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MEMORANDUM

TO: Baller Herbst Clients and Other Interested Persons

FROM: Adrian Herbst

DATE: March 13, 2007

RE: Summary of the FCC Franchising Report and Order

On March 5, 2007, the Federal Communications Commission (FCC) released its Report and Order (Order) on the cable franchising process at the local level. This Order is to become effective thirty (30) days after it is published in the Federal Register.

This summary is not meant to be a comprehensive review of the entire Order. It specifically does not include an extensive discussion of the record developed in response to the FCC's Local Franchising Notice of Proposed Rule Making (LFNPRN), upon which the FCC decided that the current local franchising process leads to an unreasonable refusal to award franchise to competitive new entrants. Nor does this summary include discussion of the Report's findings on the FCC's authority and jurisdiction to adopt the rules and regulations of the Order. Rather, this summary is intended to provide a practical overview of how the Order is likely to impact local franchising authorities (LFAs).[1]

The Order specifically deals with Section 621 (a)(1) of the Communications Act of 1934, which prohibits LFAs from unreasonably refusing to award competitive franchises for the provision of cable services. The FCC concluded in the Order that it possesses sufficient authority to issue rules and regulations with respect to franchising decisions at the local level. The Order states in Paragraph 137 that "we do not purport to identify every local requirement that this Order

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[1] Because the FCC Order will impact local franchising authorities in different ways, depending upon whether or not a state has established franchising rules and, in addition, whether or not the cable operator is a new applicant for a franchise or an existing cable service provider with an existing franchise agreement, it is not possible for this summary to provide advice on the impact to any particular local franchising authority. A local franchising authority's requirements and obligations based upon this Order must be determined on a case-by-case basis.

preempts … we merely find that local laws, regulations and agreements are preempted to the extent they conflict with this Order and the rules adopted herein."

The FCC also found that it does not have sufficient information regarding franchising decisions in which a state is directly or indirectly involved, either by issuing franchises at the state level or enacting laws governing specific aspects of the franchising process. Therefore, the Order only addresses decisions made by local franchising authorities (LFAs) and not state-level franchises that have recently been adopted or are likely to be adopted in the near future. Localities in states such as Hawaii, Connecticut, and Vermont, which franchise cable at the state level, are not likely to be directly affected by the Order. In addition, LFAs in states such as California, Indiana, Kansas, Michigan, North Carolina, New Jersey, South Carolina and Virginia, which recently have enacted statutes governing the franchising process, are generally not subject to the rules set forth in the Order.[2]

The following is a summary of the rules that preempt the local franchising process. Note that these rules do *not* apply to incumbent providers in franchise *renewals* – only to *new* competitive entrants:

1. Time Limits

- A deadline of ninety (90) days is imposed for an LFA to reach a final decision on an application for a new entrant that is already *authorized* to occupy the rights-of-way in the franchise area. The new entrant apparently need not already be *occupying* the rights of way.
- If a competitive applicant is not already authorized to occupy the rights-of-way in the franchise area, the time limit for the LFA to reach a final decision on the application is six (6) months.
- The time limit will begin to run from the date that the applicant first files the required application information and payment of a reasonable application fee, if applicable. Under new FCC Rule § 76.41(b), a competitive franchise applicant must include the following information in writing in its franchise application, in addition to any information currently required by applicable state and local laws:

  (1) the applicant's name;

  (2) the names of the applicant's officers and directors;

  (3) the business address of the applicant;

  (4) the name and contact information of a designated contact for the applicant;

  (5) a description of the geographic area that the applicant proposes to serve;

[2] Further, states with long-standing state-wide franchising requirements such as Minnesota and Massachusetts are not generally subject to the rules and regulations of this Order and, in addition, where long-standing requirements are addressed in part by state law, for example, "level playing field" in such states as Illinois, Iowa, and Florida are also not subject to the rules and regulations of this Order to the extent of such state rule.

(6) the PEG channel capacity and capital support proposed by the applicant;

(7) the term of the agreement proposed by the applicant;

(8) whether the applicant holds an existing authorization to access the public rights-of-way in the subject franchise service area as described under subsection (b)(5);

(9) the amount of the franchise fee the applicant offers to pay; and

(10) any additional information required by applicable state or local laws.

