

International Municipal Lawyers Association
2011 Annual Conference, Chicago, Illinois

Work Session IV: Current Concerns in Telecommunications
September 12, 2011

Cable Franchising: Issues and Developments

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Can a local government attorney successfully use a federal statute first adopted more than 25 years ago to fashion an agreement that will serve the community's cable-related needs and interests into 2025 or later? Yes—but it is no easy task.

Initially crafted in 1984, the Cable Act continues to be the key statute governing the negotiation of cable franchise agreements today. But local government attorneys negotiating a cable franchise agreement today face challenges that their predecessors did not. Local cable franchising authority has been under attack at both the State and federal levels, and—spurred on by these developments—cable operators have become increasingly resistant to meeting local needs. In addition, technological advances have created new issues and underscored the importance of ensuring that local communities are served by cutting-edge cable systems. These factors emphasize the need for a local government attorney negotiating a cable franchise agreement to stay on top of new developments.

To assist with this effort, this paper will first provide a background on cable franchising authority and on recent efforts to curtail it. It will then examine a handful of current issues arising out of—or related to—cable franchising.

I. BACKGROUND

The local cable franchising process is rooted in two well-established concepts in American law: property rights and police powers. At its core, a cable franchise is a privilege to use public property—typically, the public rights-of-way—that has been dedicated to public use.[1] The local government may own this property in fee, but is obligated to manage this property for the public's benefit. The local government also exercises police powers to advance "the safety, happiness, and prosperity of its people, and to provide for the general welfare." In Title VI of the Communications Act (the "Cable Act"),[2] Congress imposed certain limits on the local cable franchising process, but also fundamentally elected to preserve it. Unfortunately, recent Federal Communications Commission rules and, more significantly, State laws have limited this basic local authority.

A. The Cable Act

The Cable Act is designed, among other things, to "assure that cable systems are responsive to the needs and interests of the local community."[3] To

[1] 12 McQuillin Mun. Corp. § 34.04, *et seq.*

[2] 47 U.S.C. §§ 521 *et seq.*

[3] 47 U.S.C. § 521(2).

satisfy these needs and interests, the Cable Act allows local governments to impose a number of obligations, including:

- *To require the operator to pay a franchise fee equal to 5% of the gross revenues* derived from the operation of the cable system to provide cable services;[4]

- *To adopt and enforce customer service standards*. The FCC has adopted minimum customer service standards, and a local government can choose to enforce these requirements, or adopt more stringent standards;[5]

- *To require an operator to provide channels, facilities, equipment and capital support (above and beyond the franchise fee) for public, educational, and government use of the cable system.*[6] Thus, for example, many franchises require the operator to provide channels, equipment, and studios that non-profit groups and others can use to produce programming. PEG requirements have significantly enhanced the ability of government, schools, non-profits, and others to deliver information to the community; and

- *To establish requirements for cable system-related facilities and equipment.* The legislative history explains that, among other things, a local government may "include requirements which relate to channel capacity; system configuration and capacity, including institutional and subscriber networks." Many communities have required operators to provide capacity on their systems that the City (and local schools) can use for voice, video, or data communications, at no or relatively low charge.

- *To define where a cable operator must serve and set the time for build-out of the cable system*.[7]

The Cable Act also establishes a process for cable franchises to be "renewed." Under this process, a local government only must renew a franchise if the cable operator successfully demonstrates, among other things, that it will meet the community's cable-related needs and interests into the future. Franchises

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[4] 47 U.S.C. § 542(b).

[5] 47 U.S.C. 552(d).

[6] 47 U.S.C. § 531; 47 U.S.C. 542(g)(2)(C).

[7] 47 U.S.C. § 552(a).

can be renewed informally (through negotiations not tied to any procedural limitations), or through a formal renewal process. Under this process, between 30 and 36 months before the franchise expires, the franchising authority reviews the cable operator's past performance and identifies the community's future cable-related community needs and interests.[8] The operator then submits a proposal for franchise renewal.[9] Within the next four months, the franchising authority must renew the franchise or issue a "preliminary assessment" that the franchise should not be renewed.[10] If the franchising authority does not renew the franchise, the operator may demand an administrative proceeding to consider whether the denial was justified.[11] As part of the process, a local government can consider the cable operator's past performance and whether its proposal is "reasonable to meet the future cable-related community needs and interests, taking into account the cost of meeting such needs and interests."[12] Equally importantly, a franchise can be denied if the operator has failed to comply with its franchise or applicable law, or is unable or unwilling to comply with applicable law and the franchise going forward.

