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Franchising Fundamentals:
History
Basic Terms
Factors Aiding Success

by

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John W. Pestle[1]

Introduction: For over twenty years our firm has represented municipalities on franchises[2] and franchising related matters, including franchises for gas, electric, water, cable and telecommunications. In addition, our firm is experienced in utility matters from our representation of municipality owned electric utilities and our practice representing municipalities and private parties (not utilities) before state utility commissions and their Federal counterparts.

Based on this experience, this paper approaches franchising by standing back, taking a broader approach and addressing the question:

- What are the fundamental issues which apply generally to most types of franchises, without regard to the particular service or utility being franchised?

In this respect this paper attempts to make sure that municipalities are able to view the "forest" regarding franchising as well as the "trees" without being distracted by the issue of the day or points of major contention in a particular franchise. It addresses three major topics:

- A short history of municipal franchising, and its lessons for today (one lesson in particular)
- Basic terms which should be in most franchises
- Factors affecting success—things a municipality can do to enhance its chances of success in franchising.

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1 Varnum, Riddering, Schmidt & Howlett LLP represents municipalities nationwide on cable franchising and related matters, such as renewals and transfers of cable systems, ranging from small municipalities to large cities such as Fort Worth, Chicago and Detroit. It has represented more than 200 municipalities on such matters plus entities such as the National League of Cities, National Association of Telecommunications Officers and Advisors, U.S. Conference of Mayors, National Association of Counties, Michigan Municipal League and Ohio Municipal League.

John Pestle is Co-Chairman of the firm's Cable/Telecommunications Group and is a past chair of both the Municipal Lawyers Section of the State Bar of Michigan and the Legal Section of the American Public Power Association. He has represented municipalities on utility related matters for around 25 years, received the "Member of the Year" award from the National Association of Telecommunications Officers and Advisors in 1996 for his work assisting municipalities on the Federal Telecommunications Act of 1996 and is a graduate of Harvard College, Yale Graduate School, and the University of Michigan Law School.

2 Local practice varies as to the name given the general authorizations issued by municipalities to companies to install lines in the public rights of way and (usually) provide service to residents of the municipality, including such terms as franchise, license, or encroachment permit. For simplicity's sake, the term "franchise" is used herein. Compare Federal Cable Act Section 602(9) using the same term in such Act despite the variation in local nomenclature. 47 U.S.C. § 522(9).

Part I—History

Origins: Franchising has its roots in England with the principle that the King owned the highways and private parties could not use them, at least other than as travelers, without the King's permission. [get cite if easy] Municipal franchising in the U.S. applying the same principle dates back to colonial times, with franchises or similar permissions which were granted for plank roads, ferries and the like. In modern times the original English common law principle finds its expression in the principle that the public rights of way are owned by municipalities (or otherwise effectively held in trust by municipalities for the public at large) and cannot be used by private parties other than as travelers without municipal approval. This principle in particular applies to the permanent occupation of portions of the rights of way by utility type enterprises, whose use is far different from and somewhat conflicts with that of pedestrians and vehicular traffic.

Justice Holmes set forth this point in the classic case (involving what we would now term franchise fees) of *St. Louis v Western Union Telegraph Co*, 148 US 92; 13 S Ct 485; 37 L Ed 380 (1893) ("*St. Louis*"). There a lower court had found that the city's ordinance charging a telegraph company $5 for each pole placed in the city's rights of way constituted an unauthorized tax on the company. In reversing that holding, Justice Holmes stated as follows:

> All that we desire or need to notice is the fact that this use is an absolute, permanent, and exclusive appropriation of that space in the streets which is occupied by the telegraph poles. To that extent it is a use different in kind and extent from that enjoyed by the general public. Now, when there is this permanent and exclusive appropriation of a part of the highway**,** is there in the nature of things anything to inhibit the public from exacting rental for the space thus occupied? Obviously not.

148 US at 99.

Viewed more simply, a municipality is the landowner regarding the rights of ways, and utilities can no more use this property for their lines and facilities without municipal permission than they can the land of private parties.[3]

Broadly speaking franchises can be viewed as having two types of components—One relates to the use of the "land" (rights of way) in question and involves such issues as what lands may be used, what facilities may be placed on them, compensation for usage, more engineering related matters pertaining to such usage, insurance (to protect the municipality and its residents) and indemnities. The other involves

3 The U.S. Supreme Court has long ruled that any "permanent physical occupation of real property" is a taking under the Fifth Amendment, and has specifically applied this principle to cable and telephone systems. In the *Loretto* case, the Court considered a challenge to a New York statute that (in general) required apartment building owners to permit cable companies to install lines on the owner's (landlord's) premises so as to provide cable service to individual apartments. The Court held that because the installation of these lines constituted a permanent physical occupation of the landlord's property, it amounted to a per se taking for which just compensation is constitutionally required. *See Loretto v Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 73 L.Ed.2d 868, 102 S.Ct. 3164 (1982) and cases cited therein.

regulatory authority relating to the service—rates, terms and conditions of service, consumer protection matters and the like. American franchises from colonial times involved both components, such as early franchises which set the toll or fee for passage on private roads or ferries, evolving into franchises in the late nineteenth and early twentieth century which set rates for electric service (X cents per light fixture per month).

