Cable Franchise Renewal and Local Right of Way Management

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I. RENEWAL PROCESSES UNDER CABLE ACT II. PEG ACCESS ISSUES DURING CABLE FRANCHISE RENEWAL III. OTHER FACTORS TO BE CONSIDERED DURING RENEWAL Cable franchise renewal presents a challenge and opportunity for franchising authorities (usually cities) who seek to ensure that their communities will have modern systems capable of serving their future needs and interests. A well-conducted franchise renewal is necessary if a city is going to ensure that their needs and interests will be met. Many of the most important issues relate to public, educational and governmental ("PEG") channels, particularly the amount of capacity (channels, or bandwidth as the industry moves into a digital environment) and the requisite level of funding for such access to be meaningful in a functional sense. Franchising authorities that undertake the process in a well thought-out manner, that conduct the ascertainment process thoroughly, that pay attention to community needs and interests, and that *persevere* can achieve resulting cable service best suited to their needs and interests. Two renewals completed earlier this year that provide for capacity and support for PEG access at levels that should permit these channels to be successful and thrive are Monterey, California and Montgomery County, Maryland. The ability of video programming providers to provide service through Open Video Systems ("OVS") presents another challenge (and opportunity) for franchising authorities. Although OVS providers are not subject to the full range of franchising obligations, they *are* subject to PEG access obligations and responsible for the payment of franchise fee equivalents. The OVS Agreement between the City of New York and RCN Telecom Services of New York, Inc. has most of the significant provisions of a cable television franchise. In an order issued on June 30, which is now on appeal, the FCC sanctioned a potential new loophole in the ability of local governments to regulate cable providers by allowing a satellite master antenna television ("SMATV") provider serving multiple dwelling units through a common carrier's wires to escape local cable franchise obligations. The FCC's decision may open the way for other companies (including cable companies) to split off portions of what is now a regulated as a cable system to other companies in order to cease being cable operators subject to cable franchising.

I. RENEWAL PROCESSES UNDER CABLE ACT The procedures for renewing a cable franchise are governed primarily by federal law. *See* Section 626 of the Cable Communications Policy Act of 1984, 47 U.S.C. Â§ 546. Under that Act, a franchising authority can follow either, or both, of two processes available for franchise renewal: a formal and an informal renewal process. Generally, a cable operator will ask the city to begin formal proceedings at the same time it asks the city to begin to negotiate informally. If informal negotiations fall through, a city and cable operator can then proceed through the formal renewal process. The statutory and procedural standards for denial of renewal differ, depending on the procedure followed. While a franchising authority has great latitude in negotiating informally, a renewal request offered during formal proceedings can be denied only on one of four grounds established in the Act. The 1984 Act reflects Congress' notion that "a cable operator whose past performance and proposal for future performance meet the standards established by this section [will] be granted renewal," H.R. Rep. No. 98-934, at 7 (1984). Nonetheless, the Act does *not* guarantee the

operator renewal. A franchising authority which follows Cable Act procedures and develops an appropriate administrative record may deny renewal if the operator's service has been unsatisfactory in the past, or if the operator is unwilling (or unable) to promise to provide the services, facilities and equipment necessary to meet the future cable-related "needs and interests" of the community. Section 626, 47 U.S.C Â§546.

A. Informal Process. Section 626(h), 47 U.S.C. Â§546(h), provides that renewal can be requested by a cable operator at any time. The franchising authority may grant or deny a renewal request for any "legitimate reason" (consistent with state and local law) "after affording the public adequate notice and opportunity for comment." These procedures were included in the Cable Act to make it clear that a cable operator and a city could attempt to resolve franchise issues through informal negotiations.

B. Formal Process. Section 626(a)-(g), 47 U.S.C. Â§546(a)-(g), sets forth the "formal" renewal provisions of the Cable Act. Either the franchising authority (on its own initiative) or the cable operator (by submitting a written renewal notice to the city) can activate the process during the six-month period beginning three years before franchise expiration. If the operator does not submit a request to the city during this six-month window, the city is under no legal obligation to follow formal Cable Act procedures Â— unless the city has commenced a formal proceeding on its own initiative. In virtually all cases, operators ask cities to begin formal proceedings and at the same time also ask cities to negotiate informally. This "two-track" process is contemplated by the Cable Act. A city faced with such a request must establish procedures which allow it to proceed on both tracks in a manner consistent with federal law or risk finding itself in court. The procedures for formal or informal renewal proceedings should be devised so that the city is able to review the state of the current system, identify franchising goals, and develop strategies for achieving those goals. A city faced with a formal renewal request must take the following steps (even if the city is simultaneously negotiating with the cable operator informally):

- First, the city must begin a proceeding, no later than 6 months after a cable operator's renewal notice is submitted, to identify future cable-related community needs and interests and to review performance of the cable operator under the franchise. There is no specification of what constitutes the start of formal proceedings in federal law. Whenever proceedings are commenced, the public must be given notice and the opportunity to participate.
- Second, at any point following the completion of the public proceeding, the cable operator may submit a renewal proposal on its own initiative or in response to a request for renewal prepared by the city. The operator's renewal proposal "shall contain such material as the franchising authority may require." The franchising authority must provide "prompt public notice" that it has received the renewal proposal from the operator.
- Third, within four months of the submission of the cable operator's renewal proposal, the city must either (a) renew the franchise, or (b) issue a preliminary assessment that the franchise should not be renewed. In this four-month period, it is generally likely that a city and cable operator will attempt to resolve their differences to avoid an administrative hearing (which is the next required step).