B. *Recent Limits on Local Franchising Authority.*

In recent years, local cable franchising authority has been limited through changes at both the State and federal levels. In 2007, the FCC adopted two orders that limit local franchising authority. And a number of States have adopted laws that eliminate or greatly restrict local authority in this area.

i. *The FCC's Franchising Orders.*

In 2007, the FCC adopted two orders that limit local franchising authority under the Cable Act.[13] While the Cable Act requires every cable operator to obtain a franchise and protects local authority to issue such a franchise, the Act

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[8] 47 U.S.C. § 546(a).

[9] 47 U.S.C. § 546(b).

[10] 47 U.S.C. § 546(c)(1).

[11] 47 U.S.C. § 546(c)(1). *See Union CATV, Inc. v. City of Sturgis, Ky.*, 107 F.3d 434, 438 (6th Cir. 1997).

[12] 47 U.S.C. § 546(c)(1).

[13] In June 2008, the Sixth Circuit upheld the *First Order* in its entirety. *Alliance for Community Media v. FCC*, 529 F.3d 763 (6th Cir. 2008). The Second Order is subject to a petition for reconsideration, on which the Commission has never taken any action.

also states that a local franchising authority "may not unreasonably refuse to award an additional competitive franchise."[14] Focusing on how local governments might "unreasonably" refuse to award a franchise, the FCC adopted federal rules describing what local actions would constitute such "unreasonable" behavior.

In its first order,[15] the FCC found that local governments—but not States (which the Order does not regulate)—were unreasonably delaying the entry of new cable entrants through the local franchising process. The FCC purported to broadly preempt local laws inconsistent with its new rules. The first order did not apply to incumbents. In its second order,[16] the FCC extended some, but not all, of the requirements of the *First Order* to incumbent cable operators. Notably, the FCC endorsed differential treatment of incumbents and new entrants in several key respects. The FCC found that it was reasonable to require incumbents to continue to serve the entirety of a franchise area, even if a new entrant was not required to do so. The FCC also concluded that different and more burdensome PEG and institutional network requirements can be imposed on an incumbent than on a new entrant, even in renewal franchises.

The two orders adopt the following rules:

Time Limits for Local Action; and a Franchise "Deemed Granted."

In the *First Order*, the FCC found that it was unreasonable for a local government to take more than 90 days to act upon a complete cable franchise application submitted by a new entrant with authority to be in the rights-of-way, and 180 days in other cases. If a community fails to act within these time limits, an interim franchise is deemed *temporarily* granted, on the terms prescribed by the *applicant.* The FCC indicated that this grant terminates once the local government acts on the application. The *Second Order* found that these time limits do not apply to incumbent operators.

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[14] 47 U.S.C. § 541(a)(1).

[15] *In 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*, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd. 5101 (2007) ("*First Order*").

[16] *In 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*, Second Report and Order, MB 05-311, FCC 07-190, 22 FCC Rcd. 19633 (FCC Nov. 6, 2007) ("*Second Order*").

Unreasonable build-out requirements.

The *First Order* preempted what the FCC concluded were "unreasonable" build-out requirements on new entrants. Among other things, the Commission concluded that it is unreasonable to require a new entrant "to serve everyone in a franchise area before it has begun providing service to anyone" and to require a new entrant to serve areas of lower density than areas served by an incumbent provider. The FCC found that its limits on "unreasonable build-out" do not apply to incumbents operators. The ruling is exceptionally vague, and some new entrants are using it to claim—inaccurately—that any build-out requirements are unlawful.

The franchise fee.

