

FCC Adopts Rules Prohibiting Local Franchising Authorities from Unreasonably Refusing to Award Competitive Cable System Franchises

On March 5, 2007, the Federal Communications Commission (“FCC” or “Commission”) released its Report and Order and Further Notice of Proposed Rulemaking in its *Video Franchising* proceeding (MB Docket No. 05-311).¹ In the Order, by a 3-2 vote (with the Democrats dissenting), the FCC assumed broad authority not only interpreting statutory limits on local authority under Title VI of the Act, but also creating a procedural mechanism whereby applications to local franchising authorities (“LFAs”) for competitive cable system franchises will be “deemed granted” in the event an LFA has not acted on the application within a set period of time. The Commission foresees that its decision will promote the twin federal goals of enhanced cable competition and accelerated broadband deployment.

The FCC Relies on its General Rulemaking Authority

In 1992, in order to promote more robust competition in the local video marketplace, Congress revised Section 621(a)(1) to provide “that a franchising authority may not grant an exclusive franchise and may not unreasonably refuse to award an additional competitive franchise”² (emphasis

added). Congress also provided that where an LFA *denied* an application for a competitive franchise, the applicant could seek review of that decision in federal court or a state court of general jurisdiction.³

Concerned that the local franchising processes may be resulting in barriers to competitive entry potentially requiring Commission intervention and possibly additional forms of relief, the FCC issued an NPRM in November 2005. A threshold issue was what authority the Commission had to issue regulations governing the local franchising process.

In the Order, the Commission relied on two sources of authority: (1) its general rulemaking authority under Section 201(b); and (2) Section 706 of the Telecommunications Act of 1996. The Commission found no specific direct support for its actions within Title VI itself. Citing *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366 (1999) which found that the authority granted in §201(b) gives the Commission general jurisdiction to issue rules carrying out the ‘provisions of this Act’ in the context of the local telecommunications competition provisions of Sections 251 and 252, the FCC extended this rea-

¹ In the Matter of the 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, MB Docket No. 05-311, FCC 06-180, Report and Order and Notice of Proposed Rulemaking, released March 5, 2007 (“Order”).

² 47 U.S.C. §541(a)(1).

³ 47 U.S.C. §555(a).

soning to Title VI of the Communications Act. In addition, the FCC looked to the goal of Section 706 to encourage advanced communications through, among other things, “regulating methods that remove barriers to infrastructure investment.” The Commission took particular note of the evidence in the record that new competitive franchisees were providing the “triple play” of voice, data, and video.

The Commission emphasized that the Order does not preempt state law or state level franchising decisions, but rather only local (municipal and county) requirements to the extent that those requirements conflict with the rules or guidance adopted in the Order and are not specifically authorized by state law. A number of states have recently adopted statutes providing for state-wide or streamlined franchising processes, and about a dozen more states are expected to consider similar bills in 2007.

The New FCC Rule “Deems Granted” Pending Applications for Competitive Franchises after Specified Time Periods

The FCC’s analysis and eventual regulatory action in this matter springs from its conclusion that Congress did not provide an explicit judicial remedy for *unreasonable refusals to award* competitive franchisees that do not include an actual denial, such as an LFA’s indefinite refusal to act on a pending franchise application where agreement on certain requirements cannot be reached with the applicant. The Commission found that an LFA’s failure to issue a decision on a competitive application within the time frames specified in the Order constitutes an unreasonable refusal to award a competitive franchise within the meaning of Section 621(a)(1). The FCC established a maximum

time frame of *90 days* for entities with existing authority to access public rights-of-way (e.g., ILECs and CLECs), and *6 months* for entities that do not have existing authority to access public rights-of-way. The deadline is calculated from the date that the applicant makes a filing that includes certain requisite information the FCC lays out in the Order, in addition to any applicable state or local requirements regarding the content of an application, and pays the requisite fee for a franchise application, as set forth in state or local requirements. Failure of the LFA to act within these time periods after these conditions are met constitutes an “unreasonable refusal to award a competitive franchise” under Section 621(a). In those circumstances, the LFA will be deemed to have granted the entity’s application on an interim basis. The interim franchise will remain in effect unless and until the LFA takes final action on the application, either approving the application or denying it. Notably, the Commission did not rule that an LFA’s failure to act on an application within the prescribed timeframes will constitute a “denial” of the license, which would trigger potential judicial review under Section 635. Judicial review would be available only after an actual denial by the LFA.