- Fourth, if the city preliminarily decides the franchise should not be renewed, "at the request of the operator or on its [the city's] own initiative," the city is required to begin an administrative proceeding. The purpose of the proceeding is to consider whether:

    A. the cable operator has substantially complied with the material terms of the existing franchise and with applicable law;
    B. the quality of the operator's service has been reasonable in light of community needs;
    C. the operator has the requisite financial, legal and technical ability; and
    D. the operator's proposal is reasonable to meet the future cable-related community needs and interests, taking into account the cost of meeting such needs and interests.

- A city can deny a request for renewal if it makes a finding adverse to the cable operator with respect to any one of the four listed factors. However, a decision not to renew cannot be based on past defects in performance if (a) the operator was not given notice and an opportunity to cure the defects, or (b) if the city has waived its right to object or has acquiesced in past failures to perform by failing to object after receiving written notice from the operator of a "failure or inability to cure."
- The administrative proceeding must be conducted so that the cable operator has the opportunity to introduce evidence, require the production of evidence and question witnesses.
- At the close of the administrative proceeding, the city must issue a written decision granting or denying renewal based on the record developed in the administrative proceeding. This written decision may consider only those four statutory factors that can form a basis for denial of renewal.
- A cable operator can appeal a decision not to renew the franchise to federal or state court. The Cable Acts directs the reviewing court to grant "appropriate relief" if it finds (a) the franchising authority failed to comply with the procedural requirements of the Cable Acts (other than harmless error), or (b) the operator has demonstrated that the findings on which the franchising authority relied in denying renewal were "not supported by a preponderance of the evidence, based on the record" of the formal administrative proceedings. Section 626 (e), 47 U.S.C. Â§ 546(e). A cable operator may commence an appeal within 120 days after receiving notice of the city's decision. Section 635(a), 47 U.S.C Â§ 555(a).

C. Relationship of Formal and Informal Procedures. Informal and formal procedures can be followed simultaneously. As a result, operators trigger formal procedures 30 to 36 months prior to the expiration of the franchise, and also ask cities to negotiate informally. When this is done, a city must be careful to comply with the procedural requirements of the Cable Act, even if it appears that informal negotiations are going well.

D. Relationship of Cable Act Procedures to State and Local Laws Federal law preempts local and state law with which it is in conflict, but in the absence of any conflict, state and local laws control. For example, if local ordinances require a city to establish franchise renewal procedures by ordinance, or establish time limits in addition to those established by federal law, the city

may have to comply with those local or state requirements in addition to those required by the Cable Act.

E. Denial of Renewal. As explained above, renewal can be denied only if the franchising authority has (1) made an adverse finding with respect to one of the four factors listed above after an administrative hearing establishing evidence on the record, and (2) given the cable operator opportunity and an opportunity to cure the defects. Denial of renewal under the formal process is very rare because, in most cases, it is either difficult for a city to make the necessary showing or the city lacks the perseverance required to see the process all the way through. With respect to the first statutory factor (failure to comply with franchise terms or applicable law), minor or technical violations are not likely to be regarded as violations of "material terms" of the franchise. However, if the cable operator has failed over time to comply with franchise requirements, such as failure to provide facilities, equipment or services required by the franchise, such failure should be sufficient grounds for denial. As to the second factor, a city may consider the "quality of the operator's service, including signal quality, response to consumer complaints, and billing practices... in light of community needs." An adverse finding might result, for example, if reception has been poor, the cable operator has failed to respond quickly to customer complaints, or its billing practices have been deceptive. The third factor requires a showing that the cable operator lacks the financial, legal, or technical ability to provide the services or equipment set forth in its proposal. In *Rolla Cable System v. City of Rolla,* the court upheld the refusal of a city to renew a franchise for lack of technical competence. The city had established the following record: a consulting engineer hired by the city had established that the company's technical staff was not competent to run the system; the building inspector testified that some grounding work to bring the system in compliance with the 1987 National Electric Code was done improperly; and the city established that the cable operator proposed an untried and unreviewed system design. 761 F. Supp. at 1410. Finally, the franchising authority may deny renewal if the operator's proposal fails to meet the community's future cable-related needs and interests (for example, offering inadequate PEG capacity and capital support as established through the public proceedings conducted in the first stage of the formal renewal process). Although denials have rarely been made on this basis, a 1997 decision by the U.S. Court of Appeals for the Sixth Circuit is encouraging for cities. *Union CATV, Inc. v. City of Sturgis, Ky,* 107 F.3rd 434 (6th Cir. 1997). In that case, the City of Sturgis (population 2,184) had denied renewal of a cable franchise on the basis that the operator's proposal did not meet the community's future cable-related needs and interests as determined through public hearings. In upholding the City's denial, the court held that it would not second-guess the cable-related needs and interests determined by the franchising authority through the renewal process. Particularly significant was the court's determination that the "granting of a cable franchise is a legislative act traditionally entitled to considerable deference from the judiciary." 107 F.3rd at 441. The court noted that a city council's "knowledge of the community give it an institutional advantage in identifying the community's cable needs and interests." *Id* The court found that judicial review of "a municipality's identification of its cable-related needs and interests is very limited" and that a court should defer to the franchising authority's identification of the community's needs and interests except to the extent necessary to weigh the needs and interests against the cost of implementing them. *Id.* The standard of review the court found appropriate is to view the evidence in the light most favorable to the City, giving it the "benefit of all reasonable inferences," and only reverse if "reasonable minds could not come to a conclusion" other than that reached by the city. *Id.* Note that this standard

