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INDEPENDENT STATE AUDITOR'S REPORT ON THE MASSACHUSETTS BAY TRANSPORTATION AUTHORITY'S REQUEST FOR QUALIFICATIONS AND BIDS FOR OUTDOOR ADVERTISING LICENSE

OFFICIAL AUDIT REPORT

NOVEMBER 21, 2003

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Our review of the Massachusetts Bay Transportation Authority (MBTA) was conducted to determine the overall effectiveness of the MBTA's Real Estate Department in the negotiating and award of an outdoor advertising license to Clear Channel Outdoor, Inc., dated March 4, 2003. This license was the indirect result of an unsuccessful Request for Qualifications and Bids (RFQ/B) issued by the MBTA on July 23, 2002, to place advertisements on approximately 197 billboard sign faces located on MBTA property rights-of-way acquired from the Penn Central and Boston and Maine Railroads during the 1970s. In addition, we reviewed the MBTA's compliance with Chapter 161A of the General Laws for this license award and the decision-making process utilized by the MBTA's management in preparing the RFQ/B and negotiating the terms of this license agreement.

Our audit, which covered the period July 23, 2002 to March 4, 2003, was conducted in accordance with applicable generally accepted government auditing standards for performance audits. The objectives of this audit were to review the MBTA's compliance with Chapter 161A of the General Laws for the solicitation and awarding of the outdoor advertising license, the process utilized by the MBTA in evaluating the bids received, and the decision-making process utilized in negotiating and awarding the terms of the outdoor advertising license between the MBTA and Clear Channel Outdoor, Inc. Our methodology included reviewing MBTA documents prepared for this license award regarding the terms, conditions, specifications, and instructions to bidders; correspondence between the MBTA and interested parties and bidders, including legal opinions and research; and signed contracts for outdoor advertising dated March 4, 2003 and December 1, 1998. In addition, we interviewed appropriate MBTA officials.

Our review of the MBTA's actions regarding the solicitation and evaluation of the bids received in response to its RFQ/B for Outdoor Advertising License dated July 23, 2002 revealed that the MBTA acted within its rights, as established by Chapter 161A of the Massachusetts General Laws, when it rejected both bids received. The MBTA's determination that these bids were not in compliance with the various bidder requirements established by the RFQ/B was proper. Furthermore, the MBTA acted within its legal rights under Chapter 161A to negotiate solely with Clear Channel.

As discussed below, our audit determined that the MBTA misjudged the effect that the flawed terms of the 1998 license agreement would have on its attempt to conduct an open and competitive RFQ/B process for the advertising rights on these billboard structures in 2002. Consequently, although the new contract with Clear Channel will generate an additional $7.4 million over its 15-year term, the MBTA lost the opportunity to generate additional revenue through this outdoor advertising license agreement.

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1. BECAUSE THE MBTA DID NOT ENSURE THE TRANSFER OF BILLBOARD OWNERSHIP TO THE MBTA UNDER THE TERMS OF ITS 1998 ADVERTISING LICENSE, IT LOST THE OPPORTUNITY TO EARN UP TO $16.3 MILLION IN POTENTIAL GUARANTEED FEES PURSUANT TO THE NEW 2003 LICENSE 5

The MBTA did not establish its presumptive ownership rights and provide for the transfer of ownership of the billboards located on MBTA property during its 1998 license agreement negotiations. In addition, it did not properly ascertain its reconstruction rights under the federal Highway Beautification Act (HBA) and Chapter 93D of the Massachusetts General Laws. As a result, the MBTA's July 2002 RFQ/B was unsuccessful, and it lost the opportunity to earn up to $16.3 million in potential guaranteed license fees.

2. THE MBTA NEEDLESSLY WAIVED $5.8 MILLION IN CAPITAL IMPROVEMENT EXPENDITURES FROM ITS LICENSEE, GRANTED THE LICENSEE A QUESTIONABLE 15-YEAR RIGHT OF FIRST REFUSAL, ALLOWED THE LICENSEE CONTINUED OWNERSHIP OF BILLBOARDS UNDER THE NEGOTIATED 2003 LICENSE AGREEMENT, AND DID NOT NEGOTIATE ITS STATED MINIMUM MANDATORY ANNUAL BID OF $2 MILLION 12

The MBTA's RFQ/B of July 2002 required each prospective bidder to estimate capital expenditure costs to comply with the contract provision to erect all new billboards as a condition to secure a lease with the MBTA. The current licensee estimated its costs at $5.8 million. However, the MBTA waived this capital expenditure requirement under the terms of the 2003 license agreement without securing additional license fees in return. In addition, the MBTA granted the current licensee a questionable 15-year right of first refusal to match any competing bids solicited and received by the MBTA before the lease expiration in March 2018. In addition, the MBTA again failed to secure the outright ownership rights to these billboards until after the license expires in March 2018. Finally, the MBTA failed to negotiate the minimum annual guaranteed fee of at least $2 million, as required in its RFQ/B and established as the fair market value by the MBTA's own real estate management company.