Municipal Rights Follow Technology: One of the most important lessons for municipalities from the history of franchising and utilities is that municipal franchise rights follow the technology, meaning that:

- Municipal rights are strong when the technology keeps the service basically local, such that the provider being franchised basically serves only one municipality
- Municipal franchising authority (especially regulatory authority) diminishes and migrates to the State and Federal level as technology makes the service multi-city, regional or interstate, and
- When municipal regulatory authority is restricted, there are often related attempts to restrict municipal control over right of way management or compensation, the most recent example being Congress' enactment in 1996 of Section 253 of the Federal Communications Act, 47 U.S.C. § 253 and resultant litigation in many Federal courts as telecommunications providers attempted to turn what was intended by Congress as a preservation of municipal rights related to rights of way into a limit on municipal authority.[4]

The connection between technology and municipal rights is not always instantaneous—there may be time lags between technological changes and changes in municipal rights. But the trend is clear.

In this regard, utilities and utility type services can be divided into two groups. The first is those where regulation initially was solely at the local level (mainly by franchise terms) but where with technological change regulation later shifted (or in the case of cable and Internet/cable modem, is currently shifting) to the State or Federal level:

- Electricity
- Gas
- Telephone
- Cable
- Internet/cable modem.

The second group of utilities and utility type services are those which were generally regional or interstate from at or near outset, with little municipal regulatory role:

4 Compare such Section 253 cases as *TCG Dearborn v. City of Dearborn*, 206 F. 3d 618) (6th Cir 2000) with *City of Auburn v. Qwest* 247 F. 3d 966 (9th Cir.), *amended* 260 F. 3d 1160 (9th Cir. 2001), *cert denied* 122 S. Ct 809 (2002) and cases cited therein.

- Railroads
- Canals
- Longer private toll roads.

Electric Example: One example—the electric industry—well illustrates how technology drives the locus of regulation. Initially electricity could only be transmitted a short distance, meaning one to four miles.[5] In large part this was due to the low voltages at which electricity was distributed[6], which in turn was partially due to (1) Thomas Edison's use of DC (direct current) electricity in the many electric utilities he founded (DC electricity has to be distributed and used at the voltage at which it is generated, and all electricity is generated at relatively low voltages) and (2) the use of similar voltages in AC (alternating current) systems. It was also due to the small size of early power plants, which could only supply enough electricity to serve a small area.

The result was that in the late nineteenth and early twentieth century generally each city had its own electric utility, each with its own power plant.

Change came in the early twentieth century due to the combination of (1) the development of high voltage AC electric transmission systems which could distribute energy to large areas (many counties)[7] and (2) large power plants which were much more efficient than small plants. The result was significant economies of scale in electric generation (which comprises 80% of the cost of electricity) plus the ability to serve large areas (with large electric loads) justifying such economical plants.[8] As a result, electric utilities merged and expanded so that they served states or large portions of states.[9] And as a consequence, electric regulation at the municipal level became ineffective—among other things regulation became increasingly complex for utilities with operations over a large area and individual municipalities lacked adequate resources for meaningful regulation. In response, state legislatures passed statutes shifting such regulation to the state level—to entities such as the New York State Public Service Commission[10] and its progeny

5 This section is taken from standard treatises and histories of the electric industry.

6 The lower the voltage, the shorter the distance it can be economically transmitted.

7 Transformers in each neighborhood reduced the power to low voltages, such as 110 volts, for use.

8 Industries with declining unit costs of production, meaning here the larger the utility the lower its costs, are what economists call a natural monopoly. The consequent inevitable demise of competition in the electric industry provided another justification for regulation (as a substitute for the competition snuffed out by economies of scale). Until then the theory of electric regulation was "franchise competition"—municipalities awarded multiple electric franchises to companies who competed with one another. City by city all electric companies went bankrupt or were bought out until one remained.

9 Such mergers are reflected in the names (until recently) of some electric utilities, such as those with "Consolidated" in their names, such as "Consolidated Edison" in New York. In the last decade many utilities have abandoned such historic names for new ones having no intrinsic meaning, such as "Entergy."

10 New York was the first state to create modern independent regulatory commission to regulate utilities in 1907. Other states followed its example. *See, e.g.* Philips, Charles F., *Regulation of Public Utilities* (2d ed.) at 123 (1988).

nationwide. And later as the technological advances in transmission systems and power plants continued, so that electric utilities began to serve several states or sell power between states, there was a further shift, with the regulation of interstate sales of electricity (being sales between utilities—"sales for resale"—as opposed to retail sales to the user for consumption) shifting to the Federal Power Commission (now the Federal Electric Regulatory Commission).

