1997. Authorizing Resolution 2248 gave DoITT authority to grant non-exclusive franchises for the installation of public pay telephones and associated equipment on, over, and under the inalienable property of the City. The Authorizing Resolution further provided that any franchise granted pursuant thereto shall include provisions to allow franchisees to sell or lease advertising space on public pay telephones consistent with the provisions of the franchise agreement then existing between the City and New York Telephone, dated July 1, 1993. The Authorizing Resolution further provided that compensation paid to the City should include a percentage of gross revenues derived by the franchisee from the display of advertising.

Pursuant to the authority granted it by Authorizing Resolution 2248, DoITT approved the award of a franchise to Telebeam and Telebeam and the City executed a Franchise Agreement for Public Pay Telephone Services on or about September 30, 1999. Section 4 of the Franchise Agreement pertains to advertising and grants Telebeam the right and consent to place advertising, through a Media Representative, on its public pay telephones ("PPTs"). Section 4.2(c) of the Franchise Agreement defines a Media Representative as an "entity(ies) qualified by the City and selected by a PPT Franchisee to represent, organize and manage the advertising space available on all PPTs subject to this Agreement." Section 4.1(b) further describes the responsibilities of a Media Representative, stating that the,

> Media Representative's representation, organization and management responsibilities shall include, without limitation: the sale and lease of advertising space, the maintenance and service of advertising displays, the billing and collection of all advertising revenues, the periodic payment of compensation due to the City, and the payment to the Company of the net revenues generated by advertising displayed on the Company's PPTs after payment of compensation due to the City and after deduction of a reasonable amount due to the Media Representative as set forth in the Company's agreement with the Media Representative.

Section 4.8.1 of the Franchise Agreement describes the compensation to the City for advertising and mandates payment to the City of twenty-six percent (26%) of "net commission advertising revenues," defined as follows:

> Net commission advertising revenues shall mean the total revenues (i.e., total receipts without reduction for any costs or expenses except as expressly set forth in this definition) derived by the Company, or any subsidiary, affiliate, agent, assignee, contractor, licensee, transferee or lessee of the Company (including the Media Representative(s) with which the Company has contracted), from the display of advertising material on PPTs pursuant to this Agreement (whether such revenues are received in the form of cash or in the form of materials, services, ***or other benefits, tangible or intangible***, in which event such revenues shall be deemed to include the fair market value of such materials, services or other benefits, whether actually received by the Company, an account receivable or otherwise) less any advertising agency commission paid or deducted from such amount, but in no event shall such amount, but in no event shall such deduction for advertising agency commissions exceed fifteen percent (15%). (*emphasis added).*

Consistent with its obligations under the Franchise Agreement, Telebeam entered into agreements with Van Wagner and Vector to provide media representative services, which they have done since October, 1999.

On August 19, 2004, the Comptroller sent letters to Telebeam and Van Wagner notifying them that the Comptroller was auditing Telebeam's compliance with Section 4 of its Franchise Agreement. That audit was conducted over eight months between August 19, 2004 and April 22, 2005, at which time the Comptroller issued its preliminary draft audit report. After various communications and meetings, the Comptroller issued the Draft Audit Report.

The City of New York
Office of the Comptroller
Attention: Greg Brooks, Deputy Comptroller
Re: Audit Report FL05-089A
June 16, 2005
Page 4

**DRAFT AUDIT REPORT**

The Draft Audit Report finds and concludes that, "Telebeam did not ensure that its media representatives complied with Section 4.8 in that they did not properly report their total net commission advertising revenue, nor did they correctly calculate and pay fees owed to the City." *Draft Audit Report, pg. 1*. Based on those findings, the Comptroller recommends Telebeam should, among other things, "pay the City $1,547,456 in additional franchise fees and related interest." *Id.* The significant portion of the alleged amount due (all but approximately $3,400.00, exclusive of interest) is based on the Comptroller's specific finding that Van Wagner and Vector provided bonus free kiosk advertising to their clients as an incentive to enter into advertising agreements and did not report the fair market value of these bonuses, determined by the Comptroller to be, in the aggregate, $16,167,046. *Draft Audit Report, pg. 5*. The Comptroller's finding is based on its interpretation of the definition of "net commission advertising revenues;" in particular, the Comptroller claims that the alleged bonus panels are "other benefits, tangible or intangible."

**DISCUSSION**

The Comptroller's position is not supported by legal principles. This matter is determined very simply by contract interpretation. The most basic principle of contract law requires that the meaning of any provision of a contract is to be gleaned from the four corners of the document. Accordingly, the issue here, resulting from the Comptroller's findings, is the meaning of the definition of "net commission advertising revenues" and whether it includes bonus panels. The Comptroller determines that bonus panels are net commission advertising revenues by operation of the words, "or other benefit, tangible or intangible."

The characterization of bonus advertising panels is not consistent with the plain language of the Franchise Agreement. The Comptroller's position is wholly dependent upon reference to six words; to achieve the result desired by the Comptroller, it must extract those six words from the 121-word sentence in which they are found, ignore any context to those words and torture their meaning.

The definition of net commission advertising revenues begins with "total revenues." It is further explained by a reference to receipts – "(i.e., total receipts …)". That reference helped make clear that the Media Representative paid commission on revenues when and actually received; in other words, revenues must be received. This understanding is consistent with the practice of the Media Representatives since October, 1999, with DoITT's policies, and said understanding was accepted by the Comptroller in the course of its audit. Finally, the definition continues by stating that revenues are still considered revenues "(whether such revenues are

The City of New York
Office of the Comptroller
Attention: Greg Brooks, Deputy Comptroller
Re: Audit Report FL05-089A
June 16, 2005
Page 5

received in the form of cash or in the form of materials, service, or other benefits, tangible or intangible, in which event such revenues shall be deemed to include the fair market value of such materials, services or other benefits, whether actually received by the Company, an account receivable or otherwise)." In this context, an "other benefit, tangible or intangible" still must be "received" to constitute revenue. The clear, unambiguous meaning of this sentence is that if the Media Representative receives something instead of cash in exchange for the display of advertising on the PPT panels, it must include the fair market value of the "something" received in calculating its revenues. This provision was intended to take into account barter type transactions. Clearly, the Comptroller understood this as it included in revenues health spa and ballet memberships and gift certificates Van Wagner received. *See, Draft Audit Report, pg. 6.* No rational interpretation of these same words can include bonus panels given away to induce customers to enter into advertising agreements because no revenue is "received" solely from the bonus panels. The Comptroller ignores the entire rest of the sentence and removes its chosen words from any context.

If it were determined that the aforementioned language was ambiguous, principles of contract law would require that the intention of the parties be discerned to determine the meaning of the language in question. Van Wagner and Telebeam clearly have stated that neither of them intended that revenues include a manufactured value assigned to bonus panels, and that commissions would be paid thereon. DoITT's intention must be gleaned from its actions. DoITT previously audited Van Wagner, aware of the practice of giving bonus panels, and concluded that, except for a small sum unrelated to bonus panels, no additional commissions were due the City. Obviously, DoITT did not intend that bonus panels be valued and included in revenue. Otherwise, it would have done so in its prior audit.

The Comptroller's audit staff have indicated that audits of cable franchises were precedent for its position in this audit. However, the language in that franchise states "'Gross Revenue' means all revenue … which is received, directly or indirectly, by the company … including, without limitation, the value of any free services provided by the company …." This language clearly refers to something that is given away. Were this same language in Telebeam's Franchise Agreement, Telebeam would concede that revenue would include the value of bonus panels "given away" or "provided by" the Media Representative. But, it is not. The language in Telebeam's Franchise Agreement is very different and speaks only to revenues that are actually received. In fact, many courts would say that since DoITT also drafted the cable franchise agreement, it has demonstrated that had it intended to include bonus panels given away by the Media Representative, it would have included language more like the language in the other

The City of New York
Office of the Comptroller
Attention: Greg Brooks, Deputy Comptroller
Re: Audit Report FL05-089A
June 16, 2005
Page 6

franchises which it administers. The language is so very different that for the Comptroller's staff to offer it as precedent is disingenuous.[1]

More appropriate precedent exists and is directly contradictory to the position taken by the Comptroller in this matter. A complete discussion of a recent audit of Viacom and the Comptroller's treatment of bonus panels in the Viacom audit is contained in the Van Wagner materials incorporated herein by reference in the opening paragraph of this letter. Suffice to say, in the Viacom audit, the Comptroller allocated the contract price among sold and bonus panels. The Comptroller did not assign a value to those bonus panels based on Viacom's rate card and attribute phantom revenue to Viacom. Accordingly, even if there was no Franchise Agreement in this case, the Comptroller should treat bonus panels consistently between the Media Representative and Viacom as, on some level, bus shelter advertising competes with advertising on PPTs. For the Comptroller to require the Media Representatives to pay a commission on bonus panels, but not Viacom, would give Viacom an unfair competitive cost advantage.

While Telebeam believes its unnecessary to look beyond the four corners of the Franchise Agreement, Van Wagner's and Vector's materials explain in great detail and make a compelling case that the Comptroller's position is poor public policy, ignores well-established marketing principles, and could result in diminished revenue to the City.

## CONCLUSION

Based on the foregoing, the Comptroller's finding that "net commission advertising revenues" includes a value for bonus panels is clearly arbitrary and capricious, and in all events, erroneous. Accordingly, the recommendations are wrong and should not be implemented.

Sincerely,

TELEBEAM TELECOMMUNICATIONS
CORPORATION

By: Robert G. France
Robert G. France
Vice President and General Counsel

---

[1] Similarly, the Comptroller was disingenuous when in its preliminary draft audit report it omitted key portions of the definition of "net commission advertising revenues," which made clear that the value must be received to be included in revenues.

PAUL G. WHITBY
GENERAL COUNSEL

Van Wagner

June 16, 2005

BY HAND

Mr. Greg Brooks
The City of New York
Office of the Comptroller
1 Centre Street
New York, NY 10007

Re: Audit Report on the Compliance of Telebeam Telecommunications Corporation with Section 4 of its City Franchise Agreement FL05-089A

Dear Mr. Brooks:

Enclosed please find our response to the above referenced Draft Audit Report. Please sign the enclosed copy of this letter acknowledging its delivery and receipt.

Sincerely,

Paul G. Whitby

Receipt Acknowledged:

NEW YORK CITY
COMPTROLLER'S OFFICE
2005 JUN 16 P 1:20

**PAUL G. WHITBY**
GENERAL COUNSEL

**Van Wagner**

June 16, 2005

Mr. Greg Brooks
The City of New York
Office of the Comptroller
1 Centre Street
New York, NY 10007

Re: Audit Report on the Compliance of Telebeam Telecommunications Corporation with Section 4 of its City Franchise Agreement FL05-089A

Dear Mr. Brooks:

We are writing this letter in response to the Draft Audit Report, FL05-089A issued June 2, 2005, by the Office of the Comptroller, Bureau of Financial Audit of the City of New York on the compliance of Telebeam Telecommunications Corporation ("Telebeam") with Section 4 of its City Franchise Agreement. The Audit Report focuses on Van Wagner Kiosk Advertising, LLC ("Van Wagner Kiosk") and its competitor, Vector Media Street Furniture, each of which are Media Representatives providing advertising services to Telebeam under Telebeam's Franchise Agreement with the City. Van Wagner Kiosk vehemently disagrees with certain critical findings (factual and legal) in the Audit Report as it pertains to Van Wagner Kiosk. It is respectfully requested that this response be included in its entirety with the final version of the Audit Report, in addition to any response that may be filed by Telebeam, since the Audit Report was, in fact, an audit of Van Wagner Kiosk (and Vector Media) and not of Telebeam.