INTRODUCTION

Background

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor initiated an audit on March 3, 2003 of the Massachusetts Bay Transportation Authority's (MBTA) Request for Qualifications and Bids for Outdoor Advertising License, dated July 23, 2002, and the subsequent license agreement entered into between the MBTA and Clear Channel Outdoor, Inc. (Clear Channel). The period of our review was July 23, 2002 to March 4, 2003.

The MBTA's outdoor advertising program originated when it acquired rights-of-way from the Penn Central (1973) and Boston and Maine (1976) railroads upon which billboards were constructed. Since that time the various advertising companies that owned these billboard structures were acquired by AK Media Massachusetts, which was subsequently purchased by Clear Channel.

In 1998, after years of operating the billboard program without a written contract and despite years of unpaid and uncollected license fees, the MBTA entered into a one-year license agreement with AK Media to formally and legally clarify its use of MBTA property for its advertising structures. This license agreement called for the establishment of a billboard site inventory, set a minimum annual guaranteed license fee, provided for monthly and annual reporting of actual revenues generated by these structures, attempted to clarify the ownership for these billboards, and provided for the possible transfer of ownership of these structures to the MBTA only if the lessee offers to abandon these structures upon expiration or termination of the agreement. This agreement expired on December 1, 1999; however, AK Media continued to operate the billboard program in a holdover status, and the possible transfer of the ownership of the billboards to the MBTA did not occur.

In a letter dated September 14, 2001, the Office of the State Auditor (OSA) urged the Secretary of the Executive Office of Transportation and Construction to ensure that, for legal and financial reasons, the MBTA put its outdoor advertising contract out to bid as soon as possible. This letter was submitted in response to the MBTA's failure to adhere to a previously stated timetable to seek competitive bids for this work subsequent to the 1998 one-year contract award.

On July 23, 2002 the MBTA issued a Request for Qualifications and Bids (RFQ/B) for a 20-year license to place advertisements on approximately 197 billboard sign faces located on property owned or controlled by the MBTA. The minimum bid price for the annual license fee established by the RFQ/B was the greater of $2 million or 20% of the gross revenues earned by the licensee. In addition, the RFQ/B stipulated that the minimum annual license fee would increase by 2.5% per year and required the successful bidder and new licensee to construct new billboards on the same sites as the current billboards. This required capital expenditure was intended to create a level playing field among the bidders and not give an unfair advantage to the current licensee, Clear Channel.

The RFQ/B and the subsequent award was intended to be in strict compliance with the MBTA's enabling legislation, Chapter 161A of the Massachusetts General Laws, and accordingly was publicly advertised, contained a deadline for bidders to respond, and provided for sealed bids to be submitted and a public bid opening to be held. In addition, Chapter 161A allows the MBTA the right to reject any and all bids received and to award the license to someone other than the high bidder, if the MBTA, in its sole discretion, deems that "sound reasons in the public interest require such action. "

A public bid opening was held on October 21, 2002. The MBTA received two bids, as follows:

Bidder Name	Bid Amount
Viacom Outdoor Group, Inc.	$47,000,000
Clear Channel Outdoor, Inc.	$30,700,000

After a review of certain qualifications contained within each bidder's submission regarding the minimum annual guaranteed fee, the MBTA decided that neither bid was deemed responsive under the terms of the RFQ/B and rejected both bids. Viacom's bid did not provide for the minimum guaranteed annual fee of $2 million (increased by 2.5% annually) for the first two years of the license. However, beginning in the third year of the contract the Viacom bid met the minimum requirements of the RFQ/B, and the MBTA would have realized guaranteed annual payments totaling approximately $47 million for the remaining 18 years of the 20-year license term, subject to Viacom's receiving the necessary zoning and regulatory approvals to construct the new billboards. Similarly, Clear Channel's bid of $30,700,000, or $1,200,000 per year (increased by 2.5% annually), failed to meet the RFQ/B's annual minimum guaranteed fee requirement of $2 million.

Accordingly, the MBTA notified both bidders on October 10, 2002 that their bids were rejected because each was considered nonresponsive to certain terms of the RFQ/B regarding minimum annual guaranteed fees and proposed changes to language contained in the proposed draft license. Subsequently, the MBTA, after considering possible legal and zoning issues that could hamper a new licensee's ability to realize the necessary minimum annual guaranteed fee of $2 million, decided to negotiate a new license agreement only with the current licensee, Clear Channel Outdoor, Inc. The MBTA's decision to reject these bids and to negotiate a new license agreement with Clear Channel was an option provided by Chapter 161A of the General Laws and was deemed by the MBTA as appropriate and in the public interest, as specified by law. Therefore, the MBTA exercised its option to exclude Viacom from these negotiations, and no further offers from Viacom were considered.

After several months of negotiations, a new license agreement was executed on March 3, 2003 between the MBTA and Clear Channel. The major terms of this agreement are as follows:

- **Term** - 15 years
- **Minimum Annual Guaranteed Fee** - $1,200,000 plus 2.5% annual increase (approximately $ 21,518,000) or 20% of gross revenues, whichever is greater.
- **Transfer of Ownership of Billboards to MBTA** - Upon completion of the 15-year term.
- **Construction of New Billboards by Licensee** - Not required.
- **Right of First Refusal** - Granted to licensee to match any future bid proposals solicited and received by the MBTA during the 15-year term.