Cable Example: The cable industry provides a similar but more recent example. From the 1950's through the early 1980's individual municipalities awarded their own franchises and generally each municipality had its own cable company. Such companies mainly rebroadcast local TV stations, supplemented by (1) local public, educational and government channels and (2) a few independent[11] TV stations from outside the local area (such as WGN Chicago, or WTBS Atlanta) brought in by special antennas or microwave. And due to inherent limitations in the coaxial cables, amplifiers and analog technology used by cable systems, there were significant limits on the number of channels (10 – 20) a cable system could carry and they could not serve a large area. But starting in the 1980's advances in technology lead to commercial satellites, and video programming started to be delivered by satellite. It was now technologically easy and inexpensive to uplink many channels to satellites for distribution nationwide (initially mainly to cable companies, but now direct to residents). Cable channels such as ESPN, the Weather Channel and similar channels proliferated. This was followed shortly thereafter by the development of fiber optic cables, which together with the transition to digital technology gave cable systems the ability to provide (1) a large number of channels, plus other data (2) over long distances. These technological changes made it feasible for cable companies to serve large areas and to offer Internet and telephone services. The result was economies of scale contributing to a wave of mergers, as the individual cable companies serving individual communities were bought out and combined into one company serving an entire metropolitan area or region. And cable companies not only became regional, they began offering regional or national services, such as telephone service and cable service.

From a regulatory standpoint, in the 1940's and 1950's municipalities franchised cable companies, and under their franchises regulated them, setting rates, terms of service, what channels were carried and the technical aspects of cable systems. This so-called franchise regulation was similar to how electric utilities had been regulated at a similar stage. But starting in the 1960's (and greatly accelerating in the 1980's and 90's) municipal regulatory authority over cable has diminished. Examples include Federal preemption of such items as rate regulation, content (channels to be carried), and some of the technical aspects of cable systems.[12] The Federal government (1) in part justified this preemption of local regulation (or shift of it to the FCC) retrospectively—in the belief that technology (such as direct broadcast satellites) had lead to competition which removed the need for regulation (such as rate regulation of cable TV), and (2) in part prospectively—in the belief that municipal regulation of cable system technology would stifle technological

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11 Meaning not affiliated with the three major networks, ABC, CBS and NBC, or at least carrying a large amount of non-network programming, thus affording viewers programs beyond those carried by local network affiliates.

12 See generally the Federal Cable Act of 1984, as amended in 1992 and 1996, 47 U.S.C. §§ 521 and following.

advancement and the expansion of cable companies into providing telephone service.

For municipalities, the most recent major illustration of this trend was the FCC ruling that cable modem service was not a cable service, and thus cable companies did not need to pay franchise fees on revenues from that service. *Cable Modem Declaratory Ruling*, 17 FCC Rcd 4798 (2002), *reversed sub nom Brand X Internet Services v. FCC* 345 F. 3d 1120 (9th Cir 2003), *petitions for cert pending.* Related to this are ongoing attempts to exempt cable companies from paying franchise fees on their provision of telephone service on the theory that they have "already paid" via their franchise fees on conventional cable service.

Lesson for Municipalities—Be Aware/Changes in Law: The question for municipal attorneys is if you are aware of this trend, what do you advise your client to do in the franchising process so it is best protected? Shakespeare provides some guidance in this regard:

> There is a tide in the affairs of men
> Which taken at the flood, leads on to fortune;
> Omitted, all the voyage of their life
> Is bound in shallows and in miseries.

Julius Caesar Act 4, Scene 3, Lines 214-217.

As applied here, the quote from the Bard counsels municipal attorneys to be aware of this trend, or tide in the negotiation and drafting of franchises. To shift to a more modern source, Bob Dylan wrote that "The times they are a'changing." In other words, municipalities should be aware that changes in law leading toward decreased municipal franchising authority may occur during the duration of the franchise in question. They may occur in part because franchises are for long periods of time—often from ten to thirty years or more, which is far longer than most contracts. Being so aware,[13] the principal task of the municipal attorney is to protect his or her client against adverse changes in the law during the term of the franchise. There are three main points to address in a franchise in this regard.

No Advance Agreement to Preemption: The first is not having the municipality in the franchise agree in advance to State or Federal preemption. This is discussed more below, but usually comes up in the context of terms such as "this franchise is subject to XYZ statute, as amended." This point is easy to overlook in a franchise, which can be many pages long.

Preserve Contract Clause Position: The second is drafting the franchise itself so that it is easier for the municipality to argue to legislators or State or Federal regulators that the franchise is a contract which they cannot or should not void, in whole or in part. This involves such items as the franchise being drafted and structured as an agreement, in form like any other agreement, and perhaps being titled "Agreement."[14]

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13 Where the matter involves the renewal of a franchise, awareness is sometimes aided by considering the changes that occurred during the term of the expiring franchise.