For ease of reference, an Index to this letter is set forth at the last page hereof.

**Summary Response to "Findings"**

With respect to each of the "Findings" most all of which we challenge pertaining to Van Wagner Kiosk, our summary view is as follows:

With respect to: **"Value of Bonus Free Kiosk Advertising Not Reported"**

> Van Wagner Kiosk disputes each and every part of this factually and legally unsubstantiated claim that there should be imputed to Van Wagner Kiosk phantom income for which it should pay compensation to the City. The bonus

**VAN WAGNER COMMUNICATIONS, LLC**
800Third Avenue, New York, New York 10022-7604
Tel: (212) 699-8400 Fax: (212) 986-0927 E-Mail: pwhitby@vanwagner.com

Van Wagner



advertising provided to advertisers does not give rise to the imputation of income or net commission advertising revenues for which the City is entitled to any payment of compensation and all revenues derived from the subject advertising contracts (161) were reported and appropriate fees paid to the City. No form of benefit, tangible or intangible, flowed to Van Wagner Kiosk from any advertising contract over and above the stipulated contract price in which the City shared. The relevant provision of the Franchise Agreement does not mandate the maintenance of a rate card, does not mandate selling techniques, does not prohibit discounting and does not prohibit bonusing. The actions of Van Wagner Kiosk in delivering "bonus" advertising was part of, and integral to, "paid" advertising provided to the same advertisers, under the same fully integrated advertising contracts, each made in compliance with the Franchise Agreement and for which revenue of any nature was properly reported and all compensation paid with respect thereto. The Audit Staff was (and forever will be) unable to produce a scintilla of evidence demonstrating that Van Wagner Kiosk ever received any benefit at all - let alone the nearly $16,000,000. Further the position advanced by the Office of the Comptroller is diametrically opposed to the position advanced by the Office of the Comptroller in other audits of competitors to Van Wagner Kiosk.

With respect to: **"Revenue for Production of Advertising Not Reported"**

Van Wagner Kiosk disputes in its entirety the claimed adjustment to include revenue of $17,285 purportedly received by Van Wagner Kiosk for the direct cost of advertising copy produced by third parties under five advertising contracts of 444 audited (and the related claim for $4,959 of fees). The requested inclusion of these amounts in net revenue is contrary to the plain language of the Franchise Agreement that obliges the payment of a fee to the City with respect to revenue derived from the display of advertising materials on PPTs. The production of poster copy by third parties (which Van Wagner Kiosk ordered for these four advertisers on five contracts as an accommodation to them) does not occur on or relate to the streets of New York, in which the City has an interest, and has nothing to do with the display of advertising on PPTs. Van Wagner Kiosk does not own or have a relationship with any copy production house.

Van Wagner



With respect to: **"Value of Advertising Exchanged for Non-Cash Items Not Reported"**

> Van Wagner Kiosk previously acknowledged to DoITT that it underreported its $32.7 million revenue in year 2003 by $6,500 in connection with two separate transactions that included barter of that amount as part of aggregate contract payments of $32,000, as a result of which it underpaid compensation payable to the City in the amount of $1,690 out of $8.5 million, which was paid to the City on or about May 6, 2005. Van Wagner Kiosk objects to the other findings in the report pertaining to two other transactions, a portion of which ($14,000 of $196,750) were payable in barter, since each of those transactions were reported and related payments were made to the City.

Below in detail Van Wagner Kiosk sets forth its response to the findings and recommendations of the Office of the Comptroller. The City's Audit, which took over eight months, results in an acknowledged adjustment of $1,690. All the remaining amounts are created out of a misread and tortured analysis of the underlying Franchise Agreement and in disregard of years of written and operational history between Van Wagner Kiosk and the PPT Providers on the one hand and the Department of Information Technology and Telecommunications ("DoITT") on the other, pertaining to the conduct of the business of placing advertising on PPTs and well known, notorious, and widely used marketing techniques.

**Background of the Van Wagner Kiosk Advertising Program**

Van Wagner Kiosk was organized for the sole purpose of representing public pay telephone providers (PPTs) by providing media services as a "Media Representative" and was duly approved by the DoITT in that capacity. Van Wagner Kiosk only engages in sales of kiosk advertising and no other business. The Van Wagner Kiosk program had been detailed to DoITT in person and in writing since prior to the issuance of the relevant Franchise Agreement. Briefly stated, the Van Wagner Kiosk program contemplates the pooling of all revenue derived from the sale of advertising on kiosks wherever situated. It is placed in three pools - Core Manhattan/Verticals, Rears and Non-Core NYC. That advertising revenue is then allocated among the PPT Providers based upon the number of respective panels they have in each category. The PPT Provider is then paid a royalty with respect to the revenue as allocated based upon a negotiated royalty rate. In the case of the City, the City receives 26% of each of the three pools. This is important because it means from a monetary point of view no

Van Wagner



kiosk is "proprietary" but rather is subject to its best use as determined by the Media Representative in light of the entire program.

After DoITT issued its draft Request for Information ("RFI") dated August 5, 1998, Van Wagner Kiosk provided extensive oral and written comments to DoITT, to which DoITT gave great consideration. Van Wagner Kiosk, among other things, was very concerned about preserving and protecting the integrity of its rate card structure. The RFI contemplated detailed reports that would have made public the names of advertisers, rates, contract terms and the like which Van Wagner Kiosk determined would be detrimental to the program in the long run. By letter to DoITT dated September 11, 1998, Van Wagner Kiosk, as part of its comment to the RFI, stated:

> "Van Wagner is also concerned that the proliferation of the type of information sought by the City will have an anticompetitive effect. By necessity all pricing arrangements with advertisers (names, locations, prices, price per panel and similar information) will become public information and the ability to negotiate with advertisers for preferred rates, locations and other advantages to the Media Representatives and the PPT Franchisee will be lost. The resulting effect will be less revenues to the PPT Franchisee and less revenues to the City."

Further in the same letter, in explaining the importance of retaining to the Media Representative rights to manage the program, Van Wagner Kiosk stated:

> "The Media Representative and the PPT Franchisee are partners in the growth of revenue and the financial incentives to the Media Representative (i.e., a percentage of the total advertising sales) should be its own measure of satisfactorily fulfilling its obligations. It is possible that owing to the substantial increase in advertising space (it is our estimate that the advertising space will more than double within eighteen months after the granting of Franchises), that there may be price wars. The objective of Van Wagner as a Media Representative will be to establish advertising in as many locations as possible in order to develop long term relationships with advertisers rather that trying to substantially increase rates at spot locations to the benefit of only limited locations to satisfy ill defined contractual obligations, which will only result in advertisers leaving to a competing Media Representative."

Van Wagner



Van Wagner Kiosk also noted in its September 11, 1998 letter that it was concerned with some proposed rules of DoITT that were withdrawn in the final issuance of its RFP. DoITT agreed with this concern by altering the final requirements of the RFP based upon Van Wagner Kiosk's comments. Van Wagner Kiosk had noted: "The appearance of an empty display distracts from overall value of the advertising inventory and often creates unnecessary maintenance expense." With thousands of empty display panels in 2003, Van Wagner Kiosk did exactly what it should have done, it avoided leaving empty display panels.

Subsequently, DoITT issued a Request For Proposal ("RFP") under date of July 2, 1999. Van Wagner responded to the RFP on July 27, 1999. As Van Wagner Kiosk explained to DoITT and to the PPT Providers, the advertisers will not differentiate between the owners of the PPTs. The program would only be sustainable if there were a large number of kiosks in the program allowing for geographic diversity where the Media Representative controlled the management of the inventory.

In 1999 Van Wagner Kiosk also committed to establish rules for the maintenance of the program. In its July 27, 1999 submission to DoITT, Van Wagner stated:

> "Van Wagner Kiosk has determined to follow certain rules which it will incorporate into its license agreement to assure fairness among all PPT Franchisees. Among other things, Van Wagner Kiosk will not bundle kiosk advertising with other media forms (such as shelters, bus stops, transit, etc.), advertising between the Core Area and non-core area or between or among the boroughs. Horizontal rear panels will be priced separately from vertical panels."

Van Wagner Kiosk did implement rules and regulations consistent with its promises and they are included in the separate agreements with Telebeam and Coastal Communication Service, Inc. ("Coastal") as well as other PPT Providers.

At the commencement of the current franchises in 1999, Van Wagner Kiosk represented Telebeam and Coastal. During the years 1999, 2000, 2001 and 2002, Van Wagner Kiosk worked closely with Telebeam and Coastal in the buildout of their programs. By December 2002, Van Wagner Kiosk managed approximately one half of the number of kiosk panels as was then managed by the principal competitor of Van Wagner Kiosk, Viacom Outdoor ("Viacom"). Viacom, particularly during 2001 and

Van Wagner



2002, began selling advertising space on the kiosks at substantially below its rate card and bonusing a large number of display panels on the kiosks. This was responsive to the beginning of the advertising recession and the intensifying sales efforts of Van Wagner Kiosk.

During 2002, Van Wagner Kiosk booked $14,098,077 net advertising revenue on an accrual basis from its program on 2,811 panels, and Viacom's program produced $16,048,312 on 6,107 panels. Viewed another way, Van Wagner Kiosk produced nearly as much revenue from its program with half the number of panels as did Viacom from Viacom's program. In December 2002, Viacom sold its program, representing Verizon, TCC and three other providers, to Van Wagner Kiosk, and effective January 1, 2003, Van Wagner Kiosk's panels increased from 2,811 to 8,918.

Viacom's discounting policies had eroded the marketplace, diminishing advertising revenue to all telephone providers and by extension to the City, which shares 26% of that revenue. Many of Viacom's advertising clients were affiliated companies or advertisers with which it had close relationships and could encourage them to move their advertising to bus shelters, subways, train stations or other formats controlled by Viacom. In short, Van Wagner Kiosk had the daunting task of maintaining a rate structure, replacing and raising what had been the Viacom revenues and doing this in a sound business fashion that would achieve long term results.

Adding to these difficulties was the well known advertising recession that commenced in the second half of 2001, was exacerbated by September 11 and continued until the Fourth Quarter of 2003 when it first began to abate. Van Wagner Kiosk's struggles during this period were mirrored by our competitors nationally and in New York.

All businessmen know that the quickest way to lose clientele is to raise prices precipitously. Van Wagner Kiosk felt that to reduce its rate card to the Viacom pricing level would obliterate any prospects of long term recovery for the program. It therefore employed a well recognized industry accepted tool which has been used in the sale of kiosks, bus shelters and even laundry products. Rather than substantially reduce its rate card, it sold its product at higher designated prices with bonuses, thus at least viscerally preserving its rate card. The results of its strategy have proven successful and inured to the greater benefit of the City, which has seen its revenue increase year over year. The following chart depicts the success of Van Wagner

Van Wagner



Kiosk's efforts and the results that have inured to the City through 2004; 2005 is on track to substantially outperform 2004 in revenues and compensation to the City:

(Prepared on Accrual Basis)
(000's omitted)

| | 2002 | 2003 | 2004 |
|---|---|---|---|
| VWK Revenue | $14,098 | $32,696 | $38,686 |
| Viacom Revenue | $16,048 | | |
| Total | $30,146 | $32,695 | $38,686 |
| City Fee | $7,838 | $8,501 | $10,058 |

No value directly inures to any provider of discounts or bonuses over and above the sale made for which cash is paid, and the retention of the advertiser as a viable potential future customer. The above noted results starkly demonstrate that Van Wagner Kiosk has cultivated and expanded its customer base while attempting to retain a price structure that is viable for the operation of the program. Taken as a whole, Van Wagner Kiosk has been successful in maintaining its rate card and increasing the actual per panel amounts received from advertisers in its program. The relative per panel amounts earned by Van Wagner Kiosk and Viacom amplify this point.