The FCC found that the cable franchise fee is limited to 5% of gross revenues derived from the operation of the cable system to provide cable service. Interestingly, however, the Commission also suggested that if state law permitted it, nothing in the Cable Act prevented a local government from charging a fee for use of the rights-of-way for non-cable services (such as telephone services).[17]

A franchise fee generally is "any tax, fee or assessment" imposed upon a cable operator because of its status as such. However, the Cable Act provides that certain "tax, fees or assessments" *are not* franchise fees. The order attempted to define what franchise requirements are, and are not franchise fees.

- In-kind requirements that are not cable-related *are* franchise fees. Thus, if a franchise required an operator to build a fire station, that cost would be a franchise fee. But, the FCC (in it briefs to the court of appeals) indicated that in-kind requirements that *are* cable-related (such as free services to schools) are not franchise fees.

- Generally, if a franchise requires an operator to pay a fee to the local franchising authority to defray PEG operating costs, those fees are counted as franchise fee payments. But there are exceptions to this rule: an operator may voluntarily make such payments, and such payments could also be required as part of a settlement of disputes. Generally, payments an operator makes to a local governments for PEG capital costs are *not* franchise fees. The FCC order explaining this distinction is vague. The order states that "capital costs" for costs" for "construction" of facilities do not count against the fee, a phrase some operators are using to suggest that equipment costs *do* count against the fee. However, the FCC subsequently suggested that its reference to construction was an example, and it cited with approval earlier rulings which

[17] *Second Order*, ¶ 11 n.31.

indicate that fees used to pay for facilities or equipment, or other capital costs associated with PEG capacity are not counted against the franchise fee.

- The Cable Act states that fees incidental to the awarding or enforcing of a franchise are not franchise fees. The FCC indicated that fees charged by local governments to recover costs associated with renewal and transfer (except for certain *de minimis* costs) do count against the franchise fee.

These rulings were extended to incumbents by the Second Order. But, in the Second Order, the FCC also indicated that a local government could rely on State law authority to impose an additional fee if a cable operator uses its cable system to provide services other than cable services.

While the rulings create new hurdles for local government, read properly, the rulings need not change the franchising field for incumbents significantly. But the rulings do create risks – and are vague enough that they have invited disputes.

PEG requirements.

In the *First Order*, the FCC indicated that certain PEG and I-NET requirements would be unreasonable, including requirements that it characterized as "duplicative." While the *Order* is vague, the FCC indicated a new entrant could not be required to provide more than the incumbent, regardless of circumstances.[18] In the *Second Order,* the FCC concluded that localities could impose more burdensome requirements on incumbents, and that its finding that "duplicative" requirements were unreasonable did not apply.

Mixed Use Networks.

In the *First Order,* the FCC concluded that local authority under the Cable Act extends to "cable services" and not generally to "mixed use networks" used to provide video and other services. The FCC indicated that this means that cable franchising authority cannot be used to regulate non-cable services. In the *Second Order*, the FCC extended the "mixed use" ruling to incumbents.

[18] In its appellate brief, the FCC suggested that localities could include a provision in a new entrant's franchise that required it to "ratchet up" its obligations if the incumbent's obligations increased.

Level playing field/most favored nations

While in the *First Order*, the FCC found that certain level playing field clauses interfered with competitive entry and therefore unenforceable, in the *Second Order* the FCC suggested that incumbent cable operators could enforce level playing field provisions against the local franchising authority—if the franchising authority agreed to them.

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ii. *State Legislation Limits Local Franchising Authority.*

In recent years, a number of States have also constrained local franchising authority by adopting some form of State-wide franchise legislation. These States include: California, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Louisiana, Michigan, Missouri, Nevada, New Jersey, North Carolina, Ohio, South Carolina, Tennessee, Texas, Virginia, and Wisconsin.[19] Under many of these laws, a single State-wide franchise replaces the obligation to obtain a franchise in each municipality. These laws may limit, among other things, PEG requirements and support, I-Net support, build-out requirements, and franchise fee audits.

