

# Franchising Competitive Video Providers

— by Brian T. Grogan —

[T]oday, the Commission is federalizing the franchising process, taking it upon itself to decide, in every local dispute, what is "unreasonable," without actually looking at specific, local examples to determine the real situation. Instead of acknowledging the vast dispute in the record as to whether there are actually any unreasonable refusals being made today, the majority simply accepts in every case that the phone companies are right and the local governments are wrong, all without bothering to examine the facts behind these competing claims, or conduct any independent fact-finding. This is breathtaking in its disrespect of our local and state government partners...<sup>1</sup>

—FCC Commissioner Jonathan Adelstein

With the adoption of the Telecommunications Act of 1996,<sup>2</sup> Congress promised a "pro-competitive, deregulatory national policy framework" for the U.S. communications industry.<sup>3</sup> Whether competition in the communications industry has truly evolved from the 1996 Act is a matter of considerable debate. Recently, this debate has focused on the delivery of competing cable/video services under Title VI of federal law.<sup>4</sup> Throughout 2006, the big phone companies tried to convince Congress to overhaul the Cable Act to streamline their entry into the cable services market. That plan required modification following the 2006 mid-term elections when it became clear no Cable Act overhaul would occur.

The big phone companies then turned their attention to state legislatures, seeking relief from the time-consuming, complex, and burdensome local franchising requirements. They also sought help from the Federal Communications Commission (FCC) to accomplish a Cable Act revision that Congress was unable to provide. The FCC eagerly entered the debate and, on March 5, 2007, released an order on local franchising that will likely impact every cable franchise in the country.<sup>5</sup> A number of municipal organizations have petitioned the

court for review of the Order, including the National League of Cities, the National Association of Counties, the U.S. Conference of Mayors, the National Association of Telecommunications Officers and Advisors, and others.<sup>6</sup> This article will address the key provisions of this new FCC Order and will explain the impact on those local governments which remain in control of issuing cable franchising.

### Overview of the FCC Order

In the Order, the FCC concludes that in many jurisdictions, the local franchising process constitutes an unreasonable barrier to entry into the cable market that impedes the achievement of the interrelated federal goals of enhancement of cable competition and accelerated broadband deployment.<sup>7</sup> To eliminate such unreasonable barriers, the Order addresses several issues intended to speed competition in the delivery of cable services.

The Order goes to great length to clarify that only *local laws* are preempted, and only to the extent they conflict with the Order. The FCC concluded that it did not have sufficient information to make determinations with respect to franchising decisions where a "state" is involved, either by issuing franchises at the state level or by enacting laws governing specific aspects of the franchising process. Accordingly, the Order only applies to actions or inactions at the local level where a state has not specifically circumscribed the authority granted to a local franchising authority (LFA).<sup>8</sup>

By way of example, the Order indicates that many states have enacted comprehensive franchise reform laws designed to facilitate competitive entry.<sup>9</sup> Some of these laws allow competitive

entrants to obtain state-wide franchises, while others establish a comprehensive set of state-wide parameters that "cabin the discretion of LFAs."<sup>10</sup> Thus, the Order "does not address any aspect of an LFA's decision-making to the extent that such aspect is specifically addressed by state law."<sup>11</sup> Therefore, careful review of applicable state law for each LFA will be required to determine the overall impact of the Order.<sup>12</sup>

### Time-Frames for Franchise Negotiations

The Order establishes a maximum time-frame of 90 days for entities with existing authority to access public rights-of-way, and 180 days for entities that do not have authority to access public rights-of-way.<sup>13</sup> This new "shot clock" starts on the date an applicant files an application or other writing including certain minimum information.<sup>14</sup> An applicant and the LFA may agree in writing to extend the 90- or 180-day period for negotiations.<sup>15</sup>

If the shot clock elapses without action by the LFA, the applicant is automatically granted a "interim franchise" based on the terms of the application submitted.<sup>16</sup> Thereafter, the LFA and applicant may continue to negotiate the franchise terms in an attempt to reach a negotiated franchise. The shot clock may be "tolled" by the LFA if it has requested, and not received, information from the applicant.<sup>17</sup> However, it is not clear whether the scope of this "missing information" provision relates only to the FCC's application checklist, or includes other relevant information related to an applicant's qualifications, or state and local requirements. The difficulty for an LFA is that, once an interim franchise has been automati-

*continued on page 12*

---

**Brian T. Grogan** is a shareholder with the Minneapolis law firm of Moss & Barnett, practicing in the general corporate, business, real estate, mergers and acquisitions, and communications law areas since his admission to the bar in 1990. In his communications law practice, Brian has represented local units of government throughout the country on a variety of cable, telecommunications, and wireless issues.