Audit Scope, Objectives and Methodology

Our audit, which covered the period July 23, 2002 to March 4, 2003, was conducted in accordance with applicable generally accepted government auditing standards for performance audits. The objectives of this audit were to review:

- The MBTA's compliance with Chapter 161A of the General Laws for the solicitation and awarding of the outdoor advertising license,
- The process utilized by the MBTA in evaluating the bids received,
- The decision-making process utilized in negotiating and awarding the terms of the outdoor advertising license dated March 4, 2003 between the MBTA and Clear Channel Outdoor, Inc.

Our methodology included reviewing: (1) MBTA documents prepared for this license award regarding the terms, conditions, specifications, and instructions to bidders; (2) correspondence between the MBTA and interested parties and bidders, including legal opinions and research; and (3) signed contracts for outdoor advertising dated March 4, 2003 and December 1, 1998. In addition, we interviewed appropriate MBTA officials.

Conclusion

Our review of the MBTA's actions regarding the solicitation and evaluation of the bids received in response to its RFQ/B for Outdoor Advertising License dated July 23, 2002 revealed that the MBTA acted within its rights, as established by Chapter 161A of the Massachusetts General Laws, when it rejected both bids received. The MBTA's determination that these bids were not in compliance with the various bidder requirements established by the RFQ/B was proper. Furthermore, the MBTA acted within its legal rights under Chapter 161A to negotiate solely with Clear Channel.

However, as discussed in the Audit Results section, our audit determined that the MBTA misjudged the effect that the flawed terms of the 1998 license agreement would have on its attempt to conduct an open and competitive RFQ/B process for the advertising rights on these billboard structures in 2002. As a result of the MBTA's decision to neither assert nor seek a legal determination of its ownership and reconstruction rights, the Commonwealth lost as much as $16.3 million in potential licensing fee revenue, and the MBTA needlessly waived an additional $5.8 million in capital improvements by the licensee.

AUDIT RESULTS

1. BECAUSE THE MBTA DID NOT ENSURE THE TRANSFER OF BILLBOARD OWNERSHIP TO THE MBTA UNDER THE TERMS OF ITS 1998 ADVERTISING LICENSE, IT LOST THE OPPORTUNITY TO EARN UP TO $16.3 MILLION IN POTENTIAL GUARANTEED FEES PURSUANT TO THE NEW 2003 LICENSE

In December 1998 the Massachusetts Bay Transportation Authority (MBTA) signed a license agreement with AK Media, the predecessor licensee to Clear Channel Outdoor, Inc. (Clear Channel) to run its billboard-advertising program for the period December 1, 1998 to November 30, 1999. This license represented the first written contract that established any legal rights and obligations between the parties since at least 1988 and possibly since AK Media first obtained access to MBTA property decades ago. This 1998 license agreement (1) established the number of billboard sites located on MBTA property, (2) set an annual rental fee, and (3) established required monthly and annual reporting for revenues realized by the licensee. Prior to this agreement, AK Media operated these billboards as a tenant-at-will with little or no reporting of its activities to the MBTA.

However, the MBTA was unable to provide us with any written contract or license that was in force prior to the signing of this 1998 license agreement that unequivocally states that the ownership of the billboard structures, at the conclusion of its tenancy, remains with the tenant and not the MBTA. In effect, the series of licenses were land lease agreements where, typically, any structures erected by a tenant during the term of the lease becomes the property of the landlord at the expiration of the lease, unless the agreement specifically allows the tenant to remove such structures at the end of the lease term.

The permitting and approval process for erecting new billboards and other outdoor advertising structures in Massachusetts is governed by the federal Highway Beautification Act (HBA) of 1965 (Chapter 23 of the United States Code) and by Chapter 93D of the Massachusetts General Laws. HBA required states to either adopt the measures restricting the erection and maintenance of outdoor advertising located within 660 feet of the right-of-way and visible from the interstate highway system and freeways within their jurisdiction, or face reductions in federal funds. Massachusetts adopted these HBA provisions and codified these restrictions as Chapter 93D pursuant to Chapter 1070 of the Acts of 1971. The only exemption to the 660-foot buffer zone on the placement of new outdoor advertising structures under Chapter 93D is for

structures located in areas that are zoned either industrial or commercial. The MBTA indicated that it believes approximately 50% or more of its billboards fall within this 660-foot buffer zone, and therefore any new billboards constructed are subject to the restrictions contained in HBA and Chapter 93D.