The FCC Adopts Limits on Local Franchising Authorities’ Ability to Impose Certain Requirements on Competitive Franchise Applicants

In order to mitigate the occurrence of unreasonable barriers to entry into the cable market and to encourage investment in broadband facilities, the FCC made the following additional findings:

- *An LFA’s refusal to grant a competitive franchise because of an applicant’s unwill-*

ingness to agree to specified build-out mandates can constitute an unreasonable refusal to award a competitive franchise. The Commission found that Congress did not intend to impose uniform build-out requirements on applicants. The Commission found that Section 621(a)(4), which states that LFAs “shall 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” is a limitation on LFAs’ authority, not a grant of such authority. Moreover, the so-called “anti-redlining” provisions of Section 621(a)(3) do not, the Commission emphasized, require complete wiring of the franchise areas, provided that the identity of areas not wired is not the result of selection based on the income of the residents in the unwired areas. (The Commission also underscored that LFAs retain full authority to enforce section 621(a)(3) and to ensure that their constituents are protected against discrimination.) The Order provides examples of seemingly unreasonable (“absent other factors”) build-out mandates, such as requiring a new competitive entrant to serve everyone in a franchise area before it has begun providing service to anyone, requiring a new entrant that is already in the rights-of-way (e.g., as a telecom carrier) to build out beyond its existing facilities before providing service, requiring build-out where the cable operator cannot obtain building or right-of-way access, or requiring more in the way of build-out from a new entrant than from an incumbent cable operator.

- ▶ *Unless certain specified costs, fees and other compensation required by LFAs are counted*

toward the statutory 5 percent cap on franchise fees, demanding them could result in an unreasonable refusal. Section 622(b) limits franchise fees to 5 percent of a cable operator’s gross revenues. The Commission clarified that:

- ▶ A competitive cable operator is not required to pay cable franchise fees based on revenues from services other than “cable services” as defined in Section 602(6) of the Act. Cable modem services are excluded, as are internet access services and broadband data services.
- ▶ Fees incidental to the application process, as defined under Section 622(g)(2)(D), include only those set forth in that section (bond payments, security funds, letters of credit, insurance, indemnification, penalties or liquidated damages) and certain minor charges. Incidental fees do not include attorney fees, consultant fees, or processing or application fees that exceed the LFA’s reasonable costs, free or discounted services provided to the LFA, in-kind payments unrelated to the provision of cable services (such as contributions toward a scholarship fund or traffic light control systems), and requirements to lease or purchase equipment at above market values. These non-incidental fees do count toward the 5 percent cap.
- ▶ Contributions from competitive franchisees in support of public, educational and governmental (“PEG”) services and equipment, if collected only for the capital cost of building PEG facilities, are not subject to the cap. On the other

hand, payments made in support of the use of PEG access facilities (e.g., salaries and training) are subject to the cap.

- ▶ ***A denial of an application based on a potential new entrant's refusal to undertake certain obligations relating to PEG channels and institutional networks ("I-Nets") can be an unreasonable refusal to award a competitive franchise.*** The Commission rejected calls for standard terms for PEG channels, clarifying that LFAs can adopt their own requirements provided that non-capital costs of such requirements count toward the 5 percent franchise fee cap. The FCC also concluded it is unreasonable for an LFA to impose on a new entrant more burdensome PEG obligations than those binding the incumbent operator. Additionally, the Commission determined that, except in special situations (e.g., redundancy for public safety), duplicative PEG and I-Net requirements would be unreasonable. The FCC found that interconnection with existing PEG facilities by new entrants and a sharing of costs *pro rata* would be a *per se* reasonable means of requiring a competitive entrant to support PEG channels.⁴ But if interconnection with the incumbent's PEG facilities and feeds is not possible, then it would not be unreasonable, the FCC found, for the LFA to require the new entrant to construct comparable facilities. At the same time, the Commission clarified that I-Net requirements that "provide additional capability

or functionality, beyond that provided by existing first I-Net facilities" are *not* duplicative. The Commission stated that it "expected" LFAs to first determine if such added functionality or capability could be achieved by having the new entrant supplement the existing I-Net facilities, rather than construct new ones.