14 Although so drafting the franchise runs the risk of enhancing the franchisee's ability to argue that it is a contract which

Our experience is that legislators and regulators are reluctant to void or change existing contracts, for fear of impinging on the sanctity of contracts. As a result, if they do change the law in a manner adverse to municipalities they often "grandfather" existing contracts.

Term of Franchise: The third is making the term of the franchise longer if the municipal attorney believes the legal/technological "tide" is against the municipality. One reason a longer term is helpful is that the U. S. Supreme Court has ruled in substance that the courts shall not interpret Federal statutes as applying to or modifying existing contracts unless Congress has so specified in the clearest possible terms, which in its results is somewhat similar to a "contract clause" argument that the legislature cannot modify existing contracts, it can only affect new contracts entered into after the statute was enacted.[15] The Court's rationale is that if a contract was altered by a statute, the party harmed would then have a claim for damages in the U.S. Court of Claims. For the courts to create such a monetary claim on the Federal fisc where Congress had not clearly stated that the statute was to apply would have the courts improperly infringing on the fiscal powers of Congress.[16]

Part II—Basic Franchise Terms

The following are some of the basic terms to seriously consider for all franchises. They start with some of the basics—what service is being provided, by whom, where and so on. Such terms are desirable so that the municipality will not find out that through technological change or ambiguity it has given permission for something other than what it intended.

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the municipality therefore cannot effectively alter by adopting an ordinance under its police powers. On the other side, there are many cases stating that the police power cannot be bargained away. S*ee, e.g.* the classic statements by Justice Brandeis in *Home Building & Loan Assoc. v. Blaisdell* 290 U.S. 398 (1934), where the Supreme Court ruled that the contract clause does not prohibit a state from exercising its police power to affect private or public contracts where related to remedying a social or economic need of a community, such as "[T]he police power is an exercise of the sovereign right of the Government to protect the lives, health, morals, comfort and general welfare of the people, and is paramount to any rights under contracts between individuals," *Id.* 437-438 (citations omitted), and "One . . . cannot remove [rights] from the power of the State by making a contract about them. The contract will carry with it the infirmity of the subject matter." *Id. Home Building & Loan* in turn derives from the classic case *Stone v. Mississippi*, 101 U.S. 814 (1879) and has been recently reaffirmed in *Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400 (1983).

15 *See, e.g Landgraf v USI Film Products*, 114 S. Ct. 1483 at 1449-1500, 128 L. Ed 2d 229 (1994); *applied to cable franchise in James Cable Partners v City of Jamestown*, 43 F. 3d 277 (6th Cir. 1995).

16 Note in this regard a point which most lawyers are unaware of—that the takings clause of the U. S. Constitution protects states and municipalities against Federal takings, just as it protects private parties and their property. *See, e.g--United States v. 50 Acres of Land*, 469 U.S. 24, 31 (1984) (holding the City of Duncanville, Texas entitled to just compensation as a result of the United States' condemnation of a sanitary landfill owned by the city).

What Service: The franchise should carefully describe and limit the service to be provided. For example,

- Say "Provide electricity to customers"
- Not "Construct lines to provide electricity and related services." The electric utility will argue that the last clause will allow it provide whatever service it wants. Currently, for example, electric utilities could use such language to argue that the franchise authorizes them to provide Internet and telephone service (using the new Broadband over Power Lines or BPL technology, which is now undergoing field trials and shows some promise of success).

A related example comes from the gas industry, where the Williams Companies used their interstate gas pipelines to install fiber optic cables across the U.S and became a major telecommunications company. In general, this is a point of major importance in franchises and often one for some improvement.

Where: The franchise should also describe where the service is to be provided. If the service is very limited in nature (or if the provider's lines are just "passing through" the municipality on their way elsewhere, without providing local service) the best option may be naming or specifying the exact streets to be used, and where service is allowed. This approach is often useful at the start of services which are only to be provided in a limited area—for example a cable service only in a specific new subdivision.

Obviously the franchise should state the entire municipality as the authorized area if service is ubiquitous. Related to this, if the municipality has the authority to do so (as it typically does in the case of services such as cable service, but typically does not for electric, gas or telephone) it needs to make a choice between the following two approaches to specifying where service must be provided without any charge to the customer for extending the utility's lines so as to pass the customer's premises:

- The universal service approach, used typically in denser, more metropolitan areas requires the franchisee to serve all customers in the area. In part this makes sense because the area is dense enough that many or most customers are in areas the franchisee would serve voluntarily. In part it requires the franchisee to "take the skim milk with the cream," that is, serve some customers in less dense outlying areas in exchange for serving customers located in dense, highly profitable areas.
- The line extension approach, where the utility is required to serve all customers as long as there are X dwelling units per mile (pro-rated upwards and downwards for longer or shorter distances) where service is proposed to be extended. "X" is determined in part by what figure will lead to the franchisee getting a reasonable return on its investment in extending service, and is thus affected by such factors as the average cost of line extensions, likely number of customers passed who will take the service and likely revenues from them (average customer monthly bill).