The following chart shows the per panel amounts received (total net advertising revenue divided by total panels) by Viacom and Van Wagner Kiosk over the indicated periods:

| | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|
| Van Wagner Kiosk | $428 | $418 | $299 | $346 |
| Viacom Outdoor | $276 | $219 | | |

Van Wagner



Similarly for 2005, Van Wagner Kiosk expects per panel yield to increase over 2004 levels. Van Wagner Kiosk has always operated the program with the view that its interests and those of its PPT Providers and the City are aligned. The more revenue that Van Wagner Kiosk can bring to the program, the more each of the participants can benefit. Van Wagner Kiosk looks for a singular result - cash revenues.

In every business meeting Van Wagner Kiosk has attended with its PPT Provider clients or with DoITT, our and their focus has been on revenue per panel. This is the surest measurement of business results. The PPT Providers have parallel interests with the City in that regard.

**Comments on the Draft Audit Report**

The following discussion corresponds to the titled sections of the Draft Audit Report. Except for a small adjustment of $6,500 in net revenue out of $32.7 million in 2003 ($1690 in compensation to the City out of $8.5 million in 2003) Van Wagner Kiosk disputes the audit findings in their entirety.

**"Value of Bonus Free Kiosk Advertising Not Reported"**

The Draft Audit Report states "Van Wagner Kiosk... provided bonus free kiosk advertising to [its] clients as an incentive to enter into advertising agreements." It then contends that Van Wagner Kiosk did not report the fair market value of these bonuses. For the many separate reasons detailed below, the findings are not based upon any facts and are driven by circuitous reasoning or none at all. There was no additional value accruing to Van Wagner Kiosk other than the stated amount under the contracts and Van Wagner Kiosk accounted for all of the revenue (and *other benefits, tangible or intangible*) attributable to the program.

Quoted below is the entirely of the provision in the Franchise Agreement governing this issue.

> "Net commission advertising revenues" shall mean the total revenues (i.e., **total receipts** without reduction for any costs or expenses except as expressly set forth in this definition) derived by the Company, or any subsidiary, affiliate, agent, assignee contractor, licensee, transferee or lessee of the Company (including the Media Representative[s] with

Van Wagner



> which the Company has contracted), from the display of advertising material on PPTs pursuant to this Agreement (whether such revenues are received in the form of cash or in the form of materials, services or other benefits, tangible or intangible, in which event such revenues shall be deemed to include the fair market value of such materials, services or other advertising agency commission paid or deducted from such amount, but in no event shall such deduction for advertising agency commissions exceed fifteen percent (15%)." (Emphasis supplied).

The Audit Report asserts that Van Wagner Kiosk is obligated to pay to the City with respect to the year 2003 additional compensation in the amount of $4,096,305 which is the amount obtained by imputing to Van Wagner Kiosk $15,755,019 of revenue for which it has received no cash, trade, benefit, accrual or rights. In this discussion the imputation of this revenue is referred to as the "Phantom Income Adjustment." The Phantom Income Adjustment is not about total receipts, but imagined receipts, contrived income. The amount of the Phantom Income Adjustment is detailed in the Draft Audit Report and constitutes the number of advertising panels bonused by Van Wagner Kiosk to paying advertisers as disclosed and mandated by their contracts multiplied by Van Wagner Kiosk's full rate card - the very rate card it was trying to bolster. This proposed Phantom Income Adjustment is contested by Van Wagner Kiosk since it does not accord with sound business practice, is inconsistent with the plain reading of the documentary materials freely provided to the Audit Staff, contrary to the express text of the Franchise Agreement and is wrong as a matter of law. Highlighted below are the principal reasons the proposed Phantom Income Adjustment utterly fails to pass scrutiny.

- **Historical Precedent and the RFP**

Telephone kiosk advertising has existed in New York for decades. Initially it was managed by a predecessor to Viacom. Originally, paid advertisements only were placed on telephones owned by New York Telephone, predecessor to Verizon. For over 20 years bonusing has been a part of kiosk sales and has never been criticized by DoITT, its predecessor agency, or the Office of the Comptroller. In 1999 when Van Wagner Kiosk became a Media Representative, it confirmed in the market that Viacom regularly bonused its advertising clients that were purchasing kiosk advertising. In connection with the 2002 due diligence of Viacom's kiosk business, Van Wagner Kiosk reviewed numerous contracts where Viacom bonused (both guaranteed and space

Van Wagner



available) to advertisers. A schedule provided to us by Viacom listed 33 separate active contracts as of October 2002 providing for thousands of bonus panels under Viacom negotiated contracts. On January 1, 2003, Van Wagner Kiosk took over 13 of those 33 contracts negotiated by Viacom providing for bonusing on hundreds of panels into 2003 and thereafter Van Wagner entered into renewals of many of those contracts on similar terms in early 2003. By way of example, History Channel, Investor's Business Daily, Cellini and Coach had bonus contracts. Each was among Viacom advertisers that became Van Wagner Kiosk advertisers. Since in most cases Viacom collected the revenues from the 33 bonused advertisers, the auditors did not review those contracts - as the Audit Staff was focusing only on contracts where Van Wagner Kiosk received money in 2003.

In 2003 bonus advertising represented a higher percentage of posted kiosk display panels than Van Wagner Kiosk would prefer under its business model. Nevertheless, in Van Wagner Kiosk's view, leaving the plant with empty faces, thousands of them, was undesirable for the program, both short term and long term. We detailed this position to DoITT as early as 1999 - and DoITT agreed with our assessment; see "Background of the Van Wagner Kiosk Advertising Program". Leaving the panels blank or with dated copy would have had negative effect on the program, creating an injustice to the telephone companies, our partners and the City, our largest partner. Leaving the display panels blank, Van Wagner Kiosk has always understood, is contrary to the interests and desires of DoITT as well, leaving them subject to graffiti and vandalism.

The results shown above indicate that Van Wagner Kiosk has developed a dynamic business model that is growing the program out of the problems that were prevalent when Viacom was the largest media representative in the City. In 2003, Van Wagner Kiosk made payments to the City of $700,000 more than it had received with respect to 2002 from Van Wagner Kiosk and Viacom combined. In 2004 another $1,500,000 was added to the City's share of revenue, and 2005 is substantially ahead of 2004. The operating results of the program demonstrate that the City and DoITT were correct in the first place when they determined to leave marketing strategy to the Media Representative. Had Van Wagner Kiosk openly resorted to dropping its rate card to near the $300 level in 2002 and 2003, it would never have been able to have the results it showed in the program in 2004 in the beginning of 2005.

Van Wagner



Operating a program is about maximizing for the long term. The City receives the benefit when the customer comes back, expands its program and adds dollars to its buys. Among dozens of others, these 2003 customers that received bonuses have made further 2004 and/or 2005 kiosk commitments in which the City has shared in millions of dollars of revenue:

| | | |
|---|---|---|
| Citibank | Yahoo | Universal Pictures |
| Giorgio Armani | NBC | Investors Business Daily |
| Coach | Miller Beer | Absolut |
| Michelob | Cellini | Comedy Central |
| NY Health and Racquet | Geoffrey Beene | Court TV |
| Chelsea Piers | Walt Disney | History Channel |
| MGM Pictures | Jaguar | Skyy Vodka |

Van Wagner Kiosk has always felt that its interests of the PPT Providers, the City and Van Wagner Kiosk were aligned when it came to maximizing net advertising revenue. It is not the province of the City or the auditors to determine marketing strategies in those areas where DoITT has not reserved rights. Under the Franchise Agreement in explicit terms, DoITT has reserved specific rights with respect to the advertising (see Sections 4.4, 4.4.1, 4.10 and 4.11 of the Franchise Agreement). DoITT expressly provided restrictions on size, materials, type of advertising, style of advertising and other such matters.

The Franchise Agreement is devoid of restrictions on the manner or means by which the Media Representatives promote the sale of kiosk display advertising. The Franchise Agreement does not mandate the maintenance of a rate card, does not mandate selling techniques, does not prohibit discounting and does not prohibit bonusing. DoITT certainly had the power to include these things in the Franchise Agreement or by subsequent rule. It correctly has not done so and, as the history of the RFP process demonstrates, DoITT backed away from control of advertising in deference to the business acumen and expertise of the Media Representatives. On the contrary, the Franchise Agreement delineates that the Media Representative's responsibilities "shall include, without limitation: the sale and lease of advertising space, . . . " (Franchise Agreement at 4.1 (b)).

Van Wagner



In order to become a Media Representative Van Wagner Kiosk had to respond to a DoITT RFP described above.

In the RFP DoITT detailed the City's objectives as follows:

> "The City's primary objectives with regard to PPT advertising are to: (i) ensure cleanliness, maintenance and repair of advertising display panels according to the highest standards; (ii) create and implement a streamlined and efficient procedure for the collection of advertising revenues and the payment of a percentage of these revenues to the City and PPT Franchisees; and (iii) maximize revenue potential for PPT Franchisees and the City through multi-locational representation."

DoITT sought to qualify Media Representatives. DoITT expressed its desire to locate experts in the field that could fulfill its objective of maximizing revenue potential. DoITT stated in the RFP that:

> "To be designed as a Media Representative, proposers must demonstrate that they have relevant knowledge and experience regarding out of home advertising media in particular, and that they have a skill and ability to manage this significant advertising market."

Van Wagner Kiosk demonstrated that skill and ability and has done so since. The Audit Staff does not have the knowledge or experience to second guess Van Wagner Kiosk's skill, ability or market expertise, or by extension its marketing programs. Further, Van Wagner Kiosk is doing exactly what DoITT approved and mandated (i.e., "such services must include") - negotiate all advertising transactions. The following was detailed among the obligations assumed by a Media Representative in the RFP:

> "The Media Representative will be responsible for the sale and/or lease of PPT advertising space and will perform all services, as an independent advertising contractor, in connection with the procurement of advertising on behalf of PPT Franchisees. <u>Such services must include</u>, without limitation, the <u>marketing of advertising space</u> on PPT Enclosures, the identification and solicitation of potential clients (e.g., advertising agencies and/or businesses), the <u>negotiation of all advertising transactions including all financial and business terms</u>, and obtaining any and

Van Wagner



all approvals and authorizations required for advertising installations. (Emphasis Supplied)."

DoITT correctly perceived the need for Media Representatives. DoITT established an RFP to find qualified advertising companies. Van Wagner Kiosk is clearly such a company and has the authority and mandate to do exactly as it has done over the last five years.