is far more lenient than the guidelines specified in the Cable Act with reference to procedural and evidentiary burdens a franchising authority is subject to. Thus the needs assessment's classification as a legislative, rather than administrative, act to some extent insulates properly obtained indications of community needs and interests (considering the costs thereof) from judicial review Â— relative to those procedures strictly circumscribed by the Cable Act. A case that bears watching is one unfolding in Brunswick, Ohio where the City of Brunswick (and Brunswick Hills Township) preliminarily denied renewal of a cable franchise based on findings that the cable operator (Cablevision of the Midwest, Inc.) had not substantially complied with material terms of the existing franchise and because Cablevision's renewal proposal fails to meet the community's future cable-related needs and interests, taking into account the cost thereof. Among the grounds for noncompliance were the failure to provide (1) a public access channel (Cablevision provides a combined public/local origination channel); (2) adequate equipment and facilities for PEG access; and (3) specified access and local origination ("l.o.") services and support. The City's and Township's findings regarding future needs and interests similarly related to Cablevision's failure to offer a separate public access channel (the proposal would provide two government, one educational and one combined public/l.o. channel, as at present), failure to offer adequate capital support for PEG, and failure to propose a satisfactory Institutional Network. Brunswick conducted a thorough needs assessment comprised of structured focus groups, written questionnaires and discussions with community leaders and government officials. Six days of hearings were held before an appointed hearing officer (a retired judge), at which Cablevision attempted to discredit the evidence upon which Brunswick relied. A decision by the hearing officer is expected in October, after the submission of briefs by the City and Township and by Cablevision.

F. Relationship of Renewal Procedures to Revocation Proceedings. In certain circumstances, it may be appropriate for a city to consider revoking an existing franchise rather than to even consider the terms of its renewal. Section 626(i), 47 U.S.C. Â§546(i), was added by the 1992 Cable Act to state explicitly that the initiation of renewal proceedings by a cable operator shall not negate "any lawful action to revoke a cable operator's franchise for cause." Where a cable operator has failed to provide adequate service or comply with the terms of its franchise, for example, a city might find it necessary to revoke such franchise before its expiration and operate the system itself or solicit another franchisee. There is relatively little experience with such proceedings, with federal law providing little guidance regarding the circumstances in which a franchising authority can revoke a franchise. Before taking such a drastic step, therefore, a municipality needs to consider the legal and fiscal implications. Where a city intends to institute eminent domain proceedings Â— even with the intent of thereafter divesting itself of the cable system to a new operator Â— an economic analysis should first be undertaken. A municipality may revoke, for cause, a franchise and then have the former cable operator begin negotiations for new terms, either as a monopoly or simultaneously with other, competing providers.

II. PEG ACCESS ISSUES DURING CABLE FRANCHISE RENEWAL

A. Availability of Access. The appropriate level of PEG access availability and financial support is frequently an issue at the time of franchise renewal (or initial franchising). The basic PEG provision is set forth in Section 611 of the Cable Act, 47 U.S.C. Â§ 531, which permits cities to establish requirements for the designation of channel capacity for PEG use. A city may require

as part of a franchise, or as part of a cable operator's proposal for renewal, that channel capacity be designated for PEG use, and may require rules and procedures for the use of such channel capacity. A city may enforce "any requirement in any franchise regarding the providing or use" of PEG channel capacity, including the authority to enforce franchise provisions for "services, facilities or equipment." *Id.* A cable operator may not exercise any editorial control over any PEG channel capacity, except as provided in Section 624(d), 47 U.S.C. Â§ 544(d), to the limited extent that a franchise permits the operator to deal with programming that is "obscene or ... otherwise unprotected by the Constitution of the United States". The 1992 Act did not amend Section 611. Two significant changes regarding PEG access availability were made by that Act, however: (1) a requirement that the basic tier of service subject to rate regulation include "[a]ny public, educational, and governmental access programming required by the franchise of the cable system to be provided to subscribers" (Section 623(b)(7)(A)(ii), 47 U.S.C. Â§ 543(b)(7)(A)(ii)); and (2) the addition of explicit language that "[i]n awarding a franchise, the franchising authority ... may require adequate assurance that the cable operator will provide adequate public, educational, and governmental access channel capacity, facilities, or financial support" (Section 621(a)(4), 47 U.S.C. Â§ 541(a)(4)). Thus, under the Cable Act, whether or not PEG access is required in a community is a decision to be made by the franchising authority. An open question exists, however, as to whether the availability of access (particularly public access) is constitutionally required; another open question is whether it is constitutionally permissible to require educational and/or governmental access without also providing for public access. A significant decision is *Missouri Knights of the Ku Klux Klan v. Kansas City, Mo.,* 723 F.Supp. 1347 (W.D. Mo. 1989), which held that a city could not constitutionally eliminate an existing public access channel and turn the channel over to the cable operator for local programming if the city's purpose of such action was to suppress unpopular points of view. As noted above, the Cable Act contemplates that, during the formal renewal process, proceedings will be held to identify future cable-related community needs and interests and that the relevant test for whether renewal should be granted or denied is whether "the operator's proposal is reasonable to meet the future cable-related community needs and interests, taking into account the cost of meeting such needs and interests." 47 U.S.C. Â§ 546(c)(1)(D)). The ascertainment process during renewal is therefore critical to establishing the appropriate level of PEG access in a community. Also relevant is the language added in 1992, 47 U.S.C. Â§ 641(a)(4), that a franchising authority may require "adequate assurance that the cable operator will provide adequate" PEG "channel capacity, facilities, or financial support..." The two references to "adequate" suggest a test that is similar, if not identical, to the "reasonable to meet future ... needs and interests" standard used in the renewal section.

