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MEMORANDUM

TO: Baller Herbst Clients and Other Interested Persons

FROM: Adrian Herbst

DATE: November 15, 2007

RE: Summary of the FCC Second Franchising Report and Order

I. FCC Franchising Order Applicable to Incumbents and Franchise Renewals

The following will be our summary of and comments to the Federal Communications Commission's Second Report and Order that was released just this month. The summary that follows includes in part some of my initial observations and comments. It is expected that during the upcoming months there will be a great amount of discussion about the rules, what they mean and the interpretation of varying provisions. Rules may be applicable in some states and not others. It is important that these rules be evaluated on a case by case basis in accordance with applicable state law.

On November 6, 2007, the Federal Communications Commission (FCC) released its Second Report and Order ("Order"). This Order is applicable to local Cable Franchises and incumbent operators. This Order "extends a number of the rules promulgated in its preceding Report and Order released March 2007 ("First Report and Order") that applied to new entrants and cable operators.

The First Report and Order of the Federal Communications Commission (FCC) stated that "We therefore expressly limit our findings and regulations in this *Order* to actions or inactions at the local level where a state has not specifically circumscribed the LFAs authority." Our interpretation of this Order is that it is an extension of the First Report and Order. Therefore this Order may not be applicable where state laws have been enacted governing local franchising authority. It is important to determine this by careful review of applicable state law.

This Order does not preempt existing franchise agreements. The FCC described existing franchises as “contractual obligations” and further “This *Order* should in not way be interpreted as giving incumbents a unilateral right to breach their existing contractual obligations.” Further, the Order states “we believe that the facts and circumstances of each situation must be assessed on a case-by-case basis under applicable law to determine whether our statutory interpretation should alter the incumbents’s existing franchise agreement.” The Order goes on to state “we believe that any contractual issues arising from today’s Order should be decided on a case-by-case basis.”

This summary is not meant to be a comprehensive review of the entire Order. It specifically does not include a discussion of the FCC’s findings which support its contention that the current local franchising process leads to an unreasonable refusal to award franchises to competitive new entrants. This summary also does not include discussion of the FCC’s conclusion that it possesses sufficient authority to issue rules and regulations with respect to franchising decisions at the local level.

As in the First Report and Order, this Order specifically addresses Section 621 of the federal Cable Act (“the Act”), which prohibits Local Franchising Authorities (“LFAs”) from unreasonably refusing to award competitive franchises for the provision of cable services.

The following is a brief overview summary of the findings of the Order applicable to incumbent providers and franchise renewals:

1. Time Limits

- The “Time Limit for Franchise Negotiation” described in the First Report and Order of 90 days for providers having existing authority to access rights-of-way and 180 days for others does not apply to incumbents and franchise renewal. The renewal process in Section 626 of the Act describes the process and timeline for franchise renewal negotiations and is not changed by the Order.

2. Build-Out

- The Order states that the “Build-Out” section of the First Report and Order does not apply to incumbents. The basis for the rule in the First Report and Order is to ensure a reasonable time for completion of construction as the Act provides. The FCC concluded that unreasonable build-out requirements can serve as a barrier to entry for new entrants and “incumbents by definition are not barred from entry.” Thus, the FCC does not apply any build-out standard to incumbents and franchise renewals.

3. Franchise Fees

- The Order finds that Section 622 (g)¹ should apply equally to both incumbents and new entrants. The relevant FCC findings that apply to incumbents include the following:
 - (1) A cable operator is not required to pay franchise fees on revenues from non-cable services under the terms of a cable franchise.
 - (2) The FCC stressed in the Order that local franchising requirements that include incidental costs should be limited to what is described, see paragraph (2)(D) in the footnote. The FCC identified other required charges or fees as part of the maximum 5% of gross revenues from the provision of cable services. These, the FCC stated, included attorney or consultant fees, application or processing fees that exceed the reasonable cost of processing the application, “acceptance fees, free or discounted services, and in-kind payments.”
 - (3) Payments for municipal projects requested by an LFA, but unrelated to the provision of cable services, will count toward the five percent (5%) franchise fee cap.
 - (4) Capital costs associated with building a PEG access facility are not included in the five percent (5%) cap, but costs associated with the support of a PEG access facility, such as salaries and training, are considered franchise fees and must be counted in the five percent (5%) cap.