- **The Position Advanced is Contrary to the Position Asserted by the Office of the Comptroller in Other Similar Audits**

On June 24, 2004 the Office of the Comptroller issued an audit report pertaining to Viacom's management of the City Bus Shelters ("Viacom Audit"). In the Viacom Audit, the Office of the Comptroller took a position totally at odds with the theory underlying the Phantom Income Adjustment. In the Viacom Audit, the Office of the Comptroller allocated - evenly across the board - the revenue derived under a contact pertaining to paid and bonused advertising panels by dividing the total advertising revenue by the number of panels (parenthetically as noted below the proper accounting treatment) to determine the per panel value. In relevant part the Office of the Comptroller explained its Viacom Audit adjustment as follows:

> "[U]nder Contract No. 61684, an advertiser paid Viacom $135,000 for advertising on 90 panels. Nine of those advertisements were posted on panels owned by one of Viacom's other business ventures. Viacom took a deduction of $13,500 against revenues it reported to the City ($135,000 contract price/90 contracted panels = $1,500 per panel x 9 competitor's panels used = $13,500 deduction). However, when we reviewed the contract file, we found that Viacom had posted advertisements on 221 panels under this contract, having given the advertiser 131 additional City owned panels free of charge. If Viacom had used the total number of panels posted in its calculations, it would have deducted only $5,498 from the revenues reported to the City ($135,000 contract price/221 panels posted = $610 x 9 competitor's panels used = $5,498 deduction). Thus, Viacom would have reported an additional $8,002 in revenue to the City."

Van Wagner



The foregoing analysis is absolutely correct and 180 degrees contrary to the Audit Staff's assertion here. The correct accounting treatment is to spread the revenue over the paid and bonused panels.

- **The Phantom Income Adjustment and the Inexplicable Reading of the Franchise Agreement is Contrary to Law**

As a purely legal matter, it is inappropriate and inexplicable for the Comptroller's Office to seek to read into the Franchise Agreement contractual provisions that not are not there and are contrary to the plain text of the relevant provisions. To compound matters, the Audit Staff takes one giant step beyond rewriting the Franchise Agreement.[1] The Staff Auditors have audaciously determined that over 160 independently negotiated contracts between Van Wagner Kiosk and independent advertisers contain agreements, considerations and promises (and revenues) that are not on the face of the contracts. Each of the advertising contracts of which the auditors complain (or seek to impute phantom revenue) clearly specify the total consideration being paid by the advertisers and the total number of panels. They are not ambiguous in any regard. Implicit in its argument is that Van Wagner Kiosk and over a hundred separate prominent advertisers and advertising agencies entered into secret deals to deliver consideration to Van Wagner Kiosk outside the four corners of the negotiated contracts. This is absurdly implausible.

Thousands of New York cases can be cited for the proposition that extrinsic evidence of parties' intent may be considered only if an agreement is ambiguous; known as the "Four Corners" rule. The Franchise Agreement and each of the 161 separate advertising contracts have unambiguous language with definite and precise meanings with no danger of misconception. There can be no reasonable basis for any difference of opinion. Each of these agreements on its face is reasonable and susceptible of only one meaning.

The following is quoted from Greenfield v. Philles Records, Inc., 98 N.Y.2d 562; 780 N.E.2d 166; 750 N.Y.S.2d 565; 2002 N.Y. LEXIS 2146:

> "Thus, a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms (see e.g. R/S Assoc. v New York Job Dev. Auth. 98 N.Y. 2d 29, 32, 744 N.Y.S.2d 358, 771 N.E.2de 240, rearg denied 98 NY2d 693

Van Wagner



> [2002]; W.W.W. Assoc. v Giancontieri, 77 N.Y.2d 157, 162, 565 N.Y.S.2d 440, 566 N.E. 2d 639 [1990]). . . . A contract is unambiguous if the language it uses has a "definite and precise meaning, unattended by danger of misconception in the purport of the [agreement] itself, and concerning which there is no reasonable basis for a difference of opinion. (citing cases)."
>
> . . .
>
> "If the contract is more reasonably read to convey one meaning, the party benefited by that reading should be able to rely on it; the party seeking exception or deviation from the meaning reasonably conveyed by the words of the contract should bear the burden of negotiating for language that would express the limitation or deviation"

Van Wagner Kiosk, as a responsive party to the RFP and as an implied party to the Franchise Agreement, is entitled to rely on its plain meaning. Its plain meaning is that it should pay a 26% commission on total receipts. It has received no other benefits from the contracts subject to the Phantom Income Adjustment; it hasn't received $16,000,000 or any part thereof. The Phantom Income Adjustment is without any logical, substantive, practical or legal basis.

- **The Phantom Income Adjustment is also Inconsistent with Years of Experience and Practice with DoITT**

DoITT oversaw the kiosk program managed by TDI for New York Telephone, and after 1999 Van Wagner, TDI and its successor Viacom. DoITT performed a substantial audit of Van Wagner touching on 2002 and 2003. Never has DoITT objected to discounts, bonuses or other reasonable marketing strategies of Van Wagner Kiosk. This is not surprising, since it is reflective of its sound regulatory policy determined in the RFP process to leave marketing strategies to the marketers.

- **The Phantom Income Adjustment Is Contrary to Appropriate Accounting Treatment**

The Securities and Exchange Commission Staff Accounting Bulletin (SAB) No. 101 deals with revenue recognition in financial statements. It presents various fact patterns and interpretive responses concerning whether the revenue recognition tests are met. There is nothing contained therein that would suggest or hint that phantom

Van Wagner



income should be recorded and recognized. A careful review will indicate to the reader that the Phantom Income Adjustment is contrary to accepted accounting practice and would be fraudulent. Indeed it is fair to say that if Van Wagner Kiosk were to recognize the $15.6 million in revenue that the Phantom Income Adjustment hypothesizes, the certified public accountants to Van Wagner Kiosk would refuse to issue their report. We doubt that the Audit Staff, many of whom we understand to be certified public accountants, would sign their names to any such certification.

Throughout its businesses, Van Wagner Kiosk, the parent of Van Wagner Kiosk, has reported revenue under advertising contracts as recognized over the period in which an advertisement is placed. This means, if Van Wagner Kiosk were to have a two month showing in December and January and the month of January was given as a bonus, that the contract amount would be recognized one half in one year and the other half in the following year.

Van Wagner Kiosk cannot recognize revenue to which it has no present or future right.

- **The Audit Staff's Approach Would Have a Senseless Chilling Effect on the Media Representative Business**

The application of the Phantom Income Adjustment, if sustained, would effectively prevent anyone from engaging in the Media Representative business in New York City. If Van Wagner Kiosk were to make payment to the City upon the Phantom Income Adjustment it would mean that its actual results of operations for the year 2003 would result in losses. Under the Byzantine audit review approach, Van Wagner Kiosk's payments to the PPT Providers and the City would exceed its reported 2003 revenues!! Fortunately none of the PPT Providers agree with the tortured contract interpretation of the Office of the Comptroller, or they too might be asking for millions of dollars in additional franchise fees.

This is even more outside the realm when one realizes that in 2003 Van Wagner Kiosk lost money on operations. In real life, in the advertising recession and glut of panels, Van Wagner Kiosk was not making money without this claim for an addition $4.6 million in phantom fees.

This Phantom Income Adjustment does injustice to the program without consideration of the $2,000,000 in capital expenses outlayed during the period, or the millions

Van Wagner



expended in cost of operations, selling, cleaning, posting, electricity and overhead. Could the drafters of the Franchise Agreement have intended that Media Representatives would only work to pay rent?

- **Bonuses are a Part of Ordinary Business Practice**

Van Wagner Kiosk has provided to the Office of the Comptroller source materials, letters, and other documentation, all of which establish without question a simple fact. Granting bonuses is customary business practice as a sales tool. The benefit that flows from timely bonusing is the moving of inventory at an aggregate price acceptable to the seller and inviting enough to the customer that it says "yes". Van Wagner Kiosk has done nothing earth shattering or new. Retail stores, wholesalers and others with huge inventory supplies induce customers with a buy one get one free offer all of the time. When a customer buys the two pairs of jeans for $150, he knows that he paid $75 a piece. He also knows that at a two for one sale he is buying two items, not one; he can't buy one pair of jeans for $75.

The Audit Staff's argument rests on this conjectural foundation: "Van Wagner Kiosk and Vector provided bonus free kiosk advertising to their clients as an incentive to enter into advertising agreements". The gravamen of the Audit Staff's complaint is that Van Wagner Kiosk was actually successful in effecting sales (for which the City was paid its 26%). The Audit Staff then catapults that seemingly truthful premise (Van Wagner Kiosk entered into advertising contracts) into a wholly false conclusion by attaching a second and separate monetary value to the bonus without withdrawing the same monetary amount from the primary purchase. Indeed, in analyzing the application of the Audit Staff's conclusion of implied value, some of the Van Wagner Kiosk contracts would require the attribution of more value to the free bonus than to the paid portion of the contract because the Audit Staff has ascribed higher fair market value to the free portion than the paid portion (assuming all the money really was just for the paid portion and not the bonus portion as well). And they have done this in the face of the 161 independently negotiated fully integrated contracts that are full and complete on their face.

There was no additional cash paid by these clients. They paid what they paid and received what they contracted to receive. To the customer looking at its advertising copy on the streets of New York, the customer would have not known if any particular kiosk were in the "paid" column or "bonus" column, nor would the customer care.

Van Wagner



Let's reverse the concept and assume that Van Wagner Kiosk, in 2003 with 6,000 empty advertising displays determined to sell the inventory without the utilization of bonuses. In the short term, three alternatives were possible:

1. The customer purchased the same aggregate number of display panels (regular and bonused) for the same aggregate amount at a greater discount to the rate card.

2. Van Wagner Kiosk lowered the rate card and sold the same aggregate number of panels for a lesser amount.

3. The customer refused to buy anything at all and none of Van Wagner Kiosk, the telephone companies or the City received a nickel from that advertising.

On a long term basis any one of those three alternatives hurts the program and any businessman knows it. In Alternative No. 1 the rate card loses any meaning in the market. In Alternative No. 2 the published rate card is substantially reduced with no likelihood of raising it anytime soon, thus destroying the long term revenue prospects of the program. In Alternative No. 3 everybody loses.

Van Wagner Kiosk's business approach to a massive influx of inventory, 200% greater than it had been managing, was thoughtful, in accordance with common business practice and has provided the long term benefits to the program that were necessary.

- **Industry Experts Extol Van Wagner Kiosk's Marketing Strategies**

To achieve specified business objectives, it is critical to understand four basic marketing components (product, place, price and promotion) and utilize strategies that are adaptable to a volatile and constantly changing marketplace. In providing "bonus free kiosk advertising" or "bonus space" to advertisers, Van Wagner Kiosk is not generating additional immediate revenue or benefit. Rather Van Wagner Kiosk is simply implementing a standard business practice that reflects sound marketing concepts to meet the stated objective of increasing aggregate revenues. To provide total customer value, Van Wagner Kiosk appropriately implements value pricing and differentiation strategies.

Van Wagner



To document the support for the theoretical underpinning of Van Wagner Kiosk's strategy, the discussion in this section draws from the works of leading academic theorists and strategic marketing experts. Philip Kotler's *Marketing Management*, is widely recognized as the definitive textbook on marketing (it is now in its 12th edition). Michael Porter's *Competitive Advantage*, is considered a classic text book on business strategy. In *Competitive Advantage*, Professor Porter reduces competitive business techniques to three generic best strategies (cost leadership, differentiation and market segmentation or focus) which have become familiar business terms.

**Customer Delivered Value**

Advertisers today are faced with an endless array of media options. In an industry where it is difficult to precisely pinpoint media's return on investment, advertisers are left to make media decisions based on their perception of the value proposition, rather than on a specific price. The value proposition is quite simply the net benefit buyers realize when they agree to a media contract.