In an appropriate circumstance, the two approaches can be combined, with one applying to part of a municipality and part to another.

Somewhat related to the preceding are anti-redlining and other anti-discrimination provisions. See for example Federal Cable Act Section 621(a)(3) which states that municipalities in cable franchises "shall assure that access to cable service is not denied to any group of potential residential cable subscribers because of the income of the residents of the local area in which such group resides." 47 U.S.C. § 541(a)(3).

The U.S. Supreme Court has ruled that leased public property may not be used for discriminatory purposes in violation of the equal protection clause of the Fourteenth Amendment. *Burton v. Wilmington Parking Authority* 365 U.S. 715, 81 S. Ct. 856 (1961) Certain anti-discrimination provisions may therefore be constitutionally required in franchises for utilities or other providers using the public rights of way.

When: For new providers or new services, there should be provisions setting forth when the service will be provided, at least where such provisions are not jurisdictional with state regulatory authorities (with local jurisdiction thus preempted). These are typically provisions giving the provider a time frame with deadlines to "build out" all or relevant portions of the area where it is franchised to serve, such as deadlines to submit initial plans for the area to rebuild, dates to start rebuilding and deadlines for completion.

Who: Franchises should carefully define who it is who is being franchised. One major reason is that the municipality needs assurance that it is a responsible party which is working in the public rights of way. As municipalities are well aware, when things go wrong in the right of way, they can do so in major ways. An example from Michigan is a franchisee cutting a major water main, such that potable water was cut off to large portions of a major urban county, with the resulting shut down of all schools and commercial establishments in much of the county, including the head offices of one of the big three auto makers. Evaluating the capabilities and track record of a proposed franchisee is one aspect of protecting against such problems, plus making sure that the franchisee is sufficiently strong financially to provide compensation if problems occur. Having obtained such assurance that the party receiving the franchise is responsible the municipality does not want this assurance undercut by the franchise effectively being transferred (by assignment or a change in control) to someone who may not be as responsible.[17]

In this regard, "competition" means not only the ability to enter a business, but the ability to leave it, either voluntarily or through the bankruptcy courts. Especially with new providers or a new service with multiple providers, the municipality's obtaining appropriate assurances that the franchisee has a good track record and is financially responsible is particularly important. History is instructive here: As noted above, until the start of the twentieth century a common theory of utility regulation was "franchise competition" where the concept was to award multiple utility franchises to companies who would compete with each other like any other business. But with the businesses being natural monopolies, as discussed above, one company

17 Many municipalities have experienced analogous problems when the new telecommunications providers of the 1990's went bankrupt, leaving municipalities to remedy the problems caused by partially completed constructions projects in the public rights of way—some municipalities have spent in the hundreds of thousands of dollars remedying right of way problems caused by defunct providers.

eventually drove out or absorbed all the others. Municipalities in many instances were left to handle the problems of abandoned lines in the rights of way and partially completed work there.

At the same time, municipalities need to be careful in this area, where the provider (such as an incumbent utility) is currently regulated on a rate of return basis and has substantial financial strength, or where provisions in this area may infringe on the jurisdiction of state regulators.[18] And the courts have sometimes proved hostile to such provisions, such as when applied to existing utilities. See cases such as *Bell Atlantic v. Prince George's County*, 49 F. Supp. 2d 805 (D. Md. 1999) *vacated on other grounds*, 212 F. 3d 863 (4th Cir. 2000).

Right of Way Provisions: A franchise obviously should include provisions relating to the rights of way. These are well known to municipalities, are sometimes codified in right of way ordinances, and will not be set forth in detail here. Some of the more important items are provisions such as:

- The franchise provides no priority vs other franchisees or public use of the right of way
- Franchisee shall cause no undue burden on the right of way, and shall minimize its interference with the public's use of it
- Facilities relocated at franchisee's expense for right of way improvements
- Construction bond
- Obligation to restore the right of way after construction
- Provision of maps, often in electronic format
- Construction, engineering permits to be obtained for work in the right of way
- Removal of the system in the event of discontinuation of service.

Service Related Provisions: To the extent allowed by other state or Federal regulation of the service in question, the franchise may contain substantive provisions regulating aspects of the service in question. For example, in the cable television area, where municipalities are the primary regulators, franchises (or related regulatory ordinances) typically address such points as:

- What is to be provided (minimum number of channels, certain categories of programming, local public, educational and government channels)
- Customer service provisions (billing, installations, repairs, responsiveness to phone calls)
- Rates and other terms and conditions of service.

Franchises for other types of service (gas, electric, and the like) although they may have contained such provisions decades ago when municipalities were the primary regulators of the service in question, now typically do not contain such provisions, which are addressed instead by State or Federal regulators. Municipalities need to be careful in this area, because the presence of such conditions in franchises can anger State regulators who may view them as infringing on their jurisdiction, and apparently angered some courts

18 For example, where state regulators examine an entity's financial and other capabilities as part of approving it to provide service, and require a new approval in the event of a change in the entity or changes in its circumstances.

in challenges to municipal right of way authority under Section 253 of the Federal Telecommunications Act of 1996. See cases such as the *Prince George's County* case cited above.