Considering the potential restrictions posed by HBA and Chapter 93D, a major objective for the MBTA in formalizing the aforementioned 1998 license agreement with AK Media therefore should have been to establish the MBTA's presumptive ownership rights to these structures located on MBTA property. This issue should have been addressed by including in the license agreement a provision outlining the turnover of these structures to the MBTA at the conclusion of this license, no later than December 1, 1999. However, the MBTA inexplicably did not negotiate the legal terms necessary to accomplish this transfer. Instead, the license agreement classified the billboard structures as AK Media's Personal property and provided the licensee with the option to remove these billboards upon termination of the license, thereby granting AK Media undue leverage in any future negotiations with the MBTA. Eventually, this improper option created a so-called "cloudy permitting and zoning" obstacle that the MBTA could not overcome during its attempt to solicit competing bids for a new advertising license award in July 2002, which resulted in the lost opportunity to earn $16.3 million more in potential guaranteed annual fees.

Moreover, during the two and one-half years between the expiration of the 1998 license and the issuance of the Request for Qualifications and Bids (RFQ/B), the MBTA failed to attempt to resolve these potential permitting and zoning issues through either proposed legislation or judicial consent. Instead, the MBTA continued to incorrectly assert that no such zoning and permitting issues existed and that the RFQ/B process should move forward to the competitive-bid phase. The MBTA's inability to resolve these issues prior to the RFQ/B ultimately provided Clear Channel with the opportunity to throw the entire bid process into disarray by threatening to disrupt the RFQ/B process and to create a permitting and zoning obstacle for any potential new licensee.

In fact, after soliciting competing bids via an RFQ/B in July 2002, yet prior to the actual receipt of these bids, Clear Channel, in a letter to the MBTA dated September 13, 2002, cited the provisions of Paragraph 4.7 of the 1998 license agreement and formally notified the MBTA of

its intent to dismantle and remove all of its billboards from MBTA property effective immediately. Moreover, Clear Channel brought an action in Suffolk Superior Court seeking to reaffirm the applicability of HBA and Chapter 93D, thereby challenging the right of the MBTA and any prospective bidders to replace the existing billboards.

In recognition of the potential permitting and zoning delays that might be caused by Clear Channel's threat to remove the billboards, the bid submitted by Viacom Outdoor (Viacom) contained a qualification for the minimum annual fees to be paid for contract years 1 and 2. However, beginning in year 3, and each year thereafter, the full minimum annual fee of $ 2 million plus a 2.5% escalator, or $47 million in total, would be guaranteed, subject to zoning or other governmental impediments not in Viacom's control. The MBTA cited this qualification by Viacom as its reason for rejecting the Viacom bid. The MBTA also rejected the Clear Channel bid of $1.2 million per year plus 2.5% each year, or $30.7 million, which was approximately $16.3 million less than Viacom's bid, because it did not meet the minimum established bid of $2 million per year plus 2.5% each year thereafter.

Upon further review of the ownership and zoning issues raised by the threatened actions of Clear Channel to remove its billboards, the MBTA decided to negotiate the terms of a new license agreement solely with Clear Channel and excluded Viacom from any further participation in its billboard licensing process. The new license fee agreement negotiated by the MBTA was set at Clear Channel's previously rejected bid amount of $1.2 million per year plus 2.5% each year thereafter, and the term was limited to 15 years instead of the original 20 years. The total minimum annual guaranteed payments under this negotiated license agreement are approximately $21.5 million, or $25.5 million less than Viacom's original offer for a 20-year term and more than $10.3 million less than was offered by Viacom for years 1 through 15 of its rejected bid. In comparison to the 1998 license agreement, the new contract with Clear Channel will generate an additional $7.4 million over its 15 year term.

Because the MBTA did not provide for the transfer of ownership of these billboards from Clear Channel to the MBTA upon the expiration of the 1998 license agreement together with the MBTA's misjudgment in placing the burden of determining their actual reconstruction rights under the HBA and Chapter 93D law on the potential bidders rather than by their own legal due diligence since acquiring these advertising assets in 1973, directly resulted in this failed RFQ/B

process; compromised the MBTA's bargaining position under the negotiated license agreement of 2003; and resulted in a loss of potential revenue for its outdoor advertising program totaling between $10.3 million and $16.3 million in guaranteed annual payments.

Recommendation

The MBTA should aggressively pursue its legal options under Chapter 93D and the HBA to secure all the permits and approvals needed to regain control of these advertising sites. The MBTA's approach should address its presumption that these sites upon which the structures are located are grandfathered sites upon which billboards may be constructed or rebuilt, and that the permits necessary should run with the sites and not the structures themselves. If this approach is successful, then the MBTA should solicit competitive bids to manage its billboard property sites as soon as these matters are resolved.

Auditee's Response

As the Audit Report notes, the outdoor advertising program was a product of the MBTA's acquisition of rights-of-ways from the Penn Central (1973) and Boston and Maine (1976) railroads upon which billboards had already been constructed and maintained by Clear Channel's predecessors....Since the time of the acquisition, there had always been a presumption of ownership of the billboard structures by Clear Channel's predecessors. This is illustrated in a review of the prior agreements and correspondence between the MBTA and the license in the three decades which preceded the 1998 License Agreement. For instance, in 1985, the parties entered into a Settlement Agreement and Letter of Understanding, which among other things, required the removal of half of Clear Channel's predecessor's then existing billboard structures without compensation of the license as a result of a state highway beautification policy at the time. The Settlement Agreement and Letter of Understanding, executed by the MBTA and counsel to then Governor Dukakis, clearly assumed that the billboards belonged to Clear Channel's predecessor (Ackerley Communications of Massachusetts, Inc.), and that after the removal of 100 signs, Clear Channel's predecessor would be entitled to compensation for any additional removals mandated by the MBTA.