> Business market management is the process of understanding, creating and delivering value to targeted business markets and customer firms (e.g., corporations, institutions, governments). It relies upon the assessment of value in the marketplace.[2]

Communicating customer delivered value (CDV) then is a key and especially critical aspect in selling media. This is particularly so with respect to phone kiosks, a format that acts more as a commodity than other outdoor media products which are more location specific. Philip Kotler, the leading strategic marketing expert, defines Total Customer Value as the bundle of benefits customers expect from a given product or service.[3] In media sales, the "bundle of benefits", translates to the total blended cost media buyers pay for a given transaction. To maximize CDV, media sellers and buyers use their knowledge of the industry and current marketplace conditions to negotiate accordingly. Due to the many variables that can affect the price of kiosks (geography, quantity, seasonality, frequency etc.), there is an infinite amount of ways to create value. One of the most common methods prevalent among the industry is through the use of "bonus space". Media buyers purchase an agreed upon number of panels at a designated rate. In addition to the purchased space, they receive a given amount of either "guaranteed" or "space available" *bonus* units at no additional cost. The media buyer pays one blended cost making the per unit cost less and the media seller

Van Wagner



maintains the value of their product by maintaining the price integrity of its rate card. In this way, the kiosk value offer is differentiated from alternative media products. Professor Michael Porter, a leading authority on competitive strategy calls this a *differentiation* strategy.

> A firm differentiates itself from its competitors when it provides something unique that is valuable to buyers beyond simply offering a low price. Differentiation allows the firm to command a premium price, to sell more of its product at a given price, or to gain equivalent benefits such as greater buyer loyalty during cyclical or seasonal downturns. [4]

There is also the additional benefit of utilizing space that otherwise would be left unsold. Blank or dated copy is detrimental to media sales as it alerts media buyers of low demand and thus an opportunity to buy at a low price. Professor Porter calls the factors that buyers use to infer the value a firm will or does create *signals of value.*[5] The underlying principle reflected here is a basic one - buyers will buy from the firm that they perceive to offer the highest customer delivered value.[6] Clearly, the company that offers what the buyer perceives as the greatest Total Customer Value will get the business.

**<u>Pricing Strategies: Perceived Value Pricing/Value Pricing</u>**

It is imperative that media sellers implement a pricing strategy that meets their business objectives and takes into account the economic climate. One of the biggest challenges companies face is the dilemma between market share and margin. In the highly competitive media industry, market-share is fragile. Aggressive competitors often go through successive rounds of discounting in an effort to win share. While low prices will buy market share, they won't necessarily generate customer loyalty. Low prices often simply lead to price wars as customers become conditioned to switch to the next low price firm that comes along. This strategy is based on short term consequences and it is important not to fall into this situation if the business objective is based on long term aggregate revenue growth.

For kiosks, while non-price factors are important in buyer choice behavior, price often operates as a major determinant of buyer choice. Delivering bonus space is simply a method of providing customer value without degrading the value of the actual product. According to Dr. Kotler, the key to perceived value is to accurately determine the

Van Wagner



market's perception of the value of the offer and to deliver "more for more". This method is known commonly as *perceived value pricing* which is different than *value pricing* ("My kingdom for a horse!"), whereby a company charges a low price for a high quality offering by delivering "more for less." [7] By utilizing perceived value pricing, Van Wagner Kiosk is positioned to accomplish its objective of maximizing long term aggregate growth. During periods of recession, buyers will demand a lower price and show a readiness to switch to lower price formats and sellers. Indeed, they will search for cheaper substitutes. Pricing strategies need to be adjusted accordingly. Quoting Dr. Kotler:

> **If a company maintains its price during a recession, it will lose market share. If on the other hand, it reduces its price, it will lose margin...the smartest thing you can do is to hold on to market share. Winning customers back later may prove difficult...so it is likely that you will lower your price in order to keep your customer...however in reducing price, be sure to maintain your list price by optimizing the use of standard techniques, such as rebates, volume discounts, early purchase discounts and lower interest financing...It may be difficult to reestablish your price later if you lower the list price. The power of volume discounts... cannot be underestimated...** [8]

Dr. Kotler strongly advises against product adulteration. If media companies abandon their rate card, the media vehicle is likely to fall into a low quality trap, as price is often associated quality. Dr. Kotler also asserts the importance of standing by your position. He claims a sound position "will be hard to regain if it is lost. Remember, in a recession, the goal is survival, not profits."[9] The rate card is maintained, yet kiosks are priced at a level media buyers think the product is worth, reflecting the buyers' perceptions of value, not the actual cost in operating/selling the product. Non-price variables (i.e. bonus space) are used in the marketing mix to build up perceived value in the buyers' minds and prices are set to capture this.

This is significantly different from "value pricing" which says the price should represent an extraordinary bargain for consumers. Unlike a value pricing strategy, by utilizing the perceived value method, Van Wagner Kiosk solidifies the value of kiosks by anchoring the kiosks to customer perceived value rather than on a regimented cost per unit. According to Dr. Kotler, "...some buyers are less concerned with the product's *price* than the *total costs* of obtaining, operating, and servicing the product over its lifetime.

Van Wagner



A seller can charge more than competitors and still get the business if the customer can be convinced that the total lifetime costs are lower."[10]

The buyer then is convinced that its lifetime return on investment is higher and Van Wagner Kiosk is able to maintain the price integrity of the kiosks and raise rates accordingly in better economic periods. The reasoning behind this concept is clear. In the long run, it is simply less costly to maintain price and raise perceived quality. The short term consequence is smaller market share and short term decline in profitability, but as the stated objective is long term growth, this strategy is entirely appropriate resulting in an increase in profitability by raising rates slightly in accordance to future media inflation and reducing the amount of bonus units delivered. By increasing the perceived value of the kiosks rather than lowering its price, Van Wagner Kiosk reduced profits less than if the unit price was lowered reducing the long term value of kiosks. Using Professor Porter's theory of differentiation, Van Wagner Kiosk was and is simply differentiating its offer by creating value for the buyer through Van Wagner Kiosk's understanding of the buyer's value chain.

The authorities referred to above have remarkable backgrounds:

> Philip Kotler is the S. C. Johnson & Son Distinguished Professor of International Marketing at the Kellogg School of Management, Northwestern University, Evanston, Illinois. He received his Master's Degree at the University of Chicago (1953) and his PhD Degree at MIT (1956), both in economics. He did post-doctoral work in mathematics at Harvard University and in behavioral science at the University of Chicago. Professor Kotler is the author of: *Marketing Management: Analysis, Planning, Implementation and Control*, the most widely used marketing book in graduate business schools worldwide; *Principles of Marketing; Marketing Models; Strategic Marketing for Non-Profit Organizations; The New Competition; High Visibilit; Social Marketing; Marketing Places; Marketing for Congregations; Marketing for Hospitality and Tourism; The Marketing of Nations;* and *Kotler on Marketing*. Professor Kotler was the first recipient of the American Marketing Association's (AMA) "Distinguished Marketing Educator Award" (1985). He received honorary doctoral degrees from the Stockholm University, University of Zurich, Athens University of Economics and Business, DePaul University, the Cracow School of Business and Economics, Groupe H.E.C. in Paris, the University

Van Wagner



of Economics and Business Administration in Vienna, Budapest University of Economic Science and Public Administration, and the Catholic University of Santo Domingo.

Michael E. Porter is the Bishop William Lawrence University Professor at the Harvard University, John F. Kennedy School of Government. His research focuses on competitive strategy, international competitiveness, the relationship between competition and society, and the relationship between competitiveness and the natural environment. He is the author of 16 books and over 75 articles including *Competitive strategy (1980); Competitive Advantage (1985); The Competitive Advantage of Nations (1990), On Competition (1998).* He continues to play an active role in U.S. economic policy. He received a B.S.E. in aerospace and mechanical engineering from Princeton University in 1969, and an M.B.A. from the Harvard Business School and a Ph.D. in Business Economics from Harvard University in 1973.

James A. Narus, Professor of Business Marketing at Wake Forest University, Babcock Graduate School of Management. Dr. Narus is co-author of the book *"Business Market Management: Understanding, Creating and Delivering Value"*. He is a member of the American Marketing Association and the Purchasing Management Association of the Carolinas and Virginia. Dr. Narus received a B.A., M.B.A from the University of Connecticut, and a Ph.D. from Syracuse University.

## <u>Van Wagner Kiosk Has Met the Challenge of a Difficult Environment</u>

In an increasingly competitive environment, the challenge of media sellers is to communicate effectively the total value of their offering to their customers. To do this, they need to understand fully the four basic components of the marketing mix (product, place, promotion and pricing) and utilize fundamental marketing strategies accordingly. A company's responsibility is to clarify business objectives and develop adaptable marketing strategies that adjust to the varying circumstances of a volatile and constantly changing marketplace. It is critical that media sellers recognize that they do not compete on price alone. The pricing decision is important, but so are the other elements in the marketing mix. Maximizing Total Customer Value is the basic premise that positions a company to become a market share leader. By providing

Van Wagner



bonus space to advertisers, additional revenues are not gained. However, the value of kiosks is maintained. Delivering bonus space is a common industry practice. This tactic is in complete accordance to the advice of leading marketing professionals. It relies on the premise of customer delivered value and is simply a marketing strategy used to maintain the total value of the media product ultimately leading to an increase in revenue.

Van Wagner Kiosk has followed time tested and textbook approved marketing for the benefit of the program and the participants in its revenue.

- **The Bonused Contracts Provided Customary Discounting**

Van Wagner Kiosk's sin (it seems) is that it sold advertising panels at or near the rate card and simultaneously in the same contract included additional panels without attributing any of the consideration separately to them. But whether Van Wagner Kiosk did or did not, the net result would be the same - either all the consideration is attributed to the sold panels and nothing to the bonused panels, or some of that consideration is shifted to the bonus panels (perhaps an average price for all panels combined). In either case, the total consideration received is identical. It is also clear that if Van Wagner Kiosk had sold the aggregate number of panels to the same advertiser for the same aggregate consideration, no one in the Comptroller's Office would be concerned. This is apparent because the Comptroller's Office did not object to the 283 contracts for which no bonusing occurred. ***However, a financial analysis of the contracts that included bonusing discloses that their average yield per panel after giving effect to quantity discounts was consistent with all of the other contracts reviewed by the Audit Staff.***

We understand the auditors in total reviewed 444 advertising contracts; of those 349 had postings in 2003, of which 133 had bonuses and 216 did not have bonuses. The contracts with bonuses accounted for $12,282,724 in booked net revenue derived from 32,431 panels in 2003, with an average per contract panel count of 244 panels, and contracts without bonuses accounted for $9,310,868 in booked net revenue derived from 21,619 panels with an average per contract panel count of 100 panels. So 57% of the revenue was derived from 60% of the sold panels and 43% of the revenue was derived from 40% of the sold panels. The average number of panels contracted with sales utilizing bonusing was 245% greater than without bonusing.

Van Wagner



The average all in contract price with bonusing was $92,351 compared with $43,106 where bonusing did not exist, more than 210% greater.

As noted above, for the entire year 2003 Van Wagner's average yield per panel was $299; average yield per panel takes into account unsold as well as sold inventory.
As is to be expected, the larger customers negotiated for and received the greater discounts. Further our examination revealed that of the contracts reviewed by the auditors where Van Wagner Kiosk received 2003 revenue, 57% of Van Wagner Kiosk's 2003 revenue was derived from the 38% of the contracts where bonuses were included. The contracts that included bonusing in every measure were the most significant and economically advantageous to the City. The analysis confirms what Van Wagner has always indicated - the use of bonusing is the savior of the market in bad times.