However, such substantive provisions may be present to some degree for services such as gas, electric, water or sewer which municipally owned utilities provide outside the limits of the municipality owning the utility in question, e.g., the City of X electric's utility providing service in an adjacent community. This is because municipal utilities are typically not subject to State or Federal regulation (because the residents/customers have direct local regulatory control via the ballot box).[19] In these circumstances such provisions are often modest—such as anti-discrimination provisions to the effect that the rates, terms and conditions of service shall be the same in the "extraterritorial" municipality issuing the franchise as in the "home" municipality of the utility in question.

Compensation: Franchises should provide for compensation by the provider to the municipality for use of the public property in question, just as the provider would pay rent for a comparable easement to use private property. Municipalities' legal ability to require such compensation varies, from strong home rule states where municipal authority and autonomy under the state constitution is set at a very high level, to so-called "Dillon's Rule"[20] states where municipal authority is construed narrowly, derives solely from legislative enactments, and the legislature may have limited compensation to the recovery of costs or nothing at all.

Where compensation is allowed, there are two basic types—monetary and in kind. As to monetary compensation the methodologies can vary greatly. The major types are:

- Percentage of gross revenues based fees, based on revenues generated within the municipality by the franchisee's system (e.g. 5% of gross revenues from the system being franchised)
- Percentage of gross revenues from a particular service (the current situation for cable, where under the Federal Telecommunications Act of 1996 amendments franchise fees are limited to 5% of revenues from cable services)
- Per foot based fees, e.g. 20 cents per foot per year. Often used for providers whose facilities pass through a municipality but do not provide service there, such that there are no revenues from the municipality and a gross revenue based fee is not appropriate
- Per access line fees (in Texas for telephone service).

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19 Thus, for example, the Federal Cable Act provides that "no Federal agency, state or franchising authority may regulate the rates for cable service of a cable system that is owned and operated by a local government or franchising authority within whose jurisdiction that cable system is located . . ." 47 U.S.C. § 543(a)(1). And municipally owned electric utilities are expressly exempted from regulation under the Federal Power Act, 16 U.S.C. § 824(f) and are exempt from regulation by most State utility commissions.

20 "Dillon's Rule" refers to the rule enunciated in the nineteenth century in cases such as *Merriam v. Moody's Executors*, 25 Iowa 163, 170 (1868) by Chief Justice Dillon of the Iowa Supreme Court, and subsequently adopted in many other states, that municipal authority must be narrowly construed.

Any such fees need to be accompanied by auditing provisions allowing the municipality, individually or in combination with other municipalities, to audit the provider to ensure that the municipality is being paid what is due. Experience has shown that audits normally reveal underpayments, which sometimes can be substantial (in the millions of dollars) and almost always are enough to cover the cost of the audit.

In kind services can range from allowing the municipality to use the provider's poles or conduit free of charge; to the provider installing conduit, fiber or the like for the municipality at incremental cost when the provider is installing same; to providing certain services (e.g. free service to municipal buildings; the public, educational and governmental channel provisions of cable franchises).

Insurance and Indemnity: Insurance and indemnity provisions are important, and are of particular interest to municipal attorneys. This is because in franchises they are usually advocated for mainly by the municipal attorney, who is usually the main (or at least the initial) municipal official raising and addressing this important topic. They are important, and need to be carefully addressed by municipal attorneys because:

- They address and minimize the downsides risks to the municipality from granting a franchise. In a word, they attempt to ensure that the municipality's general fund is not put at risk from such items as accidents, injuries or other events consequent to the grant of a franchise. In this regard the provider will accentuate the positive aspects to the municipality of granting or renewing a franchise—it is usually the municipal attorney's job to note the possible negative aspects and insert provisions minimizing them.
- Relatedly, the attorney in effect should attempt to ensure that the municipal officials expectations regarding insurance related provisions are fulfilled. For example, making sure that a promise of $10 million in insurance is not effectively gutted by the policy being written with a $9.9 million deductible, or by being issued by an offshore insurer of dubious financial strength—"XYZ Surety of the Bahamas, Ltd."

Some of the typical elements of well drafted insurance sections of franchises are:

- Specifying certain types of coverages, including coverage for risks ordinarily excluded from basic comprehensive general liability policies, such as underground construction (XCU coverage) and environmental coverage (for spills or discharges caused by the utility).
- Requiring minimum amounts of coverage, with the ability for the municipality to require that the amounts be increased during the term of the franchise, as appropriate.
- Allowing deductibles, but prohibiting retainages, so as to protect the municipality and its residents.[21]

21 If the franchisee goes bankrupt with an insurance policy with a deductible, then the insurance company must pay the full amount of any claim, and then attempt to recover the deductible from the bankrupt estate. But in the same situation with a retainage, the insurance company only has to pay the amount in excess of the retainage, and the party with the claim has to file a claim against the bankrupt company for the retainage amount, and will usually get little or nothing.