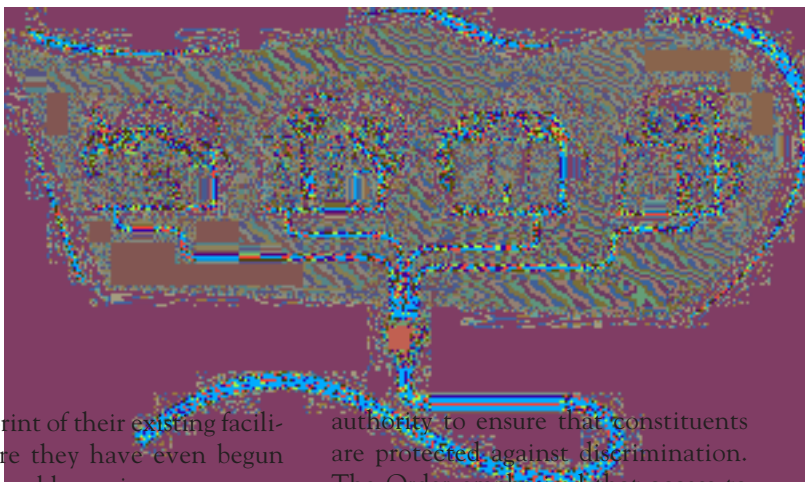
cally granted, the LFA may find it difficult to achieve a negotiated franchise if the LFA's only alternative is to deny the application, thereby potentially eliminating a competitive cable service option for consumers.

The shot clock time periods are very short. Once an application is received, negotiations should commence *immediately*. Assuming a minimum of 30 days in which to comply with local adoption requirements, LFAs could have fewer than 60 days from the receipt of a valid application to reach an agreement on the terms of a new franchise. In an effort to maximize the time available for negotiations, LFAs should consider preparing a template franchise in advance, which can be provided to applicants as soon as an application is received. LFAs should also consider revisiting their municipal code to verify that the appropriate permitting, insurance, indemnification, restoration and related issues are adequately covered. Finally, LFAs may wish to add cable franchise application obligations to their municipal code to address any additional local information requirements, as permitted by the Order.<sup>18</sup>

### Build-Out

The Order cites to the Cable Act, which provides that "a franchising authority... shall allow the applicant's cable system a reasonable period of time to become capable of providing cable service to all households in the franchise area."<sup>19</sup> The FCC views this provision not as a grant of authority, but as a limitation on an LFA's authority with respect to build-out. The Order does not specifically prescribe build-out criteria, but rather, provides a set of examples of reasonable and unreasonable build-out mandates.<sup>20</sup> Under the FCC Order, unreasonable build-out mandates are:

1. Requiring a new competitive entrant to serve everyone in a franchise area before it has begun providing service to anyone.
2. Requiring facilities-based entrants, such as incumbent local exchange carriers (LECs), to build-out beyond



the footprint of their existing facilities before they have even begun providing cable service.

3. Requiring more of a new entrant than from an incumbent cable operator by, for instance, requiring the new entrant to build-out its facilities in a shorter period of time than that afforded to the incumbent.
4. Requiring the new entrant to build-out and provide service to areas of lower density than those that the incumbent cable operator is required to build-out to and serve.
5. Requiring a new entrant to build-out and provide service to buildings or developments to which the new entrant cannot obtain access on reasonable terms.
6. Requiring the new entrant to build-out to certain areas or customers that the entrant cannot reach using standard technical solutions.
7. Requiring the new entrant to build-out and provide service to areas where it cannot obtain reasonable access to, and use of, the public rights-of-way.<sup>21</sup>