The Audit Report...assumes that the billboards would become the property of the MBTA once the agreement with Clear Channel's predecessor expired. As a matter of fact and law, this is not true. The Audit Report states that "typically, any structures erected by a tenant during the term of the lease become the property of the landlord at the expiration of the lease, unless the agreement specifically allows the tenant to remove such structures at the end of the lease term." To the contrary, there is no such presumption of ownership when the property attached to the real estate can be removed without material harm to the real property, as is the case here. See e.g., Worcester Redevelopment Authority v. Massachusetts Department of Housing and Community Development, 47 Mass. App. Ct. 525, 529 (1190); Commonwealth v. Bundza, 54 Mass. App. Ct. 76, 77-78 (2002). Rather, in these cases the intent of the parties, as discerned from the agreements, letters and other documents exchanged between them will govern the issue of ownership. Id., citing 8 Powell. Real Property Section 57.05[2][a] at 57-31

(2002). See also Rite Media, Inc. v. Sec'y of Massachusetts Highway Department, 429 Mass. 814, 816 (1999) (where tenant has right to remove billboard under lease, billboard constitutes personal property of lessee for eminent domain purposes). As stated above, the long established intent of the parties (prior to the 1998 License Agreement) was that the billboards were personal property owned by Clear Channel's predecessors.

Throughout the 1980s and 1990s, the contractual relationship between the MBTA and Clear Channel's predecessors was defined through a series of letter agreements which the MBTA's management viewed as increasingly inadequate in protecting its rights and maximizing its revenue from Clear Channel's predecessor's use of the billboards. Clear Channel's predecessor had maximum leverage in any negotiations with the MBTA over increasing royalty payments or the transfer of title. If Clear Channel's predecessor elected to remove the billboards, which both parties had historically treated as Clear Channel's predecessor's property, the MBTA was faced with the real and likely possibility that it would not be able to replace many of the billboards, including those billboards adjacent to federal highways which brought in the maximum revenue, resulting in a substantial loss of revenue for the MBTA.

The Audit Report suggests that the HBA, M.G.L. c. 93D and state and local zoning restrictions would not hamper the MBTA's power to reconstruct billboards adjacent to the interstate highway system which are located in industrial or commercial zones (which the report acknowledges may constitute up to 50% of the billboards at issue). This is not correct. Although the HBA's blanket prohibition on the construction of billboards adjacent to interstate highways does not apply to the construction of billboards located within commercial or industrial areas, M.G.L. c. 93D, Section 3, the exception however requires such billboards to comply with the permitting conditions established by the Massachusetts Outside Advertising Board (OAB) and requires an express permission form the U.S. Secretary of Transportation. The MBTA determined that it was highly unlikely that it would be able to secure in an expeditious fashion the requisite OAB and federal approvals given the inevitable opposition by Clear Channel, municipalities within which the existing billboards are located, and public interest groups whose aim is to reduce and eliminate all billboards. The Audit Report unfairly criticizes the MBTA for failing to "resolve these potential permitting and zoning issues" prior to the 2002 competitive bidding process "through proposed legislation or judicial consent." As stated, because of the state of the law and the political climate, it was highly unlikely that the court or the elected officials, at the invitation of the MBTA, would permit it the unfettered right to reconstruct all of the billboards currently maintained by Clear Channel. In the MBTA's view, such a course would be an invitation for disaster, resulting in the potential loss of millions of dollars of revenue.

The longstanding presumption of Clear Channel's predecessor's ownership of the billboards, the HBA's restrictions on the construction of new billboards, and the hostility towards billboards held by key municipalities and public interest groups created tremendous inequities in bargaining power between the MBTA and Clear Channel. Despite these inequities, the MBTA, through its management skill, was able to negotiate the 1998 License Agreement which represented a substantial improvement in the contract relationship between the parties. The Audit Report ignores the enormous achievements accomplished by the MBTA with the execution by Clear Channel's predecessor of the 1998 License Agreement. Among other things, the agreement established an updated inventory of billboards located on MBTA land which had not been accomplished since 1985; improved revenues from the billboards by establishing updated rates which had not been increased since 1990, fixed a percentage rent on all of the sites, and established an escalator based upon the Consumer Price Index in the event of

holdover. The agreement established an auditable reporting requirement upon which percentage rents could be calculated and so that data could be obtained to help establish the value of the billboard locations for future bidding purposes. The agreement established a methodology for the MBTA to maintain control over its inventory of billboard sites, and provided for the orderly removal of structures in the event such removal was required in the future.