There is a substantial question as to whether these state laws comply with the Cable Act. A federal court judge concluded that provisions of Michigan's Uniform Video Services Local Franchise Act[20]—which purported to prevent local governments from enforcing PEG provisions in local franchises that were still in force when the law went into effect—were inconsistent with the Cable Act.[21] Detroit has filed suit claiming, among other things, that the State law is inconsistent with the Cable Act's renewal provisions. The briefs filed note that the Michigan law continues to place franchising authority at the local level,[22] but it instructs the Michigan Public Service Commission to establish a standardized form for local authorities.[23] After this form is submitted to a local government, it has 30 days to approve it—or it is deemed granted.[24] The local government can

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[19] *See* P. Glist *et al.*, Cable/Video Franchising, January 2009 edition, Cable Television Law 2009: *Competition in Video Internet & Telephony*, Volume 1, at 807.

[20] Mich. Comp. Laws § 484.3301 *et seq.*

[21] *City of Dearborn v. Comcast of Mich.*, 558 F. Supp. 2d 750 (E.D. Mich. 2008).

[22] Mich. Comp. Laws § 484.3301(2)(e).

[23] Mich. Comp. Laws § 484.3302(1).

[24] Mich. Comp. Laws § 484.3303(3).

only review the form for completeness; it cannot make substantive changes. Thus, the local government cannot account for its cable-related needs and interests or require the cable operator to satisfy them. For example, with respect to PEG channels, the community's need is frozen in place as of January 1, 2007. The operator need only provide as many PEG channels as were in actual use on that date.[25] This (it is argued) cannot be squared with the renewal procedures envisioned by the Cable Act, which are intended to ensure that the cable operator agrees to terms that will meet future, cable-related needs and interests. [26]

Although the cable industry defended many of these State laws as ensuring lower rates and more competition, such benefits have rarely materialized. Recent articles suggest that, at least in some areas, a backlash may be forming.[27]

II. CURRENT AND FUTURE ISSUES ARISING OUT OF AND RELATED TO CABLE FRANCHISING.

The recent restrictions on local cable franchising authority have helped create a difficult environment to negotiate cable franchises. Bolstered by these developments, some cable operators have dug in, resisting even basic requests for improvements to local services.[28] In addition, technological and regulatory changes are affecting the issues that a cable franchise must address. For example, cable operators traditionally provided PEG to all customers; federal regulations required it. But operators contend that the federal regulation which required provision of PEG to all customers does not apply except in the (very few) communities that may still regulate cable rates. In the past, franchises did not need to require operators to provide PEG to all customers because of the federal

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[25] Mich. Comp. Laws § 484.3304(1).

[26] *City of Detroit v. Comcast of Detroit, Inc.*, Case No.: 2:10-cv-12427 (E.D. Mich.).

[27] R. Barrett, *Video Franchise Law No Boon To Consumers*, Milwaukee-Wisconsin Journal Sentinel, Nov. 8, 2008B. Dickerson, *With Regulation Like This, Who Needs Monopoly?*, Detroit Free Press, Aug. 23, 2009; D. Nelson, *Creation of State Cable Franchising Authority Hasn't Lived Up to Hype*, Athens-Banner Herald, Feb. 1, 2009.

[28] *See, e.g.*, C. Lowe, *Salem, Roanoke County End Talks With Comcast*, The Roanoke Times (Aug. 3, 2011) (noting that Comcast has been unwilling to negotiate to address customer service complaints).

regulation. But it may not be necessary to do so to ensure that all subscribers can receive the signals.

While renewal may be more challenging, local governments should not be deterred. A local government can still negotiate a cable franchise agreement that will successfully satisfy the community's cable-related need and interests for many years into the future. To do so, local governments should be aware of the following issues arising out of—or at least related to—the cable franchising process.

A. Institutional Networks

In the past, a number of communities have relied on Cable Act authority to require cable operators to provide an Institutional Network ("I-Net"). Such networks have proven to be a very useful tool to serve internal networking needs. In recent years, however, cable operators have become increasingly resistant to satisfy the need for such networks. Instead, the cable operators have attempted to *sell* services to local governments in much the same way the cable operators contract with business customers. More importantly, local government attorneys should be aware that if your community has a need and interest for such a network, it can continue to rely on the Cable Act to require one.