Reasonable build-out mandates under the FCC Order are:

1. Considering the new entrant's market penetration.
2. Considering benchmarks requiring the new entrant to increase its build-out after a reasonable period of time has passed from initiating service, and taking into account the applicant's market success.<sup>22</sup>

The FCC also noted that the Order is not intended to limit an LFA's

authority to ensure that constituents are protected against discrimination. The Order emphasized that access to cable service may not be denied to any group of potential residential cable subscribers based on the income level of the local area in which the group resides.<sup>23</sup> It is unclear whether a local government would have standing to raise this issue in many states under new state franchising laws.<sup>24</sup>

Absent any mandated build-out criteria required under state law, the FCC Order does little to clarify the build-out debate. The Order does not go so far as to prohibit any build-out criteria within a franchise; rather, it provides a list of unreasonable build-out mandates. Presumably, build-out criteria which provides a period of years over which build-out must be completed throughout a given jurisdiction would not be an unreasonable build-out mandate, although the FCC leaves open this question. It appears clear, however, that the FCC struggled while attempting to provide an Order which would prohibit an LFA from addressing build-out issues, as desired by the big phone companies, yet not run afoul of the Cable Act.<sup>25</sup>

The answer to how each LFA will deal with build-out remains open for discussion. When negotiating build-out requirements, an LFA must consider the impact of state laws, the existing franchise of the incumbent, the time period over which the incumbent was originally allowed to construct its system, and other relevant factors based on the FCC's unreasonable mandate list.

## Franchise Fees

The Order addresses four separate issues regarding the payment of franchise fees. This portion of the Order is potentially the most troubling, as it may well be argued by incumbent cable operators that existing franchises that conflict with the FCC's interpretation may, as a result, be unenforceable.

First, the Order reiterates the FCC's prior position that cable operators are not required to pay franchise fees on revenues from *non-cable* services, such as Internet access services and broadband data services.<sup>26</sup> Second, the Order references in-kind payments by providing examples of *impermissible* in-kind payments, such as mandatory contributions for municipal traffic lights, programs for recreation departments, and other payments not related to access to public, educational, and government (PEG) channels controlled by an LFA.<sup>27</sup>

Third, the Order addresses limitations on charges *incidental* to the award of a franchise. The Cable Act generally caps franchise fee payments to be received by an LFA at 5% of an operator's annual gross revenues from the provision of cable services in the community,<sup>28</sup> the Act also provides exceptions to this cap. One of the exceptions is a list of charges incidental to the award of a franchise, including payments for bonds, security funds, letters of credit, insurance, indemnification, penalties and liquidated damages.<sup>29</sup> The Order provides its own list of charges that the FCC concluded are *not* incidental to the award of a franchise, including: application or processing fees that exceed the reasonable cost of processing an application; acceptance fees; free or discounted services provided to an LFA; requirements to lease or purchase equipment from an LFA at prices higher than market value, and in-kind payments.<sup>30</sup>

Where a local government is already collecting the full 5% franchise fee, the Order could arguably prohibit the imposition of additional reimbursement costs to an LFA, even if those costs are prescribed under local law. These issues will vary depending upon the precise franchise language in question.

Another troubling aspect of this section of the Order concerns "free or dis-

counted services" provided to an LFA. Most franchises around the country contain provisions obligating a cable operator to provide free basic and expanded basic service to schools and public buildings. It is unclear what "free services" the FCC is referring to, but cable operators may seek to use the Order to argue that the costs associated with such free services should be offset against franchise fees. A careful review of individual franchises and state laws will be required on this issue.<sup>31</sup>

**The shot clock time periods are very short. Once an application is received, negotiations should commence immediately. Assuming a minimum of 30 days in which to comply with local adoption requirements, LFAs could have fewer than 60 days from the receipt of a valid application to reach an agreement on the terms of a new franchise.**