- Requiring that the insurance company be highly rated in terms of its financial strength, e.g.—A. M. Best Company rating.
- Providing that the municipality and its officials are additional named insureds.
- Making the franchisee's insurance primary for claims under it.
- Requiring notices from the insurance company of alterations in coverage or cancellations.
- Requiring certificates of insurance.

Enforcement, Defaults: Enforcement provisions of franchises are important, because franchises may run for decades and the normal enforcement mechanism present in contracts—termination—is not a realistic alternative for utility type services. Nor (typically) is the prospect of obtaining a replacement provider without an interruption in service.

Franchises thus should pay attention to other enforcement mechanisms.[22] Some of the major options which municipalities may be able to adopt unilaterally (e.g.—by ordinance or other local legislation) are:

- Making franchise violations an ordinance violation. Some municipal attorneys view this and the attendant prospect of criminal prosecution and conviction as effective. Others view the criminal process as ineffective in this context, due to the combination of the need for proof beyond a reasonable doubt, the right to jury trial and the usually minimal sanctions which result even in the event of a conviction ($500 fine).
- Civil infractions, for example where state or local law allows meaningful financial consequences, backed by the ability of the court to issue an injunction requiring correction of the underlying violation, e.g.—failure to properly restore the rights of way.
- Civil suits to require specific enforcement of the franchise provision in question and enjoin further violations.

Other measures which may be effective include:

- Liquidated damages in meaningful amounts. Usually these would need to be provided for in the franchise. Attention needs to be paid to the amount of such damages and how they are assessed (e.g.—by city manager with right of appeal to city council).
- The municipality performing at the franchisee's expense, and then recovering its costs of performance.

Term: Usually the term provision of a franchise is straightforward. As a matter of clarity it is better to specify a date certain as the end date of the franchise (e.g.—July 31, 2010) rather than specify a term of years ("fifteen years from adoption"). This is because many times with franchises which use the latter approach both the municipality and the franchisee end up being unsure of the exact expiration date as it draws near because the relevant "date of adoption" or "effective date" from which the start of the term is

22 Usually there are notice and cure provisions which must be satisfied prior to proceeding to enforcement, at least as to violations of an ongoing nature.

measured cannot be exactly determined. Bottom line—the exact expiration date should be set forth in the franchise as occurring on a certain month, day and year. By the same token, the initial or "effective date" of the franchise should be set forth with equal clarity (even though it may subject to contingencies, such as the franchisee signing and returning a document "accepting" the franchise, provision of insurance certificates and the like).

Considerations suggesting that in some circumstances a longer term is better for municipalities are noted above. Usually franchises are for at least five to ten years, and may extend to fifteen to thirty years or more.

Changes During Franchise Term: As discussed above, one of the more important items for the municipal attorney to address in a franchise is the legal changes which may occur during the franchise term, which typically runs for decades. This is particularly the case if, as noted above, the attorney reasonably concludes based on present evidence or past trends that there is likely to be a trend towards State or Federal preemption during the franchise term. Several aspects of this are discussed next.

Preemption: In some instances the State or Federal government can preempt franchises,[23] analogous to how under a proper exercise of the police power (see discussion below) the municipality may override provisions of a franchise it has signed. However, the municipality should not agree to Federal preemption in advance. Stated otherwise, if the Federal or State government can and in fact properly does preempt certain provisions of a franchise, so be it. But a municipality should not agree to this in advance, because the attempted preemption may seriously infringe on municipal rights or benefits under a franchise and the municipality may wish to preserve its right to challenge questionable attempts to preempt. To overstate the point somewhat, agreeing to preemption in advance is a waiver—it cedes authority to Federal bureaucrats in Washington who often have little knowledge about or interest in municipal matters.

Key franchise provisions to be alert for which relate to preemption/not agreeing to it in advance include:

- Stating that the franchise is subject to State and Federal law "as of the effective date"
- Or stating that the franchise terms govern despite subsequent changes in State or Federal law
- NOT stating that the franchise
    - Is "subject to State and Federal law as from time to time in effect", or
    - Is subject to a certain statute "as amended", or
    - Shall be interpreted "consistent with Federal law"
- Requiring notice by the franchisee of any such preemption, and

23 Such ability may be subject to restrictions, such as restrictions on the Federal Government under the 10th Amendment (Federalism) or the Commerce Clause, as well as the need for a Federal agency to be authorized to preempt and comply with applicable legislation. States may be restricted under their constitutions or statutes.

- Stating that if preemption occurs, the municipality may amend the franchise/substitute alternative franchise terms so as to provide an equivalent benefit to the municipality, so as to achieve the same or similar intent.[24]
- Finally, it may help to have major terms of the franchise appear in a document signed by the franchisee (not just as a statement in a franchise that it incorporates the terms of a general franchise enabling ordinance). If nothing else, having the major franchise terms appear in a document signed by both parties should aid a municipality in making grandfathering or "contract clause" type arguments against preemption.