- If the LFA has requested certain information and is waiting for that information, the running of the time limit is tolled until that information is received.
- If the LFA does not act within the applicable timeframe, it is deemed to be acting unreasonably, and the franchise will be deemed to have been granted by the LFA on an interim basis.

2. Build-Out

- The Order states that "LFAs are prohibited from refusing to award a competitive franchise because the applicant will not agree to unreasonable build-out requirements." The Order provides examples of both "reasonable" and "unreasonable" build-out requirements but leaves much room for disagreements.
- The Order further notes that nothing in the Order is meant to encourage the practice of "redlining," but it does not discuss specific anti-redlining practices.

3. Franchise Fees

- The Order attempts to clarify the calculation of gross revenues from which the five percent (5%) franchise fee is derived. Among other points, the Order states that non-cable services, specifically Internet access services, including broadband data services, should not be included in gross-revenue calculations.
- Incidental fees are limited to those listed in Section 622(G)(2)(d) of the Communications Act, i.e., "payment for bonds, security funds, letters of credit, insurance, indemnification, penalties, or liquidated damages." Other non-incidental fees such as attorney or consultant fees, application or processing fees that exceed the reasonable cost of processing the application, must be counted towards toward the five percent (5%) franchise fee cap.
- 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.
- 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.

4. PEG/Institutional Networks

- An LFA cannot require a new competitive entrant to provide "more burdensome PEG carriage obligations than it has imposed on the incumbent cable operator," but an LFA is free to design PEG requirements that are not more burdensome than the incumbent's, and non-capital costs are included in the five percent (5%) fee cap.
- A pro rata cost-sharing approach for a new entrant is a reasonable approach to the requirement of providing PEG support.
- Completely duplicative PEG and I-Net requirements are unreasonable. An I-Net requirement is not duplicative if it would provide additional capability or functionality, and the FCC expects LFAs to ask competitive new entrants to provide financial support or equipment to supplement existing facilities rather than to construct new facilities.
- Requiring payment for an I-Net that will not actually be constructed is unreasonable.

5. Mixed-Use Networks

- An LFA has jurisdiction only over "cable services" provided over a "cable system" as these terms are defined in the Communications Act. As a result, the FCC concluded that an LFA may not require a separate cable franchise for an entity that solely seeks to upgrade non-cable facilities. The Order did not specifically address whether video services provided using Internet Protocol are, or are not, cable services.
- Additionally, the FCC said that an LFA may not use its franchising authority to regulate a new entrant's entire network beyond the provision of cable services.
- The FCC noted that "Section 602(7)(C) excludes from the definition of 'cable system' a facility of a common carrier that is used solely to provide interactive on-demand services," but it did not further address a LFAs' authority to regulate interactive on-demand services.

6. Preemption of Local Laws, Regulations and Requirements

- The Order states that it does not preempt state law or state-level franchising decisions. It only preempts local franchising laws, regulations and agreements that conflict with the rules and guidance of the Order and that are not specifically authorized by state law. Thus, if a state regulates certain aspects of cable franchises but not others, the non-regulated areas are subject to the FCC's Order. It is not clear how the Order will affect states that enact new cable franchising laws. On the one hand, one can read the Order as circumscribing any new state laws that would be inconsistent with the Order. On the other hand, one can read the Order as leaving states to enact new laws that override inconsistent provisions of the Order.
- One specific type of local requirement that the Order preempts are "level playing field" requirements that are inconsistent with the rules, guidance and findings adopted in the Order, as the FCC found that such requirements impede competitive entry by requiring a new entrant's franchise to have substantially the same terms as an incumbents. It is not entirely clear how the Order affects local requirements (effectuated through local ordinances) that interpret and give effect to state level playing field laws.

In a Further Notice of Proposed Rulemaking, the FCC sought comment on the following issues:

- Whether, as the FCC tentatively concludes, the Order should apply to cable operators that have existing franchise agreements as they negotiate renewals of those agreements;
- Whether, as the FCC tentatively concludes, the FCC has the authority to implement the above finding;
- What effect, if any, the findings in the Order may have on "most favored nation" clauses in existing agreements;
- Whether the FCC can preempt state or local customer service laws that exceed the FCC's standards or prevent LFAs and cable operators from agreeing to more stringent standards.

The FCC states that it will conclude this rulemaking and release an order no later than six (6) months after release of this Order.