Finally, the Order calls into question contributions made in support of PEG services and equipment. The Order attempts to distinguish between "capital" and "operational" costs, as specified in the Cable Act.<sup>32</sup> Generally, LFAs have understood that capital costs may be negotiated in a franchise above the 5% franchise fee cap.<sup>33</sup> However, operational costs, such as salaries for employees, are generally not excluded from this cap. In the Order, the FCC references "capital costs" as payments collected "only for the cost of building PEG facilities."<sup>34</sup> The Order also provides that "capital costs refer to those costs incurred in or associated with the construction of PEG access facilities."<sup>35</sup> This provision may prove to be a source of contention between LFAs and cable operators. It is possible that both competing providers and incumbent operators will attempt to construe this statement as limiting the ability of an LFA to seek capital support for PEG equipment. Operators may argue

that, unless an LFA is seeking to "construct" a PEG facility, other capital costs must be deducted from franchise fees. An equally viable interpretation of this language, however, is that capital costs include any asset which has a depreciable life span, such as PEG equipment—including cameras, edit decks, lights, microphones, playback equipment—and other costs "incurred or associated with" PEG facilities.

## PEG and Institutional Networks

The Order concludes that it is unreasonable for an LFA to impose, on a new entrant, more burdensome PEG carriage obligations than it has imposed on the incumbent cable operator. The FCC also concludes that a "pro rata cost-sharing approach is a reasonable means of meeting the provision of adequate PEG facilities."<sup>36</sup> It is not clear, however, whether a pro rata cost-sharing approach includes only per subscriber amounts paid by an incumbent operator, or all in-kind PEG obligations, including periodic capital grants, cable operator-owned and operated facilities, and related expenditures.

The Order is not particularly harmful with respect to institutional network (I-Net) requirements, and provides that an I-Net requirement is not duplicative if it would provide additional capability or functionality beyond that provided by existing I-Net facilities. However, the Order encourages LFAs to consider whether a competitive franchisee can furnish such additional functionality by providing financial support or actual equipment to supplement existing I-Net facilities, rather than by constructing new I-Net facilities.<sup>37</sup>

## The Regulation of Mixed-Use Networks

Under the Order, it is unreasonable for an LFA to refuse to grant a cable franchise to an applicant for resisting an LFA's demands for regulatory control over non-cable services or facilities.<sup>38</sup> The Order states that an LFA has no authority to insist that an entity obtain a separate cable franchise in order to upgrade non-cable facilities. So long as there is a non-cable purpose associated with the network upgrade, a local ex-

*continued on page 37*

## FCC ORDER

continued from page 13

change carrier is not required to obtain a franchise until and unless it proposes to offer cable services. The FCC goes on to provide that “the same is true for boxes housing infrastructure to be used for cable and non-cable services.”<sup>39</sup>

This portion of the Order appears to be a direct reaction to AT&T’s efforts to upgrade its facilities by installing large (5' x 6' x 4') pedestals on public boulevards throughout the country, purportedly to upgrade its telephone and broadband network. Many jurisdictions have aggressively resisted AT&T’s efforts by insisting that the company first obtain a cable franchise, since the primary purpose of the pedestals is to facilitate the delivery of video programming. The Order may call into question the ability of municipalities to mandate a cable franchise prior to such a network upgrade; however, nothing in the Order impacts the LFA’s control over the right-of-way, or its permitting authority.

### “Level Playing Field” Requirements

State “level playing field” requirements appear to still be enforceable under the Order; all such local requirements are preempted. In franchises where an LFA has agreed to “most favored nation” clauses (requiring that the LFA will impose the same terms and conditions on any other cable service provider seeking a franchise), it remains unclear how these provisions will be impacted by the Order, and a careful review of the language of each franchise will be required to determine the answer. However, many local franchises contain provisions which contractually relieve the incumbent cable operator of certain obligations should a new competitor not be held to the same requirements by the LFA. The Order may not preempt contractual provisions which provide relief to incumbent cable operators. This is an issue which the FCC will address in a Further Notice of Proposed Rulemaking (FNPRM).<sup>40</sup>

The primary purpose of the FNPRM is to determine whether the Order should apply to cable operators

that have existing franchise agreements as they negotiate renewal of those agreements with LFAs.<sup>41</sup> On this issue, the FCC has tentatively concluded that the Order should apply at the time of renewal.<sup>42</sup> The FCC also seeks comment on whether it has authority to preempt state or local customer service laws that exceed the FCC’s customer service standards. The FCC has tentatively concluded that it does not have authority.<sup>43</sup>