The Cable Act contemplates that local governments may require Institutional Networks and capacity on such networks. The Cable Act defines an Institutional Network as a "communications network which is constructed or operated by the cable operator and which is generally available only to subscribers who are not residential subscribers."[29] The Cable Act provides that "a franchising authority may not require a cable operator to provide any telecommunications service or facilities, *other than institutional networks*, as a condition of the initial grant of a franchise, a franchise renewal, or a transfer of a franchise."[30] It further indicates that a franchising authority "may in its request for proposals require as part of a franchise, and may require as part of a cable operator's proposal for a franchise renewal, subject to section 626, . . . [that] channel capacity on institutional networks be designated for educational or governmental use."[31] The Cable Act also recognizes that a local government may recover "capital costs which are required by the franchise to be incurred by the cable operator for public, educational, or governmental access facilities" separately from the franchise fee.[32]

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[29] 47 U.S.C. § 531(f).

[30] 47 U.S.C. §541(b)(3)(D) (emphasis added).

[31] 47 U.S.C. § 531(b).

[32] 47 U.S.C. § 542(g)(2)(C).

Despite this statutory language, some cable operators have expressed an unwillingness to continue to provide I-Nets for local governments. Instead, they offer to provide "managed services"—an arrangement by which the cable operator will *sell* capacity to the local government over cable-operator-owned facilities, just as the cable operator sells capacity to many other businesses. For many reasons, this model will often not work as well for local governments over time. Local governments that are even considering a service model should also be aware of a risk: some operators are attempting to lure governments with existing I-Nets to abandon them and to purchase services by offering a grant to defray services costs. An operator could later argue that the "grant" is an "operating cost" that may be offset against the franchise fee. Accordingly, local governments should think carefully before accepting a service offer in lieu of an I-Net.

B. Level Playing Field Clauses.

In the past, many local governments included "mutual" level playing field clauses in franchises to serve two purposes: first, to protect the community, by ensuring its system was at least as advanced as the system serving nearby or similar communities; second, to protect cable operators against "sweetheart" deals between the community and a favored cable operator. Operators are now refusing to agree to the former, and expanding the latter in ways that are dangerous to local communities. First, some operators are insisting that the local government agree that the franchise may be terminated if a State or federal franchising law is passed. This allows the operator to escape "grandfathered" requirements. Many States have grandfathered critical local franchise provisions, and a local "wipe-out" provision could be quite costly. Second, several operators attempt to undo the distinctions that the FCC's orders draw between incumbents and new entrants, urging local governments to treat the two the same. These provisions could also prove quite costly, and may prevent a local governments from enforcing "build-out" requirements. Third, some operators suggest that they must be treated the same as anyone providing video services—including, for example, cell service providers who deliver video via cell phones or satellite providers. As the local government may have little or no authority to regulate these entities, an overly broad clause could create serious problems.

C. System Improvements.

Many operators are refusing to make system improvements, or are limiting obligations to build out all areas in a community. Particularly for smaller communities, it may be critical to insist on a schedule for upgrades, and to require that the system will be technically able to support advanced, digital services.

D. PEG Channels and On-Demand Capacity.

As suggested above, PEG negotiations have become more complex because of changes in technology. For example:

- What is a PEG channel? In the past, PEG channels have been provided in exactly the same manner, and with the same quality, as local broadcast channels. Now some operators are attempting to provide PEG in a format that requires subscribers to pay extra fees to receive them. In a digital world, it is possible to provide channels of varying quality levels (there is no FCC standard defining the signal quality for digital PEG channels). The franchise should address this issue.

- Where will a channel be located? How will it be accessed? Is it accessed the same way as other channels? Some operators have created special hurdles to accessing PEG channels that make it virtually impossible to easily view the channels. And in an environment where channels can number in the thousands, where will PEG channels be found?

- How will signals get from the point of origination (City Hall) to the subscriber? Will the connections work well as systems switch from traditional (analog) video to digital? Some operators are refusing to even pick up the PEG signals unless the franchise specifically requires it to do so.