Note, in any event, there is a natural distortion that increases the yield per panel on contracts without bonuses (taken as a whole) because the yield on these panels includes sales that were not significantly discounted if at all, such as of specific sites where Van Wagner Kiosk negotiated a higher rate, contracts for limited showings in the most valuable areas of the core, rather than general coverage, and special contracts where extra services are provided like electrified LEDs. At the same time, larger buys resulted quite naturally in bigger discounts to the advertisers.

Taken together, this information establishes that the use of bonusing is nothing more than a successful tool for sales and no different in any way than discounting. The yield per panel on the contracts with bonusing and the contracts with no specified bonusing that were included in the 2003 postings and reviewed by the auditors, in each case, were commensurate ($379 compared to $488) and ~~significantly~~ above the 88
120 plant per panel yield of $299. In summary, a 20% discount on average to volume purchasers, which purchased on average 245% greater contract commitments, is entirely appropriate and to be expected.

94 This proves unequivocally that Van Wagner Kiosk's marketing strategy was correct - bonusing, discounting, call it what you like, had the effect of moving inventory. And the auditor's view that somehow the City lost something is fallacious.

Van Wagner



- **Consistent with Van Wagner Kiosk's Market Approach, its Customers Responded as Hoped and Purchased Kiosk Display Advertising**

Following are excepts from letters from industry experts and significant customers of Van Wagner Kiosk, all holding for the same proposition:

> Bonusing is a standard business practice that promotes customer loyalty and assures sales.

It is important to consider what industry professionals who are involved in the industry for their livelihood have to say. The views of all these professionals are at diametric odds with the Audit Staff's perception of the industry.

John Miller, Managing Partner of Mediaedge:cia, a buying service that is one of the largest purchasers of outdoor advertising space in the United States, recognizes the importance of bonusing to the industry. He has been involved in the outdoor media business for over 40 years, during which time he has been responsible for the purchase of over $2 billion of outdoor advertising space representing clients such as AT&T, Met Life, Diageo and Philip Morris.

> I am fully familiar with the practice of bonusing advertisers as part of a package in the sale of advertising space. I have negotiated contracts on behalf of advertisers in many instances where I have generated bonus advertising time or space. This is the norm, and is a regularly accepted and respected business practice. This practice simultaneously serves two interests. It allows an owner of advertising space such as a billboard company, a franchisee of bus shelters or telephone kiosks to maintain rate integrity simultaneously allowing an advertiser to negotiate to a rate acceptable to it for the aggregate purchase of time and space. As a general rule advertisers and, without exception, buying services are attuned enough to the relative strength or weakness of the market, that they have a good sense or expectation of the likelihood that they will receive the space allocated to them under the bonus portion of an advertising contract. Quite simply, without the facility of bonusing available to the holder of advertising space, that marketer would either lose the sale, or lose its rate card; neither of which are acceptable alternatives, particularly in a market where oversupply is prevalent. In

Van Wagner



> short, bonusing is often the last incentive to put a customer in the sold category.

Stanford Nygard, currently a consultant to and the former President of Outdoor Vision, the buying service responsible for the significant 2003 Citibank purchase, reflects from his perspective on the value of bonusing:

> Our clients engage us to maximize the media dollars they spend. If a client wishes to purchase telephone kiosks in New York City, I try to make certain that I obtain the best coverage, best locations and best price within the scope of the allocated budget for the program. In order to achieve this result, I need to understand the business needs of the media outlets with which I deal in order that I can maximize my client's results and fulfill their media objectives within the constraints of those businesses.
>
> . . .
>
> What I achieved in [the 2003 kiosk purchase for Citibank], I have done in many markets throughout the country with many forms of out of home media. It is a common practice and in fact the very definition of my job function. I have never heard of any franchisor/licensor claim that a cash value is attributable to a bonus under these or similar circumstances.

Dom Camera, owner/president of Dom Camera Associates, the agency for Trio Television, explained his buying decisions in 2003 as follows:

> During the advertising calendar year 2003, our agency purchased telephone kiosks at what we perceived to be substantial discounts to rate card that reflected the vast oversupply of locations and the soft advertising market. While our overall purchases were indicative of a soft market, the price per panel was near Van Wagner Kiosk rate card. This is so because we married paid and bonused panels in order to provide a blended rate at a price for which our agency and client were willing to pay. No additional consideration was granted nor expected.

Van Wagner



Zenith Media is the advertising agency representing Estee Lauder in many of its advertising endeavors. As an agency is understands the need to negotiate for the benefit of its client. Note that even with the bonused panels, the rate derived was $567 gross ($85,000/(100+50), for a one month campaign. Joel Balcita, Vice President - Associate Media Director, who negotiated the contract for this important Estee Lauder campaign with Van Wagner Kiosk explains:

> In August of 2003, Estee Lauder undertook a major marketing initiative for its product "Beyond Paradise". On behalf of our client, we negotiated a substantial contract with Van Wagner Kiosk. It was unusual in that it specified a minimum number of illuminated kiosks, 75 of 100, an important matter for the fashion and beauty industries. There were an additional 50 vertical panels at bonused locations. In all, we negotiated a blended rate with coverage and illumination that we felt comfortable recommending to our client. Had we not been able to negotiate an overall rate and exposure component, we would have turned to other forms of advertising media. At that time there were plenty of alternatives since there was a glut of advertising locations in New York City of these commodity type of displays. Available at that time were large numbers not only of kiosks, but also bus shelters and urban panels, each of which would have met the criteria that this marketing initiative required.

Mary Corigliano, Senior Vice President, Marketing for Court TV explains how her decision to purchase kiosks is made:

> Court TV has been an advertiser on telephone kiosks on the streets of New York for years. We have had many programs with Van Wagner Kiosk Advertising, LLC. Kiosk advertising is an excellent medium for Court TV to promote its television programs. Kiosk advertising provides geographic diversity and the ability to promote specific programs over a specified duration - often highlighting the introduction of a new show or series. Within the scope of our budgets, we always attempt to make the most cost effective purchases available to us. Our criteria in making purchases includes scope of coverage (how may eyes are going to view our copy), location of coverage, competing alternatives such are urban panels and bus shelters, and above all cost per unit of advertising.

Van Wagner



> When we focus on cost per unit of advertising we are looking at the blended rate offered to us by the provider for the coverage provided. The blended rate is simply the total cost divided by the number of displays. When a provider, such as Van Wagner Kiosk, wants to hang on to its rate card, then it must make other accommodations for us to make the purchase or Court TV will place its advertising dollars elsewhere with a more competitive provider. One of the most common means available to reduce the blended rate to us - thus allowing us to buy the coverage we desire at the cost the market dictates - is to bonus Court TV additional locations. We care about the total geographic distribution and are indifferent as to whether any particular unit is bonused or not - in short, Court TV buys a charting map for a specific duration at a sum certain aggregate price.

Bonusing, as a marketing tool, is an important arrow in the Van Wagner Kiosk quiver. It directly creates an environment understandable to the customers where "win win" is realizable. The City is the beneficiary of every sale made on the kiosks. The City has benefited and will continue to benefit from the Van Wagner Kiosk long term approach to marketing. The City has won and continues to win.

- **The Applied "Fair Market Value Test" Is Baseless**

For inexplicable reasons, covered by footnote only, the Draft Audit Report indicates that the imputed value to bonus panels is the Van Wagner Kiosk rate card. The very rate card that Van Wagner Kiosk sought to protect in the market place now, according to the Audit Staff, constitutes the "fair market value of the free kiosk advertising posted." This choice of reference only draws more closely into focus the enormity of the error in promoting the Phantom Income Adjustment. Achieving a rate card is a salesman's dream, a goal, target and wish. If rate card is being achieved with any regularity, it is too low and the inventory is not being maximized. The reports submitted to DoITT by Van Wagner Kiosk as part of its periodic reporting, copies of which were provided to the Audit Staff, highlight what was shown above, in 2003 Van Wagner Kiosk had net advertising revenue of $27.4 million earned on 9,100 panels for an average per panel rate of $299. Every aspect of the audit Phantom Income Adjustment theory is flawed, including the valuation attached to the bonus advertising.

Van Wagner



**"Value of Advertising Exchanged for Non Cash Items in Report"**

The Audit Staff had identified four contracts for which Van Wagner Kiosk was paid a portion of the advertising fee through consideration other than for cash. Van Wagner Kiosk agrees that it is required to report and pay franchise fees to the City based upon the fair market value of such materials, services or other benefits. Van Wagner disputes the findings pertaining to two of the four contracts for the reason that the amounts were reported and paid:

> Contract No. 11049, dated February 25, 2003, American Ballet Theater, $170,000 cash and $10,000 barter. The barter portion was reported in July 2004 and included in the revenue report delivered to the City with respect to the Third Quarter.
>
> Contract No. 11029, dated February 11, 2003, Crunch, $12,750 cash and $4,000 Barter. The barter portion from the Crunch memberships was reported in July 2004 and included in the revenue report delivered to the City with respect to the Third Quarter.

Of the other two contracts referred to in the Draft Audit Report, Van Wagner Kiosk made compensation payments in response to the preliminary audit aggregating $1690 as follows:

> Contract No. 10876, dated September 12, 2002, Rothman's, $12,750 cash and $2,000 barter - The barter portion should have been booked in the Fourth Quarter of 2002 and was not; therefore the City is entitled to an adjustment of $638.47 (fee of $520 plus interest of $118.47). This amount was paid to the City on or about May 6, 2005.
>
> Contract No. 10950, dated December 5, 2002, Crunch, $12,750 cash and $4,500 barter - The barter portion should have been booked in the First Quarter of 2003 and was not; therefore the City is entitled to an adjustment of $1384.64 (fee of $1170 plus interest of $214.64). This amount was paid to the City on or about May 6, 2005.

Van Wagner Kiosk also wishes to comment on the phraseology of the first sentence of the report pertaining to this matter. Van Wagner Kiosk did not provide these

Van Wagner



advertisers "free kiosk advertising space" but rather sold it for the agreed fair value of the goods given in exchange. In each case, the barter represented only a small portion of the total contract price the remainder of which was paid for in cash.

**"Revenue for Production of Advertising Not Reported"**

Van Wagner Kiosk disputes this claimed adjustment in its entirety.

Van Wagner Kiosk requested the Audit Staff to provide a detail of the claimed $17,285 of revenue. It is as follows:

| Advertiser | Contract | Amount |
|---|---|---|
| Ask Jeeves | 11046 | $12,375 |
| Planet Out Partners | 11093 | 565 |
| Universal Music Group | 11191 | 2,800* |
| Universal Music Group | 11206 | 500* |
| Outback | 11237 | 850* |

* Note that these amounts erroneously include sales taxes aggregating $350.00

Copies of the five relevant contracts, each of which clearly refer to and delineate <u>cost of production separate and distinct from advertising space</u>, and the related invoices, have been provided to the Audit Staff.

As a general matter, most advertisers produce or contract to produce their own advertising copy and ship it to Van Wagner Kiosk for posting. Occasionally (in five cases out of 444 contracts reviewed by the Audit Staff), advertisers do not have the relationships or facilities, particularly if they are not using an advertising agency and request Van Wagner Kiosk to contract the production on their behalf. None of Ask Jeeves, Planet Out Partners, or Universal Music Group had an advertising agency and Outback came to us after the fact to help with production, which occasionally occurs as a result of compressed time schedules or similar problems.

The Draft Audit Report correctly refers to the reimbursement to Van Wagner Kiosk of any such amounts as "payments to Van Wagner Kiosk for the <u>cost of producing</u> the advertising". Net commissions advertising revenue as defined in the Franchise

Van Wagner



Agreement, however, does not include the cost of producing the advertising. Van Wagner Kiosk is obligated to pay compensation to the City with respect to revenues derived from the display of advertising material on PPTs. The production of posters occurs in factories, not on the streets of New York, unrelated to Van Wagner Kiosk and has nothing to do with the display of advertising on PPTs.