B. Franchise Fee Limitation. The franchise fee limitation in Section 622, 47 U.S.C. Â§ 542, may pose the most significant barrier to requiring an adequate level of PEG access. That section limits franchise fees to a maximum of 5 percent of a cable operator's gross revenues from providing cable services. It excludes from the definition of franchise fee: (1)in the case of any franchise in effect on October 30, 1984, payments which the franchise requires the operator to make for, or in support of the use of, PEG facilities; and (2)in the case of franchises granted after October 30, 1984, capital costs which the franchise requires the operator to incur for PEG facilities. For franchises granted after October 30, 1984, cash payments, other than for capital costs, which the *franchise* requires the operator to make to support access must be treated as part of the franchise fee payment. A decision by a U.S. Magistrate Judge a year ago found that any payments made for PEG *equipment* are not payments for capital and are therefore

includable as franchise fees in calculating the 5 percent franchise fee cap. *Cable TV Fund 14-A, LTD. d/b/a/ Jones Intercable v. City of Naperville,* No. 96 C 5962 (N. Ill., July 25, 1997). This decision, which has occasionally been relied upon by other cable companies in claiming that capital costs are only those incurred for bricks and mortar, ignores the common meaning and understanding of capital costs. Some cable operators have argued that, for franchises issued after October 30, 1984, the cost of providing access services can be treated as a payment "in-kind" and deducted from the franchise fee payment owed. The Cable Act, however, does not state that the operator has the right to treat provision of services as in-kind payments. Based on legislative history, there is a strong argument that access service requirements do not get counted against the franchise fee. The House Report underlying the 1984 Cable Act states, with respect to Section 622, that that section "defines as a franchise fee only monetary payments made by the cable operator, and does not include as a 'fee' any franchise requirements for the provisions of services, facilities or equipment." *Id* at 65, adding "[i]n addition, any payments which a cable operator makes voluntarily relating to support of public, educational and governmental access and which are not required by the franchise would not be subject to the 5 percent franchise fee cap."

C.Effect of PEG Access on Subscriber Rates and Itemization of Bills. The 1992 Cable Act requirement that the FCC establish basic service tier rate regulations provided for such regulations to "include standards to identify costs attributable to satisfying franchise requirements to support public, educational, and governmental channels or the use of such channels or any other services required under the franchise." Section 623(b)(4), 47 U.S.C. Â§ 543(b)(4). The FCC adopted rules that provide that the costs attributable to satisfying franchise requirements shall include (47 CFR Â§ 76.925): the sum of: (1) all per channel costs for the number of channels used to meet franchise requirements for public, educational, and governmental channels; (2) any direct costs of meeting such franchise requirements; and (3) a reasonable allocation of general and administrative overhead. The FCC's determination of costs associated with meeting franchise requirements, including costs of PEG, is particularly significant because of language added by the 1992 Cable Act to Section 622(c), 47 U.S.C. Â§ 542(c), to provide that a cable operator may itemize, as a separate line item on subscribers bills:

(1) The amount of the total bill assessed as a franchise fee and the identity of the franchising authority to which the fee is paid.

(2) The amount of the total bill assessed to satisfy any requirements imposed on the cable operator by the franchise agreement to support public, educational, or governmental channels or the use of such channels.

(3) The amount of any other fee, tax, assessment, or charge of any kind imposed by any governmental authority on the transaction between the operator and the subscriber. In its Rulemaking Report and Order released May 3, 1993, in MM Docket No. 92-266, the FCC explained (Â¶546; n. omitted): [C]osts that are itemized include those that are direct and verifiable, as well as a reasonable allocation of overhead, and for PEG costs, the sum of the per-channel costs for the number of channels used to meet franchise requirements. Therefore, to the extent a franchising authority imposes special costs not of benefit to all subscribers in consideration of the award or renewal of a franchise, these may be included in an itemization as

either a franchise fee or PEG cost, as appropriate under the precedents. The determination of costs associated with PEG, as well as other costs of meeting franchise requirements, are also significant because they qualify as "external" costs under the FCC's benchmark rate regulation. That benchmark regulation provides for an FCC-established price cap formula under which requested increases may not exceed general inflation, except for increases in external costs that are beyond the cable operator's control. Cable operators are *required* to reflect any decreases in external costs at the time of any increase, to reflect decreases in the annual inflation adjustment, and to file revised rates to reflect decreases in external costs no later than one year from when such decreases occur. *See* First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, released Aug. 27, 1993 in MM Docket No. 92-266, Â¶123. Because costs related to PEG access requirements required by a franchise agreement are treated as external costs for rate-making purposes, a new dimension is added to franchise renewal. **Remember that external costs affect rates only to the extent that they are changed from the levels then in existence, starting with those in effect at the time rate regulation began. Thus, if no change is made in a renewal franchise in the amount of channel capacity provided or in the amount of support for PEG access, there should be no effect on rates.** On the other hand, if the amount of support for PEG access is reduced in a renewed franchise, there should be a **reduction** in rates. Indeed, if a cable operator makes payments or provides equipment or facilities to a third party (such as a non-profit access center) that are not required by the franchise, such costs would not be external costs and therefore should *not* affect rates.