¹ Section 622 (g) states,

“For the purposes of this section—

- (1) the term “franchise fee” includes any tax, fee, or assessment of any kind imposed by a franchising authority or other governmental entity on a cable operator or cable subscriber, or both, solely because of their status as such;
- (2) the term “franchise fee” does not include—
 - (A) any tax, fee, or assessment of general applicability (including any such tax, fee, or assessment imposed on both utilities and cable operators or their services but not including a tax, fee, or assessment which is unduly discriminatory against cable operators of cable subscribers);
 - (B) in the case of any franchise in effect on the date of the enactment of this title, payments which are required by the franchise to be made by the cable operator during the term of such franchise for, or in support of the use of, public, educational, or governmental access facilities;
 - (C) in the case of any franchise granted after such date of enactment, capital costs which are required by the franchise to be incurred by the cable operator for public, educational, or governmental access facilities;
 - (D) requirements or charges incidental to the awarding or enforcing of the franchise, including payments for bonds, security funds, letters of credit, insurance, indemnification, penalties, or liquidated damages; or
 - (E) any fee imposed under title 17, United States Code (h)(1) Nothing in this Act shall be construed to limit any authority of a franchising authority to impose a tax, fee, or other assessment of any kind on any person (other than a cable operator) with respect to cable service or other communications service provided by such person over a cable system for which charges are assessed to subscribers but not received by the cable operator.”

In summary, it will be exceedingly important to make clear in a franchise what is and is not part of the franchise fee 5% cap.

4. PEG/Institutional Networks

- The Order finds that some of the findings of the First Order should apply to incumbents such as:
 - (1) Capital Costs for facilities and equipment may be required in a franchise. However, payments may be required by a cable operator to be paid by subscribers. LFAs need to clearly outline in a franchise what capital costs apply to and document the use of such payments to ensure that a record will support the proper application of any required capital cost payments made to it by the cable operator.
 - (2) The non-capital costs of PEG requirements must be offset from the cable operator's franchise fee payments.
 - (3) It is not *per se* unreasonable for LFAs to require the payment of ongoing operation costs to support PEG "so long as such support costs as applicable are subject to the 5% franchise fee cap."
- The FCC concludes that it would not be *per se* unreasonable for an LFA to impose either more or less burdensome PEG carriage obligations or PEG Support on a new entrant than those imposed on an incumbent, such greater or lesser obligations imposed by an LFA may be reasonable under different circumstances and there is no statutory provision precluding such an approach.
- The Order includes a finding that incumbent operators may be required to comply with more stringent PEG requirements than a new entrant.

5. Mixed-Use Networks

- The FCC findings with regard to Mixed-Use Networks are clarified. The Order makes clear that a cable franchise only applies to cable services and not other services that may be offered by a cable operator.
- This Order as well as the First Report and Order does not specifically address whether video services provided using Internet Protocol are, or are not, cable services.

6. Timing

- As discussed above, the Order finds that franchise agreements involve contractual obligations and that the Order does not give incumbents a unilateral right to breach existing franchise agreements.

7. Most Favored Nation (MFN) Clauses

- The Order finds that the First Report and Order does not have any effect on MFN clauses in incumbent franchises. The FCC finds that generally most “MFN clauses allow franchisees to adjust their obligations if and when an LFA grants a competing provider any franchise provisions that are more favorable than the provisions in the incumbent’s existing franchise agreement.” Therefore the FCC found that “pursuant to the operation of their own design” MFN clauses will allow incumbents to change applicable sections of existing franchises.