Illustrating the importance of such provisions is the fact that in a suit by Jefferson Parish, Louisiana against Cox Communications to require Cox to continue to pay franchise fees on cable modem service (despite the 1992 FCC ruling noted above) the Court ruled against the municipality based on the fact that in its franchise the Parish had effectively agreed to subsequent changes in Federal law. *Parish of Jefferson v Cox Communications Louisiana LLC*, 2003 Westlaw 21634440 (D. La, 2003). By contrast, in our experience, franchisees have honored franchises which had payment terms which State or Federal law subsequently attempted to preempt where the franchise lacked "advance agreement to preemption" provisions, or had provisions expressly stating that they applied despite subsequent changes in State or Federal law.

Other Change Related Terms: Other terms to include (or not include) in a franchise to help prevent changes adverse to a municipality during its term include the following:

- Inflation related escalators, which can apply to any fixed dollar amounts, such as fixed dollar payments to the municipality, insurance limits, bonds and the like
- No force majeure clause (because the obligations in a franchise are almost exclusively those of the franchisee, so such clauses work overwhelmingly to the franchisee's benefit), or narrow clauses with obligations of the franchisee to minimize the effects of any force majeure act
- For similar reasons, no or narrow impossibility or commercial impracticability clauses
- Express reservation (as a matter of good drafting and practice) of municipal police powers, despite court cases stating that the police powers can "never be bargained away"[25] so that the

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24 A common provision in many initial cable franchises or enabling ordinances is the following.

> "If the City determines that a material provision of a franchisee's franchise issued under this Chapter is affected by any subsequent action of the State or Federal government, the City shall have the right to modify any of the provisions herein to such reasonable extent as may be necessary to carry out the full intent and purpose of this Chapter and any franchises issued under it."

25 *See, e.g., Home Building & Loan Assoc. v. Blaisdell* 290 U.S. 398 (1934), quoted above, As a practical matter, some judges are more receptive to powers that have been expressly " bargained away' by the franchisee.

municipality has as much authority as possible to use that power to address changes which occur during the franchise term.[26]

Part III—Factors Affecting Success

The preceding portions of this paper have indicated franchise terms which municipalities should seek to achieve or avoid. What can municipalities do to enhance their chances of success in this regard?

Some key items affecting success are not within a municipality's control. These include such items as:

- The size of the municipality (larger municipalities tend to do better in franchising than small ones
- Which provider the municipality is dealing with (some are easier to deal with than others)
- The current State and Federal regulatory environment.

Factors affecting success which are more within a municipality's control include:

- The level of municipal officials participating in the renewal negotiations. Participation by the Mayor, his/her deputy, the City Manager or his/her deputy sends a message and can have a significant effect. Sometimes the municipality can insist (or the provider believes) that it needs to have a representative at the negotiations of equivalent stature to that of the top municipal official. Having a high level municipal official can thus help, because the higher the level of provider official that is present, usually the greater their authority to say "yes" on key terms.
- Having demonstrated problems illustrating the importance of an issue. It is far better to have concrete examples of why a provision is needed than to argue in the abstract.
    - Without suggesting every cloud has a silver lining, municipal bargaining power is enhanced when utility problems are on the front page of the newspaper, are repeatedly before council and elected officials volubly make their displeasure known.
- Clear backing from the legislative body (Council, Commission) of the municipality, especially if the franchisee may end run city staff and go to that body on franchise issues.
- Working jointly with other municipalities
    - We have done joint refranchisings where as few as two or as many as fifty-nine municipalities who were served by the same provider worked together. These have largely been done informally (the communities simply all retained the same law firm

26 Note in this regard that there may be two lines of cases, one interpreting the police power of municipalities with respect to franchises more narrowly, along the lines of *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977), the other interpreting it more broadly along the lines of *Home Building & Loan* and *Energy Reserves Group*, supra. Stated succinctly, courts adhering to the former line of cases appear more concerned than the latter about municipalities using the power to unilaterally amend bilateral contracts.

and negotiated jointly, with the final document subject to approval by each municipality's Council/Commission)

- Working jointly or in groups is <u>one of the most effective things</u> a municipality can do to increase its chances of success, because such larger groups are given more attention by the provider, have more bargaining power, and are more likely to lead to the involvement of higher level officials from the provider, who have the authority to say "yes."
- Working jointly with other municipalities also has political benefits for the participating municipalities, because with all municipalities getting the same franchise, one municipality and its officials can't be criticized for "not getting as good a deal" as some other municipality.

- Good preparation and homework on the franchise
- Focused issues and concerns—no tilting at windmills
- Stamina!

<u>Conclusion</u>

There is no magic wand for municipalities to obtain good franchises. The preceding items are based on approximately twenty-five years of working with municipalities on utility-related matters, especially franchises, and hopefully will help municipalities in their franchising endeavors.

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