D.Competitive Franchises and Level Playing Field Issues. The 1992 Cable Act contains provisions that encourage competitive franchises. Section 621(a)(1), 47 U.S.C. Â§ 541(a)(1), was amended to prohibit cities from granting exclusive franchises or from "unreasonably refus[ing] to award an additional competitive franchise." While municipalities thus are not allowed to protect an existing franchisee from competing franchise applications, a city may require adequate PEG assurances in awarding a competitive franchises (*see discussion supra at 3-5).* During the renewal process, municipalities are invariably faced with demands that they include "level playing field" language in a franchise. The level playing field is always a one-way provision that would reduce the obligations of the incumbent cable operator if there is any accommodation to a new video service provider, no matter what the justification for such accommodation may be, but never increase those obligations. PEG Access issues Â— capacity and funding Â— are often central to the discussion of "level playing field" provisions during renewal and present the uncomfortable possibility of a race-to-the-bottom as regards PEG terms.

III. OTHER FACTORS TO BE CONSIDERED DURING RENEWAL There are other factors to be considered during franchise renewal that should be addressed and dealt with in any franchise agreement.

A. Length of Franchise Term The length of the franchise term is often a significant issue in renewal negotiations. There is no explicit provision in federal law regarding the length of a franchise term. Until recently, cities have generally opted for shorter franchise terms in order to preserve opportunities to review the performance and facilities of the cable operator. However, as cable operators have been seeking other (for example telecommunications) opportunities, operators are at times reluctant to enter into lengthier franchises. For these reasons, a number

of franchising authorities have opted for a graduated franchise term of five years, for example, with the option to extend the franchise term if certain objectives are met. Another approach is a long-term franchise with reopener provisions.

B. Equipment Standards Section 624, 47 U.S.C. Â§ 544, permits the following to be included in a request for renewal proposals: "requirements for facilities and equipment, but...not...for video programming or other information services." It adds that a franchising authority may enforce requirements in the franchise "for facilities and equipment...[and] for broad categories of video programming or other services." However, Subsection (e), added in 1996, apparently reduced the ability of franchising authorities to regulate areas of technical standards, customer equipment, and system design. The amended section provides that "[n]o State or franchising authority may prohibit, condition, or restrict a cable system's use of any type of subscriber equipment or any transmission technology." 47 U.S.C. Â§ 544(e).

C. Consumer Protection and Customer Service Standards Section 632, 47 U.S.C. Â§552, which was added by the 1992 Cable Act, provides that franchising authorities may establish and enforce customer service requirements and construction schedules and other construction-related requirements. Pursuant to this section, the FCC has adopted minimum customer service standards which may be enforced by franchising authorities. 47 C.F.R Â§ 76.309. These standards are more detailed and comprehensive than those typically contained in franchises. If a city wishes to enforce the FCC standards, it must give the cable operator 90 days written notice (by certified mail) of its intention to enforce those standards. The kinds of matters covered by these standards are office hours and telephone availability; installation; outages and service calls; and communications, bills and refunds. Cities also have the right to impose standards that exceed the FCC minimum standards if they wish.

D. Competitive Franchises and/or Non-Cable Competitors The 1992 Cable Act added provisions that encourage competitive franchises by outlawing regulatory and industry barriers to entry Â— such as for example monopoly regulations and cable company practices disadvantaging consumers and new entrants. Section 621(a)(1), 47 U.S.C. Â§ 541(a)(1), prohibits cities from granting exclusive franchises or from "unreasonably refus[ing] to award an additional competitive franchise." *Id.* However, within the level-playing field constraints discussed above, a city may continue to require adequate PEG assurances in awarding competing franchises. In addition, it may require adequate assurances that the new cable operator has "the financial, technical, or legal qualifications to provide cable service" within an initial grace period to "allow the applicant's cable system a reasonable period of time to become capable of providing cable service to all households in the franchise area." Section 621(a)(4), 47U.S.C. Â§ 541(a)(4).

E. Open Video Systems The 1996 Act permits the creation of open video systems ("OVS"). OVS is essentially a video programming system operated by a local telephone company or others (perhaps including cable operators, according to the FCC), intended to replace the previous video dial tone scheme, which was implemented in only a very few places. With respect to local governments, the significant issue is that OVS operators are generally exempt from the Title VI (the cable title of the Communications Act) franchise and rate regulation requirements. However, certain restrictions apply to OVS operators. Local franchising authorities can still charge OVS operators the equivalent of franchise fees, and OVS operators are also required to provide channels and support for PEG access to the same extent as do franchised cable

operators. Until recently, few companies have elected to be certified as OVS operators, and it does not now appear that any traditional local telephone companies will elect the OVS option. For example, the telecommunications carrier Ameritech has obtained through a subsidiary, and is continuing to obtain, cable franchises instead of filing for OVS certification. On the other hand, RCN, which is likely to become a major player, has received OVS certifications to serve major metropolitan areas (often together with electric utilities). The FCC's OVS rules have been appealed by Dallas, Texas, the United States Conference of Mayors, the National Association of Telecommunications Officers and Advisors, the National Cable Television Association ("NCTA"), and BellSouth; those appeals are pending before the U.S. Court of Appeals for the 5th Circuit which heard arguments earlier this month (Nos. 96-6052 (and consolidated cases)). The municipal groups challenge the FCC orders on grounds that the FCC preemption of Title VI franchise requirements for OVS operators conflicts with the 1996 Act and the U.S. Constitution, that the Commission improperly preempted franchise authorities from being able to require OVS operators to construct institutional networks, that the FCC improperly limited the gross revenues to which a franchise fee can be applied by excluding gross revenues of unaffiliated OVS programming providers, and that the FCC erred in permitting entities other than local telephone companies to operate OVS systems. NCTA challenges the orders on grounds that the FCC erred by denying cable operators eligibility to be OVS operators in the absence of effective competition and by barring them from providing programming on competing open video systems. BellSouth challenges the provision of the rules that requires OVS operators to obtain FCC approval of their certifications before they begin any construction related to their open video systems.