8. Franchise Modification

- The Order finds that an incumbent may seek modification of its franchise when a new entrant enters its market under the process set forth in Section 625 of the Act. However, the FCC emphasized that it is the responsibility of the incumbent to make the required showing of commercial impracticability under that section.

9. Generally Accepted Accounting Principles (GAAP)

- In the Order the FCC declines to adopt a requirement that general accounting principles, GAAP, be used in determining an incumbent’s gross income for the purposes of franchise fee payments. The FCC concludes these are merely professional guidelines.

10. Fresh Look

- This Order declines to adopt a provision to “require that LFAs reconsider existing franchises when a new entrant enters the franchise area,” the so called “fresh look doctrine.” However, the FCC encourages cooperation and review between incumbents and LFAs.

11. Customer Service

- The FCC found in the Order that Section 632 of the Act “explicit language makes clear that Commission standards are a floor for customer service requirements, rather than a ceiling, and thus do not preclude LFAs from adopting stricter customer service standards.” Further, the Order finds that the FCC “cannot preempt local or state cable customer service requirements, nor can it prevent LFAs and cable operators from agreeing to more stringent standards.”
- The Order further finds that the FCC does not have the authority to require uniform data collection requirements in complying with local data reporting requirements.

II. The FCC Report and Order on Exclusive Service Contracts and Multiple Dwelling Units (MDUs)

As in the summary above, this summary will include my initial observations and comments and is in not intended to be a comprehensive review of the FCC’s Report and Order on Exclusive

Contracts for Provision of Video Services in Multiple Dwelling Units and Other Real Estate Developments, herein (“MDU Report and Order”). Specifically, this discussion does not include the findings on the FCC’s authority and jurisdiction, as set forth in section IV “Legal Authority,” to adopt the rules and regulations of the MDU Report and Order.

The FCC in this MDU Report and Order bans exclusive contracts for cable services in both existing contractual agreements and in new agreements. The Order applies to only cable operators and does not apply to Direct Broadcast Satellite providers or other Multichannel Video Programming Distributor (“MVPD”). The basis for this finding is that such clauses harm competition and broadband deployment. Further, the FCC found that the majority of providers with exclusivity contracts are incumbent cable operators.

The FCC finds that the defining attributes of MDUs are “voluntary long-term residency and significant control by the resident over uses of the private dwelling space.” This gives a resident a “strong interest in making his or her own choice of an MVPD.”

Such exclusive contracts impede competition and thus the benefits of competition such as “lower prices, more channels and a greater diversity of information and entertainment from more sources” as well as deny access to alternative providers and the “triple play” of communications services, all of which the FCC found harms MDU residents. Further, it found that exclusive contracts also may be deterring new entrants by putting a “significant number of new customers off limits.”

Based on the above findings, the FCC states that “no cable operator multichannel video programming distributor subject to section 628 of the Act shall enforce or execute any provision in a contract that grants it the exclusive right to provide any video programming service (alone or in combination with other services) to a MDC. Any such exclusivity clause shall be null and void.”

The MDU Report and Order includes a Further Notice of Proposed Rulemaking to “address exclusivity clauses entered into by DBS providers, Private Cable Operators (PCOs) and other MVPDs who are not subject to Section 628” as well as to seek comment “on the prohibition of exclusive marketing and bulk billing arrangements.”

Conclusion:

These Orders are to become effective thirty (30) days after they published in the Federal Register. Therefore, we expect the Orders to become effective before year end. Due to the significance of both Orders, there are likely to be questions and clarifications and we will therefore provide a further update in the near future. Additionally, we do not know if there will be a court challenge to either of the above Orders including whether or not the pending Sixth Circuit proceeding brought by a consortium of national municipal organizations will be amended to include the above Second Report and Order.

I will be pleased to answer questions or comments regarding any of the matters included in this update and further, upon request, will make available the full text of the First Report and Order, the Second Report and Order or the MDU Report and Order.