The 2002 competitive bidding process was the MBTA's next step in its attempts to enhance the revenue obtained form the outdoor advertising program and obtain control and title to the billboards so that no outside party could use its ownership and control to obtain and preserve forever a "sole-source" position. The solicitation attempted to shift the risk of the loss of new billboards due to statutory and regulatory restrictions to a third party who was required, under the terms of the RFQ/B to construct new billboards and pay a guaranteed revenue stream. The two bidders which submitted bids were not willing to assume that risk. Viacom expressly conditioned its bid on compliance with federal, state, and municipal zoning restrictions (i.e., no guaranteed fee) and sought indemnification from the MBTA with respect to any action against it in performing its obligations under the new license agreement. Importantly, the solicitation process awoke opposition to the reconstruction of billboards from Boston, Revere, and Haverhill which all wrote letters opposing reconstruction of billboards in their communities. The City of Boston alone is the home to approximately 80 billboards, and the majority of those billboards comprise the most valuable locations.

For the reasons stated herein, both Viacom's and Clear Channel's bids were nonresponsive and illusory. It is unfair and incorrect to claim that the MBTA's rejection of Viacom's bid resulted in the loss of up to $16.3 million in potential annual guaranteed fees. Since Viacom's bid was conditioned on the new billboards surviving HBA, OAB, and local zoning restrictions, an award to Viacom would have inevitably resulted in the loss of at least half of the existing billboards controlled by Clear Channel and exempt from such restrictions, and a substantial loss of revenue to the MBTA. However, the procurement process created an environment where the MBTA was able to finally break the logjam of title with Clear Channel. The 2003 Agreement, for the first time, provides that the MBTA will gain title free and clear of the existing inventory of billboards paving the way for a truly competitive procurement at the end of the agreement's term.

Auditor's Reply

Regarding the matter of presumptive ownership of the billboards, it is unfortunate that the MBTA willingly granted to Clear Channel the presumed ownership rights to these structures. Contrary to what the MBTA suggests in its response, removal agreements, signed and unsigned letter agreements, and "understandings between the parties" do not suffice as evidence of residual ownership and removal rights upon termination of these prior informal agreements. The MBTA, in its quest to seek a more balanced relationship with its advertising licensees, should have been more aggressive in attempting to assert its potential rights to these structures. Indeed, when Clear Channel attempted to disrupt the RFQ/B process just before the deadline for the submission of sealed bids by threatening to begin demolishing billboard signs effective September 1, 2002, the MBTA's response to this threat should have been aggressive and swift.

Moreover, we noted that the MBTA's Director of Real Estate, in a letter to Clear Channel dated August 23, 2002, did attempt to challenge Clear Channel's assertion to these presumed ownership rights. In fact, the MBTA's Director of Real Estate challenged the threatened take-down of these signs by requesting, "As a threshold matter, please provide me with all documentation attesting to the fact that Clear Channel has title to the structures, billboards and signs which are the subject of the current agreement and specifically that are identified in the attachment to your letter.…Based upon your stated intentions, this information is to be provided by 12 pm, August 31, 2002." We determined that Clear Channel never provided this documentation of ownership to the MBTA. Furthermore, the Director of Real Estate castigated Clear Channel for making "threats and insinuations [that] seemed designed to unlawfully and unfairly disrupt the competitive bidding process and intimidate the MBTA into taking actions favorable to Clear Channel to the prejudice of all other prospective bidders and the public interest" and warned Clear Channel that "If you insist on your stated course of action, the MBTA will seek appropriate remedies." Unfortunately, the MBTA failed to seek appropriate remedies, abandoned the RFQ/B process, chose to "negotiate" only with Clear Channel, and ultimately acquiesced to Clear Channel's demands for the new agreement. We reiterate that the MBTA gave away a great deal of future bargaining leverage when it granted the predecessor company legal personal property rights and the right to remove these billboard structures in the 1998 agreement.

In addition, the MBTA's position that its ability to reconstruct these billboards on the same sites is subject to the permitting and approval constraints established by the HBA and the OAB is incorrect. In fact, the MBTA's right to erect, rebuild, or refurbish these billboards is, with certain conditions, protected by the HBA. Moreover, the OAB has already taken the position that it has no authority over these signs. In fact, the OAB, in a letter provided to us by the MBTA dated September 23, 1998, stated that "The Outdoor Advertising Board has no authority over signs located on property owned by any public agency, a situation that is reinforced in the case of the MBTA by explicit statutory grant of authority to the MBTA to lease its property for public advertising purposes." Therefore, the only possible roadblock that the MBTA might have encountered in any attempt to rebuild new billboards on these federally protected sites would be from local communities in the building permitting process. However, the MBTA's failed business decision to forego its presumptive and statutory rights when

negotiating both the 1998 and 2003 agreements resulted in the aborted RFQ/B process and the potential loss of $16.3 million in added billboard revenues.

Finally, the fact that the Viacom bid was conditioned on HBA, OAB, and local zoning restrictions was the direct result of the MBTA's erroneous perception of a "cloudy permitting process" fostered by its lack of initiative in properly addressing these potential deal breaking issues prior to issuing the 2002 RFQ/B. The unfortunate result of this inaction is the further entrapment of the MBTA in a 15-year agreement that may or may not end in the willing transfer of these billboards to the MBTA.