F. A New Loophole Permitted by the FCC: A Company May Provide Cable Service to Customers and Not be a Cable Operator On June 30, the FCC issued a Memorandum Opinion and Order *In the Matter of Entertainment Connections, Inc.,* FCC No. 98-111 (June 30, 1998), finding that a satellite master antenna television ("SMATV") provider that serves multiple dwelling units through a common carrier's wires is not a "cable operator" even though it provides "cable service." The ruling opened the possibility that by disaggregating ownership rights in separate parts of what would otherwise be a cable system, a franchisee may no longer be a cable operator and regulated as such. The case drew considerable attention from local governments, community access organizations, cable operators and SMATV operators, who filed comments and met with FCC Commissioners and staff. The proceeding was unique because local governments and community access organizations (the Alliance for Community Media, the Alliance for Communications Democracy, and the Chicago Access Corporation) were on the same side of the case with cable companies opposing the attempt by SMATV companies to escape franchising. Those access organizations, a number of cities, and NCTA have filed appeals of the FCC's decision. *City of Chicago, et al. v. FCC,* 7th Cir. No. 98-2729 and consolidated cases ECI provides cable service to subscribers by using a tariffed video transport service provided by a common carrier ("Ameritech") without having constructed any of its own facilities in public rights-of-way, as found by the FCC (on facts that are disputed by some of those opposing ECI's request). The FCC concluded (in paragraph 61) "that ECI's facilities and Ameritech's facilities do not constitute a single, integrated cable system" and that "ECI is not a cable operator as defined by ... the Communications Act because it does not provide service to subscribers through a cable system." The FCC added an alternate basis for its conclusion Â— finding that ECI qualifies for the private cable exemption of the Communications Act. The FCC found (in paragraph 62) that the fact that "ECI's signal moves across public rights-of-way to

reach its subscribers does not by itself render ECI the operator of a cable system," and it stated that "[w]e cannot conclude that ECI's mere interaction with Ameritech's authorized facilities in the public right-of-way is the type of use to which Congress spoke in defining what constitutes a cable system." The opinion was decided by a 4 to 1 vote, with Commissioner Tristani issuing a forceful dissenting statement noting that the long-standing definition of a cable system has been functional rather than by ownership. Moreover, she noted that the policy concerns which have driven the PEG requirements were even more applicable in situations like ECI's, where that company will have even more editorial control than a traditional cable operator since it will have no leased access, must carry or PEG access obligations. Commissioner Tristani spoke to the policy considerations which argue against the majority's decision. She first noted that the decision "upsets the careful regulatory balance struck by Congress in the Communications Act," commenting that "even under the 'reduced regulatory burdens' of the open video system ... model," Congress imposed must-carry, PEG and franchise fee obligations. Next, she recognized the fact that the majority's decision deprives local governments of the ability to protect their communities by ensuring that their needs are met, "such as [by] requiring that all neighborhoods be served and that capacity for PEG access be provided." Finally she notes:

today's decision poses a substantial risk of unintended consequences. For instance, I see no legal basis for limiting the decision solely to entities that want to serve MDUs [multiple dwelling units]. If ECI's system is not a "cable system," it would not be a cable system whether it serves MDUs or single family homes. The next case before us could be an overbuild of an entire cable franchise area that would look exactly like a cable system in every respect Â— except that no Title VI obligations would apply. Moreover, the next case may not involve a small entity like ECI; telephone companies, incumbent cable operators and others have already expressed an interest in obtaining similar treatment if ECI's petition is granted. We should not underestimate the incentive that today's decision gives companies to artificially restructure their ownership arrangements to evade Title VI regulation. Unfortunately, by failing to articulate a clear legal or factual standard of review for future cases, the majority has done little to discourage such behavior.

G. Preemption of Franchising Authority Regulation of Telecommunications Services

The regulation of cable operators by local franchising authorities has also been limited in another respect. The Telecommunications Act of 1996 prohibits, in Section 253 (47 U.S.C. Â§253(a)), the imposition of any limits or restrictions on cable operators that would have the effect of preventing them from offering telecommunications services. Municipal regulations which run afoul of this paragraph may be pre-empted. While this law aims to set a functional standard seeking to prevent the erection of barriers to entry into the provisions of telecommunications services, it does not constitute a complete bar to municipal regulation of cable firms offering telecommunications services. It is important to recognize that the same cable entity will be subject to distinct and different provisions of the law as regards its cable, versus its telecommunications, activities. Municipal regulators are well advised to maintain these issues as separate as possible, avoiding, for example, requiring the provision of telecommunications services in order to obtain or renew a cable franchise. This separate regulation is also reflected in the fact that the Act changes prior law to provide that, in calculating a cable operator's revenues for purposes of a franchise fee, the revenues may extend only to those derived from the provision of cable service rather than all revenues derived from the operation of a cable system.