Local governments can also negotiate new ways to use PEG capacity. As described above, the Cable Act contemplates that a local government can require "that channel capacity be designated for public, educational, or governmental use."[33] Cable systems have now added interactive capability that can be used to satisfy local needs—if a franchise is updated to provide for it. For example, a key FCC condition on Comcast's recent joint venture with NBC Universal is Comcast's commitment to provide this PEG "on-demand" capability.[34] Comcast told the FCC that without such conditions "evolving technologies may quickly make today's solutions obsolete."[35]

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[33] 47 U.S.C. § 531(b).

[34] *In the Matter of Applications of Comcast Corporation, General Electric Company and NBC Universal, Inc.; For Consent to Assign Licenses and Transfer Control of Licensees*, MB Docket No. 10-56, FCC 11-4, at ¶ 210 (Jan. 20, 2011).

[35] *In re Applications for Consent to the Control of Licenses General Electric Company, Transferor, to Comcast Corporation, Transferee*, Applications and Public Interest Statement, MB Docket No. 10-56, at 69 (Jan. 28, 2010), *available*

E. Franchise Fees

Although the Cable Act limits a franchise fee to "5 percent of . . . gross revenues derived . . . from the operation of the cable system to provide cable services," local governments and cable operators often disagree about how to define "gross revenues." For example, among other things, cable operators often refuse to include "launch fees"—payments from programmers to cable operators in exchange for the carriage of their programs—even though such fees are clearly derived from the cable system's provision of cable services. Local governments should continue to adopt a strong definition of "gross revenues," and ensure that the franchise agreement permits the local government to audit the cable operator's franchise fee calculations.

F. Other Community Networks

Some communities have successfully negotiated for non-traditional communications networks. For example, press reports indicate that the City of New York recently negotiated agreements with Time Warner Cable and Cablevision that require, among other things, the provision of free broadband access to low-income communities at public computing centers across the city; free commercial-grade Internet service to all public libraries; and Wi-Fi networks in City parks. Any such agreement, of course, would need to be carefully crafted to avoid the FCC's order on "non-cable related" franchise requirements.

G. Cellular Backhaul and Ethernet Services

Cable operators are increasingly using local property to provide services other than cable services. For example, cable operators are increasingly providing backhaul services for cellular phone companies.[36] For this reason, it is important to clarify that the *cable* franchise agreement only authorizes the provision of *cable* service. If the cable operator seeks to use local government property to provide Ethernet services or backhaul service for cellular phone companies, additional authorizations may often be required.[37] Indeed, in several cases that have found that the local government may not charge a fee on a cable operator's provision of

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at:
http://www.comcast.com/nbcutransaction/pdfs/Public%20Interest%20Statement%20-%20FINAL.pdf

[36] *See, e.g.*, C. Ziegler, *Time Warner Cable Offering Its Tubes To AT&T, Verizon,* Engagdet (Mar. 8, 2010), *available at*:
http://www.engadget.com/2010/03/08/time-warner-cable-offering-its-tubes-to-atandt-verizon/

[37] The scope of local authority over such services will turn on State law.

Internet service, the critical factors were franchise terms that were read to permit the provision of Internet service without further authorization.

H. Over-the-Top Service/Interactivity.

Another issue on the horizon arises from the growth in "over-the-top" video service—video services that are delivered to the home outside of the operator's control. Hulu Plus and Netflix online—both service which allow users to access video for a fee via the public Internet—are examples. Those services have traditionally not been treated as cable services, and have not been subject to franchise fees because the video provider does not have facilities in the rights-of-way. But what happens when the franchised cable operator begins to deliver services to computers and to mobile devices as part of the cable service subscription or for a supplementary fee? Is a franchise fee owed on all, part, or none of those revenues? Relatedly, at least one operator is claiming that revenues from DVR service are not subject to franchise fees. Local governments not only need to watch the language in the franchise but, as part of the renewal, a rigorous audit may be appropriate to ensure that local counsel is aware of any revenues that the operator is excluding from its franchise fee calculation.

III. CONCLUSION

Although the local cable franchising process has been the target of significant State and federal changes, local government attorneys should not be discouraged. The Cable Act remains an important tool for protecting local needs and interests. By staying current on recent developments, local government attorneys can fashion franchise agreements to protect their communities for many years into the future.

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