2. THE MBTA NEEDLESSLY WAIVED $5.8 MILLION IN CAPITAL IMPROVEMENT EXPENDITURES FROM ITS LICENSEE, GRANTED THE LICENSEE A QUESTIONABLE 15-YEAR RIGHT OF FIRST REFUSAL, ALLOWED THE LICENSEE CONTINUED OWNERSHIP OF BILLBOARDS UNDER THE NEGOTIATED 2003 LICENSE AGREEMENT, AND DID NOT NEGOTIATE ITS STATED MINIMUM MANDATORY ANNUAL BID OF $2 MILLION

The RFQ/B prepared by the MBTA required each prospective bidder to estimate its capital constructions costs to erect all new billboards as a condition to secure a license with the MBTA. This provision was designed to ensure a level playing field among the bidders and not give an unfair advantage to the current licensee, Clear Channel Outdoor Inc. Clear Channel's bid stated that it intended to spend approximately $5.8 million in capital improvements for new billboards in addition to its bid of $1.2 million in annual license fees. However, under the terms of the negotiated license agreement for 2003, the MBTA agreed to waive this $5.8 million capital expenditure requirement by Clear Channel yet failed to secure additional license fees in return.

We also noted that under the terms of the 2003 license, the MBTA would be unable to regain control of its own property sites for at least another 15 years unless this agreement is terminated for cause, such as nonpayment of rent or breach of other material conditions of the lease. In fact, under the terms of the new license agreement between the MBTA and Clear Channel, the ownership of these billboards will be transferred to the MBTA only if Clear Channel "secures the full and complete enjoyment of all rights granted by this License for the full fifteen (15) Contract Year Term. " This contract is slated to expire on March 3, 2018.

We question the necessity for a 15-year contract term since, as stated above, no mandatory capital outlays were negotiated by the MBTA. Although federal regulations require the MBTA to seek a waiver for any contract term longer than five years, the MBTA has traditionally

defended these extended contract terms based on a need for reasonable amortization periods for capital costs by the successful bidder. However, in this case such reasoning would not apply, since ultimately the extended contract term benefits only Clear Channel and unnecessarily delays the ultimate turnover of these billboards to the MBTA.

The license agreement also grants Clear Channel a right of first refusal, which allows it to match any competing bids solicited and received by the MBTA prior to March 3, 2018. In accordance with the agreement, Clear Channel would have three calendar days to notify the MBTA that it accepts "each and every condition offered by such third person. " The effect of granting this right of first refusal may be to discourage any other potential bidders from incurring the necessary expense and committing the needed time and effort to submit a bona fide offer to the MBTA for any future RFQ/B issued prior to March 3, 2018, knowing that Clear Channel need only agree to match the terms of their good faith bid to retain its right to the billboard advertising license.

When asked why the MBTA granted Clear Channel these continued ownership rights and right of first refusal during the new license "negotiations, " MBTA officials stated that it was Clear Channel's position that the right of first refusal was a non-negotiable condition for its entering into a new license agreement with the MBTA. In effect, the licensee (the tenant) was dictating the terms of the lease to the lessor (the landlord). As previously mentioned, the MBTA's compromised bargaining position was the direct result of its failure to assert its ownership rights and ensure the timely transfer of the billboard sites during the 1998 license negotiations between the MBTA and AK Media.

Finally, the MBTA failed to negotiate the annual guaranteed fee of at least $2 million established in its RFQ/B and the maximum amount recommended by its real estate management company, Transit Realty Associates, LLC (TRA). TRA noted that AK Media held a virtual monopoly in the Boston area billboard marketplace and that bidders would be eager to enter this market. However, the MBTA was unable to negotiate any additional funds from Clear Channel above its original rejected bid amount of $1.2 million per year. As indicated by the resulting negotiated contract terms that it obtained, the MBTA undermined its bargaining position when it refused to include Viacom in these contract negotiations and informed Clear Channel that it was the sole participant in this process.

Recommendation

The MBTA should ensure that it does nothing under the terms of its current contract with Clear Channel that could trigger a repeat of the lessee's threat to remove the billboard structures prior to expiration of the lease without first establishing the MBTA's ownership use rights to these billboard sites as provided under federal and state law. Specifically, any attempt to re-bid or solicit new proposals from competitive operators must be predicated on the fact that the MBTA's legal representatives are certain that they have either fulfilled all their obligations under the existing lease or have successfully upheld their presumptive ownership rights and use to these grandfathered billboard sites as provided by HBA and Chapter 93D.