H. Removal of Prohibitions on Entry A touchstone of the Telecommunications Act of 1996 is the restriction on the ability of states or local governments to maintain requirements that bar "any entity" from entering the telecommunications business. 47 U.S.C. Â§ 253(a). The Act, states that: [n]o State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service. Even more specific to local governmental interests, the Conference Report accompanying the new law states that "explicit prohibitions on entry by a utility into telecommunications are preempted under this section." This section is concerned with two sorts of barriers: monopolies precluding any entry achieved legislatively or through economically prohibitive exactions, and comparative barriers created through discriminatory regulation of new entrants relative to (less-regulated) incumbents or other favored providers. For example, the FCC has determined that a city may not franchise one telephone company to provide local exchange service, while denying a franchise to another, similarly situated telephone company. *Classic Telephone, Inc.,* 11 F.C.C.R. 13.082 (1996). Section 253 permits the FCC (after notice and public comment) to override a state or local statute or ordinance which imposes a *prohibition* on entry. The FCC is not authorized to search out and eliminate offending ordinances; it may act only to review regulations and ordinances only when specific complaints are filed. Since there has been relatively little case law regarding the implementation of this section, the precise scope of local regulation is somewhat indeterminate. However, Section 253(c) explicitly recognizes the authority of state and local governments to manage their rights-of-way and to require "fair and reasonable compensation" for their use. Therefore, local governments appear to have retained their ability to apply use requirements, such as construction permits or conditions for approvals of transfer, and to collect (franchise) fees as compensation for use of municipal rights-of-way from any user (so long as these exactions are applied in a competitively neutral fashion). However, a number of state governments are considering Â— and in some cases enacting Â— legislation designed to eliminate the ability of municipalities to charge revenue-based franchise fees for the use of public rights-of-way. The issue of what constitutes "fair and reasonable compensation" for use of rights-of-way is, and will continue to be, the subject of considerable dispute and litigation. The cable industry, incumbent local exchange carriers ("ILECs"), competitive local exchange carriers ("CLECs"), and others asked the FCC to drastically limit municipal authority in a recent case involving the City of Troy, Michigan. In that case, TCI Cablevision of Oakland County, Michigan, asked the FCC to preempt a Troy telecommunications ordinance under Section 253 because the ordinance was being applied in a discriminatory fashion. TCI claimed that the ordinance would require TCI, as a condition of providing local phone service, to obtain a franchise from, and to pay a franchise fee to, the City. By contrast, TCI contended that the ILEC, Ameritech, was operating in Troy under a turn-of-the-century franchise that does not require payment of a franchise fee. TCI further argued that, under the 1996 Act, no *telecommunications* franchise could be required by the City of a cable operator (which already has a cable franchise). The FCC's ruling in *Troy* in large part denied TCI's request and left in place the City's Telecommunications Ordinance. *In the Matter of TCI Cablevision of Oakland County, Inc.*, FCC Docket No. CSR-4790, Memorandum Opinion and Order (September 19, 1997). The FCC failed to reach the issue, finding that because TCI had no current plans to provide local telephone service in Troy, a ruling on Section 253(a) would be an "advisory" opinion. The FCC declined to issue such an opinion. Having saved some of the substantive issues in *Troy* for a later case, the Commission nonetheless chose to, in paragraphs 102-106, "address generally some issues related to Section 253," stating (nn. omitted):

We are troubled by several aspects of the Troy Ordinance in the context of the effort to open local telecommunications markets to competition ... we are concerned that Troy and other local governments may be creating an unnecessary "third tier" of regulation that extends far beyond the statutorily protected interests in managing the public rights-of-way. 103. *** Local governments must be allowed to perform the range of vital tasks necessary to preserve the physical integrity of streets and highways, to control the orderly flow of vehicles and pedestrians, to manage gas, water, cable (both electric and cable television), and telephone facilities that crisscross the streets and public rights-of-way. *** These matters include coordination of construction schedules, determination of insurance, bonding and indemnity requirements, establishment and enforcement of building codes, and keeping track of the various systems using the rights-of-way to prevent interference between them.

A case recently decided by the U.S. District Court for the Eastern District of Michigan revisited the issue of competitively neutral municipal franchise charges for rights-of-way use. *TCG Detroit v. City of Dearborn,* No. 96-CV-74338-DT (E.D.Mich. Aug. 14, 1998). In *Troy,* the FCC avoided an expansive decision that would have broadly preempted municipal authority to require telecommunications franchises, to enact telecommunications ordinances, or to charge rental-based fees for use of public rights-of-way. *TCG Detroit,* however, is a significant victory for municipal authority on the franchise fee issue. In holding for the City, the court found the proposed franchise charges to be both "fair and reasonable" as well as competitively neutral in application, despite the presence of a non-franchised incumbent local telephone company. The *TCG Detroit* court reasoned that the franchise charges sought to be imposed were fair and reasonable because (1) "there is nothing inappropriate with the city charging compensation, or 'rent,' for the City owned property" and (2) other providers are paying comparable franchise fees and are operating telecommunications systems in Dearborn. Thus, it could not be argued either that such franchise fees rendered operating in Dearborn economically infeasible, nor could the terms be called unfair in that they were comparable to those required of TCG Detroit. Additionally, the court found significant that, in negotiations conducted prior to the enactment of Section 253, TCG Detroit had apparently negotiated nearly identical terms with the City, changing its stance only after passage of the 1996 Act. With respect to a claim brought by TCG that Dearborn's franchising requirements were not competitively neutral within the meaning of Section 253(c) so long as no less than identical treatment was applied to all telecommunications providers within the City, the Court examined the legislative history of the law and found the appropriate standard to be "comparable" regulatory treatment, recognizing that no two providers will be identically situated. With respect to the City of Dearborn's inability to impose its franchise fee upon the incumbent telephone operator Ameritech, which holds a state franchise pursuant to an 1883 law Â— and thus was found immune to municipal franchising Â— the court held that the City's suing to impose its fees upon that company satisfied the Section 253 requirement of competitive neutral imposition of franchise fees. Any attempt to reconcile the *Troy* and *TCG Detroit* cases is a somewhat speculative endeavor. The FCC is not bound to take notice of the *TCG Detroit* opinion, and indeed did not in an order issued on September 4, 1998, denying Troy's request for partial reconsideration of the September 1997 order. A cautious approach would suggest that the statutory mandate of Section 253 and a desire for administrative continuity may make the *Troy* dicta relevant to future municipal action in the telecommunication franchising arena.