Van Wagner Kiosk does not own, operate or control any production houses, any factories or equipment on which such production occurs. All of the production was effected by unrelated, unaffiliated third parties and billed to Van Wagner Kiosk and rebilled to the advertiser.

**Conclusion**

For the many reasons detailed above, Van Wagner Kiosk contests the most significant findings contained in the Draft Audit Report. With respect to the single matter assented to under "Value of Advertising Exchange for Non Cash Items in Report," Van Wagner Kiosk notified DoITT and transmitted the applicable payment of $1690 plus interest on May 6, 2005.

We look forward to a withdrawal of those items subject to the responses in this letter.

Very truly yours,

Paul G. Whitby

PGW:SKT
Enclosures

Van Wagner



---

[1] In each of the 133 subject contracts the bonus panels were sold integrally with paid panels for a total stated amount of consideration. Van Wagner Kiosk believes and contends that it has full right and authority as a Media Representative to enter into a contract to provide bonus free advertising only as a demonstration to the potential advertiser of the soundness of kiosk advertising, with a long term view to entering into a paying contract in the future, and that in doing so, Van Wagner Kiosk will have received nothing tangible or intangible in value and it will not incur any obligation or liability to the City for compensation. Van Wagner Kiosk has not provided bonus only advertising under any of the audited contracts, or otherwise, but views the use of that sales technique as within its scope of authority in the exercise of sound business judgment.

[2] James C. Anderson and James A. Narus, *Business Market Management: Understanding, Creating and Delivering Value,* (Prentice-Hall, 1999).

[3] Philip Kotler, *Marketing Management: Analysis, Planning, Implementation and Control,* 8th ed. (Engelwood Cliffs, NJ: Prentice-Hall, Inc. a Simon & Shuster Company, 1994), 37.

[4] Michael Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York: The Free Press, a division of Simon & Shuster, 1985), 120.

[5] Porter, 139.

[6] Kotler, *Marketing Management*, 37.

[7] Kotler, *Marketing Management*, 502.

[8] Kotler, Marketing Group (asiapages.com - Singapore 2000), Interview Philip Kotler.

[9] Kotler, Marketing Group, *Ibid.*

[10] Kotler, *Marketing Management*, 518.

Van Wagner

INDEX

WolfBlock

250 Park Avenue, New York, NY 10177
Tel: (212) 986-1116 ■ Fax: (212) 986-0604 ■ www.WolfBlock.com

David E. Bronston
Direct Dial: (212) 883-4942
Direct Fax: (212) 672-1142
E-mail: dbronston@wolfblock.com

June 15, 2005

By Federal Express

Mr. Greg Brooks, Deputy Comptroller
The City of New York
Office of the Comptroller
1 Centre Street
New York, NY 10007

Dear Mr. Brooks:

We represent Vector Media Street Furniture, LLC ("Vector Media"). We are writing in response to the draft "Audit Report on the Compliance of Telebeam Telecommunications Corporation ("Telebeam") with Section 4 of its City Franchise Agreement (FL05-089A)." Vector Media is an authorized Media Representative and as such represents Telebeam in sales of advertising on Telebeam's public pay telephones in Northern Manhattan, Bronx, Brooklyn, Queens and Staten Island. Vector Media has pioneered the sale of advertising in these "non-core" areas for most public pay telephone franchisees and as a result has tapped a new vein of revenue for the franchisees and the City of New York (the "City"). It is and has been the only Media Representative selling space on phones in the non-core to the smaller (non-Verizon) pay phone operators. Vector Media's success in growing this totally underserved market niche is illustrated in the attached Exhibit A. By using its outdoor advertising selling skills and expertise, Vector Media has grown the total royalties paid to the City of New York from all the franchisees it represents in just three years by over 1,000%.

Instead of being applauded and commended for this success, Vector Media is instead being faulted by the audit. As we stated previously in our letter of May 11, 2005 and in conferences with your office, we totally disagree with the finding on Page 5 under the heading "Value of Bonus Free Kiosk Advertising Not Reported." Vector Media, as is common in the media advertising industry, provides free kiosk advertising to its clients as a selling tool and incentive, in lieu of discounting its rate card. Vector Media has paid the City a full 26% franchise fee based on the total receipts it has received from the sale of kiosk advertising as required by Telebeam's contract with the City. What the auditors seek is for Vector Media to also pay a 26%

NYC:518362.2/VEC004-190811

fee to the City on revenue Vector Media did not receive. This defies logic and is contrary to common business practices and accepted industry standards.

The Audit's Approach to Commonly Understood Concepts of Revenue is Wrong

The audit bases its conclusion on a fundamentally flawed approach to the calculation of "revenue" under the franchise agreement language. Were the audit's approach adopted and were Vector Media a public company that reported revenues as the auditors recommend, it, its officers and directors, not to mention its accountants, would be subject to allegations of securities fraud. What the auditors seek to include in "revenue" is imputed phantom income which does not constitute actual receipts upon which the City's fee is to be calculated under the franchise agreement. Indeed, booking phantom revenues as suggested by this interpretation would materially distort Vector Media's business's financial position.[1] According to the Accounting Reference Desktop,[2] revenue "is the **inflow of funds or related accounts receivable or other assets** from other business entities in exchange for the provision of products or services by a company." (emphasis supplied). Bonus panels are clearly not funds or accounts receivables. Nor are they assets that "inflow" to Vector Media from other business entities. In a franchise context, the courts have consistently held that "gross revenue" refers to money or receipts actually collected or received.[3]

The definition of "net commission advertising revenues" is as follows:

---

1 See Collingwood, Sherman and Yang, *Revenue Recognition: What Is a Sale and When do You Book It?*, August 29, 2003 in Profits You Can Trust: Spotting and Surviving Accounting Landmines (Financial Times Prentice Hall).

2 Accounting Reference Desktop, §20-2 (2003, John Wiley & Sons, Inc.).

3 See City of Dallas v. FCC, 118 F.3d 393 (1997, 5th Cir.) ("The phrase 'gross revenue' has a generally accepted meaning: unless expressly limited by the terms of a statute, regulation or contract, gross revenues mean all amounts received from operation of a business." 118 F.3d at 395); Public Service Company of Colorado v. City and County of Denver et al., 387 P.2d 33 (1963, Sup Ct. Colo.) ("Generally the term 'gross revenue' means gross receipts of a business before deductions...." 387 P.2d at 36; Lane Electric Cooperative, Inc. v. Oregon Dept. of Revenue, 765 P2d 1237 (1988) ("the term 'all gross revenue' ... is to be construed in the broadest sense i.e. all money received" 765 P2d at 238). See also United States v. Reitano, 865 F.2d 982 (2d Cir. 1988) (gross revenues includes all money coming into the possession of the business), Veterans Rehabilitation Center, Inc. v. Birer, 551 P.2d 1001 (1976).

> "Net commission advertising revenues" shall mean the total revenues *(i.e., total receipts without reduction for any costs or expenses except as expressly set forth in this definition)* derived by the Company, or any subsidiary, affiliate, agent, assignee, contractor, licensee, transferee or lessee of the Company (including the Media Representative(s) with which the Company has contracted), from the display of advertising material on PPTs pursuant to this Agreement (whether such revenues are received in the form of cash or in the form of materials, services or other benefits, tangible or intangible, in which event such revenues shall be deemed to include the fair market value of such materials, services or other benefits, whether actually received by the Company, an account receivable or otherwise) less any advertising agency commission paid or deducted from such amount, but in no event shall such deduction for advertising agency commissions exceed fifteen percent (15%). [Emphasis supplied.]

The auditors had left out the parenthetical equating "revenues" to "total receipts" (and failed to indicate that omission by an ellipsis) in the preliminary draft but have restored it in the final draft after we pointed out the omission (although it is still misquoted in footnote 2 of the audit). The term "receipts" generally refers to money actually **received** or taken in by a business.[4] As such, the auditors' approach to include phantom, imputed income as if it were actual revenue received is inconsistent with the Franchise Agreement and commonly applied accounting standards.

<u>Bonus Panels are a Legitimate and Accepted Means of Marketing to Phone Kiosk Advertisers</u>

These bonus panels are a marketing incentive and strategy, not a revenue source. They are the equivalent of a discount. The auditors acknowledge that the bonus panels were offered to Vector Media's clients to induce them to enter into advertising agreements. As such, they are no different from other marketing and business solicitation and negotiation methods of the Media Representatives. Under the Request for Proposals issued by the City,[5] Media Representatives such as Vector Media are obligated to provide the following services to the franchisees: "the marketing of advertising space on PPT Enclosures, the identification and solicitation of potential

---

4 See <u>Webster's Dictionary</u>: "the thing or amount <u>received</u>, as money taken into a business." The word receive means, according to <u>Black's Law Dictionary</u>, "to take into possession and control; accept custody of; collect."

5 <u>Request for Proposals for Public Pay Telephone Media Representatives to Provide Advertising Support Services for the Advertising Space on Public Pay Telephones Located on City Streets and Other Inalienable Property of the City of New York</u> (Project Identification Number 85899CE11014).

clients (e.g. advertising agencies and/or businesses), the negotiation of all advertising transactions including all financial and business terms...." The bonus panels are precisely that: a method of marketing advertising space, a method of soliciting potential clients and a method of negotiating the financial and business terms of the advertising transaction. They are a means of producing the actual revenue received on which Vector Media properly paid the full franchise fee due and owing.

As a startup business in an untested market, Vector Media needed every possible sales tool it could muster to attract advertisers to the non-core areas. Bonuses were exactly that type of tool since there was an excess inventory of kiosks available for advertising display. Neither the Franchise Agreement nor the Media Representative RFP nor Vector Media's Media Representative Agreement with Telebeam has any prohibition, restriction or negative covenant on Vector Media's ability to negotiate discounts or add bonus panels. Stated otherwise, <u>none of those agreements state that Vector Media may not grant discounts or give bonus panels to its advertising clients</u>. DoITT granted Vector Media status as a Media Representative based on its expertise and knowledge of the pay telephone kiosk market. Vector Media is doing its job and doing it well and in compliance with the Franchise Agreement.

<u>The Audit Does not Explain What Benefits Are Received by Vector Media From Bonus Panels</u>

The audit does not explain how Vector Media received any benefit, tangible or intangible, that could conceivably be treated as a revenue item or receipt. As if unwilling to come up with any plausible interpretation that would survive legal scrutiny, the audit merely and summarily highlights the phrase "or other benefits, tangible or intangible". The clause highlighted in the audit referring to tangible or intangible benefits is properly interpreted in the finding on page 6 of the Audit captioned "Value of Advertising Exchanged for Non-Cash Items Not Reported". Non-cash barter items, such as health spa and ballet memberships and gift certificates, where Van Wagner clearly and explicitly received tangible (or intangible) benefits of value are meant to be included as revenue.[6]

The only benefit to Vector Media from the use of bonus panels is to make sales of phone kiosk advertising. Even if one makes the tortured conclusion or interpretation that the benefit to Vector Media is that a sale to the same client is made in the next month, then the City will receive 26% of that future sale as contemplated by the Franchise Agreement when such future sale is made. The City is not entitled to 52% (or more) of the current sale or to payment twice for the future sale. By the spectacular illogic of that approach, the City would be "double dipping" and no Media Representative would negotiate to make the next sale. The result would

---

6 An intangible benefit would be, for example, a discount from a hotel advertiser to Vector Media for a night's stay at the hotel. That would be an inflow of an intangible asset or benefit to the Media Representative. However, this simply did not occur.

be completely counterproductive to maximizing revenues. Not only is the City suffering no loss but it is actually benefiting by any future increase of sales caused by discounting and bonusing. If anything, these bonus panels are a benefit to the clients of Vector Media and not to Vector Media.