Auditee's Response

The Audit Report erroneously assumes that the MBTA "waived" $5.8 million in capital expenditures that Clear Channel included in its 2002 proposal. The $5.8 million was the figure Clear Channel identified in its bid as the cost of building all of the new billboard structures. It was not part of the revenue stream that Clear Channel was offering to pay to the MBTA. Moreover, the figure was illusory because Clear Channel filed suit to prevent the solicitation process from going forward. The 2003 License Agreement does not include a provision for replacement costs since Clear Channel will continue to use the existing billboards. However, the agreement does require the maintenance, renovation, and refurbishment of the existing inventory so that they are all in good repair and working order at the end of the license term. Although we have not estimated the capital expenditures that Clear Channel will have to incur to undertake such efforts, they are not insubstantial and may approach $5.8 million in number. These capital expenditures justify the fifteen year term, and in any event, the fifteen year term is a significant improvement to the twenty year term originally contemplated.

The Audit Report incorrectly asserts that the MBTA was required to seek federal approval of the new License Agreement because the term exceeds five years. Although the MBTA did seek and received a waiver from the Federal Transportation Administration in December 2000 in preparation for the public bid process, there is no longer a regulation requiring federal approval of the revenue contracts in most cases. The FTA changed its rules pursuant to a circular dated June 15, 2001. In this particular case, no waiver is required because this is a non-exclusive agreement.

We do not view the right-of-first refusal as creating an atmosphere in which other bidders will be discouraged from bidding in a competitive bidding process. As we have indicated, the MBTA will offer to pay for the bid preparation costs of any disappointed bidder whose high bid is matched by Clear Channel. Further, we believe the right of first refusal will provide a strong incentive for competitors of Clear Channel wishing to enter this market to submit rates higher than they otherwise would have bid for fear that Clear Channel will match the bid.

Finally, we reject the Audit Report's conclusion that the MBTA erred in not obtaining a minimum annual guaranteed fee of at least $2 million in the 2003 License Agreement. The 1998 License Agreement provided for a minimum annual payment of $771,000. Transit Realty Associates, LLC, through its outside consultant JVI Solutions,

recommended that the market value of the appropriate revenue stream should be "$1 million dollar or higher." This calculation was based on Clear Channel's gross revenue figures, together with industry standard lease costs as a percentage of gross revenues, which indicated a supportable rent of $881,000 per year. TRA recommended that the minimum guaranteed fee for the RFQ/B should be between $1.5 million and $2 million based on Clear Channel's high vacancy rate and its belief that competitors would seek to pay a premium in order to break Clear Channel's virtual monopoly in the Boston Metropolitan Area billboard marketplace. Because of the statutory and regulatory restrictions identified above, no competitor, including Viacom, was able to submit a responsive bid. Moreover, Clear Channel was unwilling to pay more than the $1.2 million minimum annual fee offered in its proposal. The MBTA correctly determined that acceptance of such a bid, coupled with a reduced term and ultimate transfer of ownership of the billboards, was in the public interest. The minimum annual fee accepted is almost twice that of the fee provided for the 1998 License Agreement and $200,000 above the market rate determined by TRA and its advisor JVI.

Auditor's Reply

The RFQ/B issued by the MBTA required each bidder to construct new billboards as a condition of the license agreement. Clear Channel's estimated cost to comply with this mandate was $5.8 million. This expected capital improvement cost would logically be reflected as an amortized cost of obtaining the license by each potential bidder, and therefore would have reduced Clear Channel's net profits by approximately $386,000 per year. In return for unjustly increasing Clear Channel's profits by this amount, the MBTA received nothing more than an agreement to maintain these billboards in a condition necessary for the operator to continue to place their advertisements on them. This standard language was a requirement of the 1998 agreement as well as this RFQ/B and is a distinct requirement separate from the capital expenditure requirement. Clearly, it was to the MBTA's advantage to have required that new billboards be turned over in 15 years rather than the existing signs, most of which are already more than 40 years old and will be more than 55 years old when finally relinquished to the MBTA.

Moreover, the MBTA's claim that no federal approval was required at the time of the license award to Clear Channel is incorrect. Since this license was not awarded by virtue of a competitive bid process but rather the result of negotiations solely with Clear Channel, a waiver was, and still is, most certainly required. The waiver issued to the MBTA in December, 2000 was granted as an exemption from the five-year rule and not an exemption from competitive bidding requirements. The June 15, 2001 change in the waiver requirements does not apply to the 2003 license agreement since it is, in fact, an exclusive agreement where only Clear Channel

was allowed to participate. Therefore, we recommend that the MBTA immediately contact the FTA to apply for a new waiver for the 2003 license, as required by federal law.

Also, we fail to see the benefit to the taxpayers in offering to reimburse unsuccessful bidders for incurred bid costs. Ultimately the right of first refusal benefits no one, other than Clear Channel. Therefore, the MBTA should ensure that this right of first refusal is never offered to Clear Channel by allowing the current license to expire, and at that time, ensure compliance with the license requirement to turn over the billboards to the MBTA before a new RFQ/B is offered. Even if the MBTA suffers a temporary loss of revenue until a new license is awarded, it will be justified if the taxpayers can be assured that fairness and competition have finally been incorporated into the next advertising license awarded by the MBTA.

Finally, we defer to the expertise of the MBTA's paid real estate advisors, Transit Realty Associates, LLC, and agree with their assessment that the true value of this advertising license was $1.5 to $2 million per year, and not the $1.2 paid by Clear Channel.