### Notes

1. Dissenting Statement of Commissioner Jonathan S. Adelstein, *Re: Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992* (MB Docket No. 05-311) (Dec. 20, 2006).
2. Pub. L. No. 104-104, 110 Stat. 56. The 1996 Act amends the Communications Act of 1934, 47 U.S.C. §§ 151 *et. seq.* (West 2007) (hereinafter the “1996 Act”).
3. *See* S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 1 (1996) (joint explanatory statement).
4. The statutory framework for cable regulation was first established by the Cable Communications Policy Act of 1984. The Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779 (1984), 47 U.S.C. § 521 *et. seq.*, adding Title VI to the Communications Act of 1934, as amended, 47 U.S.C. § 151 *et. seq.* Title VI was further amended by the Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992) (hereinafter the “1992 Act”), 47 U.S.C. § 521 *et. seq.* (collectively, the “Cable Act”).
5. *Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Consumer Protection and Competition Act of 1992*, MB Docket No. 05-311, Report and Order, FCC 06-180 (rel. March 5, 2007) (hereinafter “Order” or “FCC Order”).
6. *See* AMC v. FCC, No. 07-3391 (consolidated) (6th Cir. filed April 3, 2007). On June 18, 2007, national organizations filed a motion to stay the Order while the litigation is in progress.
7. ¶ 1 of the Order.
8. *Id.*
9. ¶ 27 of the Order, n. 90; ¶ 126 of the Order.
10. ¶ 1 of the Order, n.2.
11. *Id.*
12. The Order only impacts *local* franchising decisions, and does not preempt state statutory franchise requirements. States where

franchising is now governed at the state, not local, level include Alaska, California, Connecticut, Florida, Hawaii, Indiana, Kansas, Michigan, Missouri, North Carolina, South Carolina, Texas, and Virginia. At the time this article was written, numerous other states were on the verge of adopting new legislation, including Georgia, Iowa, Kentucky, Tennessee, Wisconsin, Illinois, Ohio and others.

13. ¶ 67 of the Order.
14. A new section has been added to the Code of Federal Regulations, 47 C.F.R. § 76.41, which provides the an applicant must remit the following minimum information: the applicant’s name; the names of the applicant’s officers and directors; the business address of the applicant; the name and contact information of a designated contact for the applicant; a description of a geographic area that the applicant proposes to serve; the PEG channel capacity and capital support proposed by the applicant; the term of the agreement proposed by the applicant; whether the applicant holds an existing authorization to access the public rights-of-way in the subject franchise service area; the amount of franchise fee the applicant offers to pay; any additional information required by applicable state or local laws.
15. 47 C.F.R. § 76.41 (d); ¶¶ 67, 70-73 of the Order.
16. ¶ 77 of the Order.
17. ¶ 75 of the Order.
18. *See, generally*, ¶¶ 70-77 of the Order.
19. 47 U.S.C. § 541(a)(4)(A) (West 2007).
20. ¶ 89 of the Order.
21. ¶ 90 of the Order.
22. ¶ 89 of the Order.
23. ¶ 92 of the Order, citing 47 U.S.C. § 541.
24. ¶ 1 of the Order, n.2.
25. 47 U.S.C. § 541 (West 2007).
26. ¶ 98 of the Order.
27. ¶¶ 107, 108 of the Order.
28. 47 U.S.C. § 542(b) (West 2007).
29. 47 U.S.C. § 542(g)(2)(D) (West 2007).
30. ¶ 104 of the Order.
31. *Id.*
32. *See* 47 U.S.C. § 542 (g)(2) (C) (West 2007).
33. *Id.*
34. ¶ 109 of the Order.
35. *Id.*
36. ¶ 120 of the Order.
37. ¶ 119 of the Order.
38. ¶ 121 of the Order.
39. *Id.*
40. ¶ 139-143 of the Order.
41. ¶ 140 of the Order.
42. *Id.*
43. ¶ 141 of the Order. **M**