In addition, Vector Media does not bundle the phone kiosks with other media as was the case in Viacom's 2004 Audit.[7] Vector Media Street Furniture, as its name implies, is a media representative solely for phone kiosks on public rights of way and will so assert in a certification or representation. In fact, Vector Media is EXPLICITLY prohibited by its agreement with Telebeam from bundling the phone kiosks with other media.[8]

The Audit Misreads the Franchise Agreement

It is nowhere stated in the Franchise Agreement that bonus panels are to be included as revenue. The auditors take a definition of a revenue based fee and arbitrarily and capriciously treat it as if it should apply to something more than revenue and receipts. The public pay telephone franchise agreement explicitly calls for a fee based on actual revenues, not on an imputed value 'as if' all panels with advertising were sold. If the public pay telephone franchise agreement meant to include free services as revenue it would have specifically included them as the cable television franchise agreements do. The cable television franchises also have a franchise fee that is based on revenues. The cable television franchises were drafted and negotiated by the same agency that drafted and negotiated the public pay telephone franchises. The definition of gross revenues in those franchises specifically call for the inclusion of free services and even ascribes a specific cash value to them.[9] Unlike the cable television franchises,

---

7 See Audit Report on the Compliance of Viacom Outdoor with its City Franchise Agreement (FM03-139A), page 5, June 28, 2004, quoting a similar gross revenues definition.

8 "Section 6.1 Vector will not 'bundle' advertising sold on the Advertising Panels with advertising sold by it to advertisers on other media forms, without Telebeam's prior written consent. For purposes hereof, bundle means the sale of advertising on Advertising Panels contingent on, or in price packages with, or otherwise tied to the purchase of advertising on or through other media."

9 "Gross Revenue" means all revenue ... which is received, directly or indirectly, by the Company ... including, without limitation, the value of any free services provided by the Company ... which value of free services shall include, in the case of free cable services, the retail value of all tiers of service actually provided." Cablevision Television Franchise Agreement for the Borough of Brooklyn between The City of New York and Cablevision Systems New York City Corporation, October 8, 1998, §1.31.

the public pay telephone franchises do not call for the inclusion of free services. One must assume if DoITT meant to include the value of free services in the definition of revenue it would have specifically included them in the Franchise Agreement.

The Franchise Agreement was the product of long negotiations, approved by the Franchise and Concession Review Committee and based on the precedent of agreements with Verizon (formerly New York Telephone) going back over 15 years. The auditors have no right to change the contract or make a new or different contract for the parties.

In addition, we understand that Van Wagner was subject to an audit by DoITT. DoITT is charged by the City Council Authorizing Resolution[10] with enforcing and interpreting these franchise agreements. DoITT did not require Van Wagner and has never required any Media Representative to pay a franchise fee on bonus panels.

Conclusion

The Audit Recommendation is both counterintuitive and counterproductive. These bonus panels would have been blank and many other panels may not have been sold if not for the bonus incentive. If the audit's recommendations are upheld, no Media Representative would want to provide bonus panels and pay a 26% penalty against non-existent revenues. The result would be fewer panels sold and fewer panels with advertising displayed, and more blank displays. Blank displays would lead to vandalism and diminished neighborhood support for this program. And, without the bonus panels acting as an incentive, fewer paid-for panels would have been sold resulting in lower total receipts and lower franchise fees to the City.

The only proper analysis is to calculate the franchise fee on the total receipts from the sale of all panels (including the bonus panels) as if sold at a discount. That is how the Media Representatives would report it to DoITT except that they need to maintain their rate cards without these bonus panel discounts included in order to have negotiation flexibility and to be able to respond to constantly changing market conditions.[11] If Vector Media, in its sound and experienced business judgment, makes use of barren inventory in a manner that is an accepted industry practice and effectively raises revenues for itself and thereby for the businesses it partners with AND the City of New York, it should be saluted rather than defaulted.

10 See Authorizing Resolution No. 2248 (passed by the New York City Council on March 25, 1997).

11 This is even the methodology previously accepted by the Comptroller in an audit. See Audit Report on the Compliance of Viacom Outdoor with its City Franchise Agreement (FM03-139A), page 7, June 28, 2004.

Consequently for these reasons the audit is completely and utterly mistaken as to its first recommendation and Vector Media will vigorously contest any attempt to implement that recommendation. There is no evidence presented of any benefit received and the recommendation has no rational basis. It is an arbitrary and capricious determination. Vector Media will, however, agree to pay the $6,148 to DoITT for the slight (1.35%) overdeduction of commissions in the finding entitled "Excessive Deductions for Agency Commissions".

Sincerely,

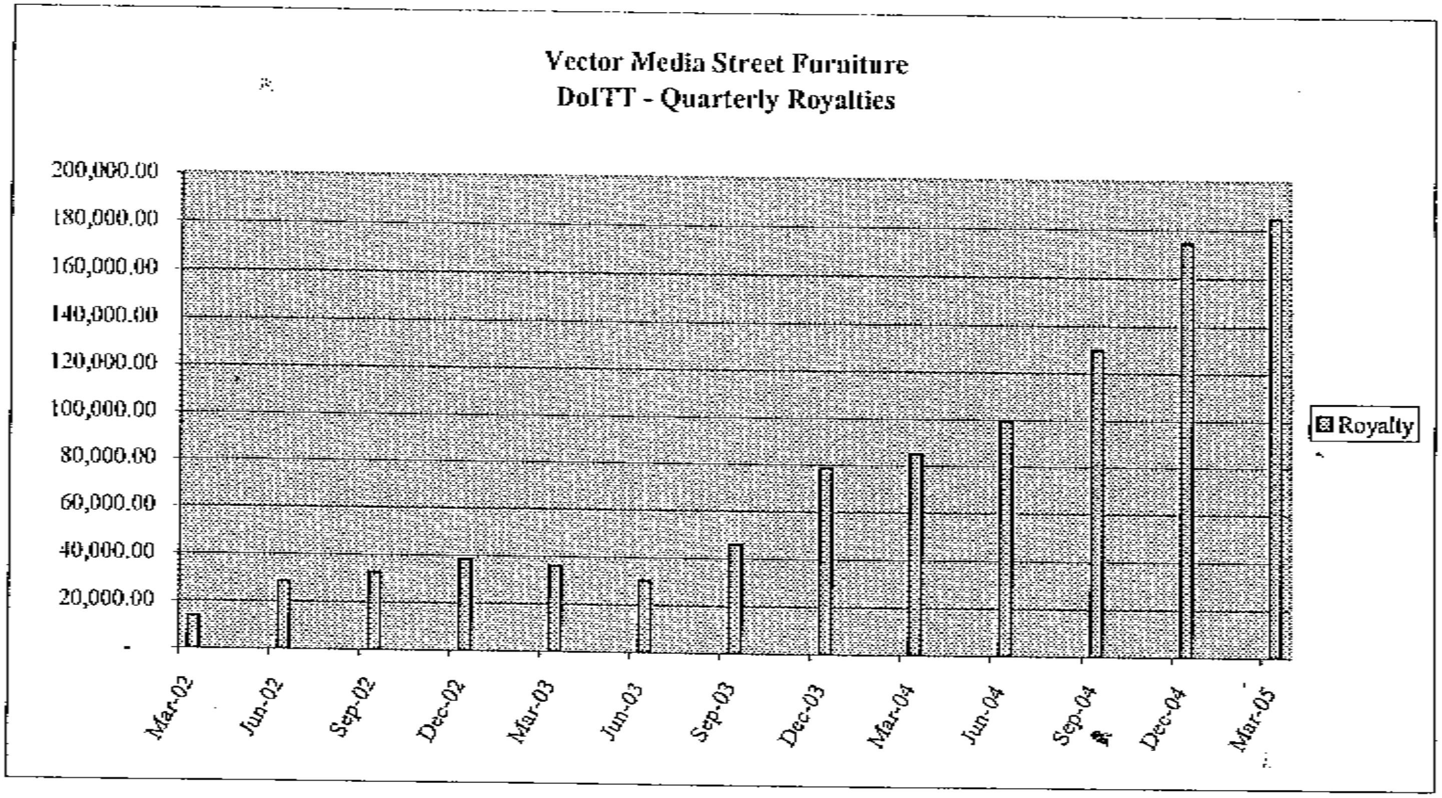
David E. Bronston

cc: Bill Schwartz
Bob France, Esq.

**EXHIBIT A**

Vector Media Street Furniture
- Quarterly Royalties

| Qtr Ended | Royalty |
|---|---|
| 03/31/02 | 13,715.00 |
| 06/30/02 | 28,301.00 |
| 09/30/02 | 32,534.49 |
| 12/31/02 | 38,565.38 |
| 03/31/03 | 36,125.66 |
| 06/30/03 | 30,219.48 |
| 09/30/03 | 46,006.90 |
| 12/31/03 | 78,862.45 |
| 03/31/04 | 84,952.79 |
| 06/30/04 | 99,318.28 |
| 09/30/04 | 129,518.53 |
| 12/31/04 | 174,360.29 |
| 03/31/05 | 184,577.15 |



The City of New York

**DEPARTMENT OF INFORMATION TECHNOLOGY AND TELECOMMUNICATIONS**

75 Park Place, 9th Floor
New York, NY 10007
(212) 788-6640
Fax (212) 788-7536

**GINO P. MENCHINI**
*Commissioner*
*Chief Information Officer*

**AGOSTINO CANGEMI**
*Deputy Commissioner*
*Franchise Administration and Planning/General Counsel*

June 17, 2005

Greg Brooks
Deputy Comptroller
Policy, Audits, Accounting and Contracts
1 Centre Street
New York, NY 10007-2341

Re: Payphone Advertising Audit Draft Report – FLOS-089A

Dear Mr. Brooks:

Commissioner Menchini has requested that I respond to the draft report of the payphone advertising audit dated June 2, 2005. The primary issue raised in the report is the practice in the payphone advertising industry of providing advertisers "free" advertising panels in addition to the panels purchased at established rate. As discussed, DoITT agrees that the franchisees should be directed to assure that accounting methods should be corrected in the future to avoid the vulnerability to misconstruction that is created by this system of designating groups of panels being sold as "free". DoITT also notes that if further investigation by the auditors produces evidence that actual additional value was received in connection with the "free" panels then DoITT would of course support pursuing payment in full of percentage-based franchise compensation reflecting that value. In addition to these areas of agreement, DoITT remains concerned that without evidence of some value having been received from advertisers for the "free" panels in question, the City may have difficulty supporting an action seeking payment of back compensation with respect to such panels. Absent evidence of other value having been received, a strong argument can be made by the franchisees that the inclusion of "free" panels in addition to paid panels represents merely a method of characterizing a reduction in per panel prices rather than evidence of additional value received beyond revenue on which the City has already received its percentage-based franchise compensation.

It is our understanding that leasing space at 100% of the price listed on the rate card is rare and that it only constitutes fair market value for a small percentage of locations. We would be interested in learning more about the documents you received that lead to your conclusions.

Sincerely,

Agostino Cangemi

C: Gino Menchini
Margery Brown
Stanley Shor