- ▶ ***It is unreasonable for an LFA to refuse to grant a franchise based on issues related to non-cable service or facilities.*** The Commission clarified that an LFA's jurisdiction applies only to the provision of cable services over cable systems, even on so-called "mixed-use networks." Thus, for example, a LEC without a cable franchise may perform a network upgrade that will also facilitate the future provision of cable services if there is a non-cable purpose associated with the upgrade. The LFA may insist on the cable license in such situations only once the LEC proposes to offer cable services. The Commission emphasized that local regulations seeking to regulate non-cable service provided by video providers are preempted as beyond the scope of the LFA's authority.
- ▶ ***Common carrier facilities used solely to provide "interactive on-demand services" are excluded from the definition of "cable system."*** The FCC noted that video programming that is prescheduled is not, by definition, "interactive on-demand service." The Commission declined to address

⁴ Indeed, the Commission stated explicitly that if the new entrant is willing to pay *pro rata* costs, then the PEG programmer must, if feasible, allow interconnection with the new entrant paying the interconnection costs. *Pro rata* contributions would be based upon average subscriber fees and the size of the subscriber base of the sharing cable operators.

what particular services may fall within the definition of “cable services” – for example, video services that use Internet protocol – deferring that to the *IP-Enabled Services* proceeding.

The Commission’s New Rules Have Preemptive Effect

The Commission preempted local laws, regulations, practices and requirements (but not those found in existing competitive or incumbent franchise agreements) that conflict with the “rules” and “guidance” adopted in the Order, except where the local laws, regulations, practices and requirements are specifically authorized by state law. The Commission noted that as long as it acts within the scope of its jurisdiction to adopt rules implementing Title VI, its rules have preemptive effect, sweeping aside concerns of some parties that it does not have jurisdiction to preempt local franchising authority decisions, as well as some parties’ constitutional arguments. The Commission noted that, while finding that its rules have preemptive effect, it did not purport to identify specific local requirements that are preempted. Thus, while the Commission found specifically that so-called “level playing field” requirements adopted by LFAs may be unreasonable, it limited its finding of unreasonableness to level playing field requirements that are inconsistent with other “rules, guidance, and findings” in the Order.

The Further Notice of Proposed Rulemaking

The FCC limited the scope of the Order to applications for competitive franchises under Section 621(a)(1). The Order does not alter

the relationship between incumbent and other existing cable operators and LFAs. However, the FCC proposed, in a further notice, that some of the decisions in the Order would seem to be applicable to existing franchises and tentatively concluded that the Order’s findings should apply to existing cable operators as they negotiate renewal of their franchise agreements with LFAs. The Commission also seeks comment on its authority to implement this conclusion and what effect, if any, the findings have on most favored nation clauses that may be included in existing franchises. Additionally, the FCC seeks comment on its tentative conclusion that it cannot preempt state or local customer service laws that exceed Commission standards, nor can it prevent LFAs and cable operators from agreeing to more stringent standards. The Commission intends to conclude the further rulemaking and release an order on the further notice no later than six (6) months after release of the Order.

Comments are due **30 days** after the date of publication in the Federal Register; Reply Comments are due **45 days** after the date of publication in the Federal Register.

An Appeal of the Order Is Virtually Assured

This proceeding was hotly contested, with LFAs and incumbent cable operators lining up against any sort of action by the Commission. There is little doubt that this constituency will seek judicial review of the Order, and possibly even a stay. As noted, both Democrats dissented. Commissioner Jonathan Adelstein gave a particularly vigorous dissenting statement predicting that the

courts will likely reverse the Order as legislation disguised as regulation. Among other faults found with the Order, the Commissioner's principal complaint is over the Commission's jurisdiction. He stated that the franchising process laid out in the Act is inherently local, with state and local authorities having primary responsibility for the administration of the franchising process.

Petitions for reconsideration of the Order are due 30 days after publication in the Federal Register. Petitions for judicial review are due 60 days after publication in the Federal Register. As of the date of this advisory, the item has not yet been published.

For more information or if you would like a copy of the Order, please contact:

Chip Yorkgitis

(202) 342-8540

cyorkgitis@kelleydrye.com

Thomas W. Cohen

(202) 342-8518

tcohen@kelleydrye.com