* * * Where does this leave local governments? We believe that, except where there are state law limitations, local governments may properly require telecommunication carriers, other than

cable companies, to obtain franchises or other authorizations and may charge for the use of public rights-of-way in whatever reasonable way they consider appropriate, so long as such charges are competitively neutral and nondiscriminatory. Because of likely challenges, and the FCC's concerns quoted above, care needs to be taken by cities in crafting such requirements.

I. Level Playing Field and "Transition" Issues With the ongoing convergence of industries and players, the regulation of local telecommunication providers is a consideration of substantial importance to the issue of cable franchise terms and renewals. Some of the problems encountered in this ongoing transition will be of relevance to cable regulation. The policy behind the 1996 revisions of the Communications Act is to establish competitive neutrality among telecommunications providers in order to provide a framework for (as yet largely unrealized) competitive provision of telephone service. It remains undecided to what extent cable franchisees which may want to provide other telecommunications services must be permitted to offer service on terms equivalent to those to which the incumbents are subject Â— and by implication whether the terms of the cable franchise can be kept conceptually segregated from the competitive neutrality requirement of Section 253(c). The presence of incumbent telephone companies which are not municipally regulated is a widespread concern to which the FCC, in *Troy* or elsewhere, has not yet had occasion to respond definitively. The first signal from the FCC was not encouraging, however, and was woefully incomplete. The FCC stated in paragraph 108 of *Troy* (n. omitted):

One clear message from section 253 is that when a local government chooses to exercise its authority to manage the public rights-of-way or to require fair and reasonable compensation from telecommunications providers, it must do so on a competitively neutral and nondiscriminatory basis. Local requirements imposed only on the operations of new entrants and not on existing operations of incumbents are quite likely to be neither competitively neutral nor nondiscriminatory.

Normally, due process and other traditional requirements applicable to local governments require that similarly-situated carriers be treated in a similar manner. If two new entrants seek permission to operate in a city at the same time, and propose to provide the same service with the same burdens on the rights-of-way, there is no dispute that they are entitled to equivalent treatment. The problem, of course, is that carriers are rarely identically situated; they do not generally propose to provide the same services with the same community impacts. Carriers commence providing service at different times, provide different types of services, in different locales, with different demands for public property, and undertake service obligations under different state and local regulatory regimes. Indeed, because incumbents and new entrants are seldom similarly situated, there should be no presumption that identical treatment is either appropriate or "competitively neutral and non-discriminatory." Despite the FCC's language in paragraph 108 in *Troy* (quoted above), there is nothing in the 1996 Act requiring that arrangements with new providers mirror those entered into years earlier. The court in *TCG Detroit* noted that a provision that would have required identical treatment was amended before passage to allow for municipalities to account for differences between providers: [L]ocal Governments must be able to distinguish between different telecommunications providers." [141 Cong. Rec.] at H 8460 [(Aug. 4, 1995)]

*** *** [N]othing in the debate of the Stupak-Barton amendment, which became Section 253(c), indicates that it was intended to force local authorities to charge exactly the same fees

> and rates, and, in fact, it explicitly rejects that proposition. *** *** The Legislative history clearly allows the City to account for the differences between providers and it is enough that the City imposes (or plans to impose) comparable burdens.

TCG Detroit, at 18 and 19. Where, however, the incumbent local telephone companies are not amenable to municipal authority and therefore cannot be charged comparable franchise fees for rights-of-way usage, the *TCG Detroit* decision sensibly calls for the municipality to show a best effort to implement comparable treatment. Although the incumbent issue is a nationwide problem, it is affected by a host of differing local and state statutory and regulatory requirements which may determine the scope of municipal efforts to impose comparable treatment. However, the problem is solvable over the near-term, provided the FCC does not place cities in a strait jacket by adopting the restrictive approach advocated by TCI and others in the Troy case. Indeed, such a result could be counterproductive, as in many circumstances a requirement of parity of treatment that fails to recognize fact-specific differences. Surely Section 253 was not a statement of Congress' intent that the conditions of the past, in the form of old agreements entered into under vastly different statutory, regulatory and practical circumstances, were to set the playing field for the future. In light of these provisions, it is advisable for a city to consider enacting a comprehensive telecommunications ordinance that sets forth the way the city will manage (and be compensated for the use of) its rights-of-way. Such an ordinance should express the city's policy goals based on long-term planning regarding the community's future development and needs. The ordinance's structure needs to be adequate for dealing with all potential telecommunications providers, while recognizing differences among providers in an appropriate way, so that the city does not run afoul of the federal law seeking to achieve competitive neutrality.