

## **BACKGROUND**

Section 621(a)(1) of the Cable Act prohibits LFAs from unreasonably refusing to deny an application for a competitive franchise. Although Section 621(a)(1) expressly provides that any applicant who is denied a competing franchise may challenge the reasonableness of that action in federal court, the FCC found that this delegation of authority to the judiciary does not prevent the FCC from adopting its own rules interpreting and implementing Section 621(a)(1). The agency cited, as the source of its authority, its general statutory power to administer the Communications Act and to prescribe such rules as necessary to carry out the Act's provisions.

The FCC also pointed to Section 706 of the 1996 Telecommunications Act as an independent source of authority. Section 706 directs the FCC to encourage broadband deployment through the adoption of measures designed to promote competition and remove barriers to infrastructure investment. According to the FCC, actions by LFAs that slow or impede the grant of competing franchises conflict with federal goals of enhanced cable competition and rapid broadband deployment.

As noted above, the *Order* contains a key limitation: it applies only to the actions and practices of municipal (*e.g.*, city, county, town, etc.) authorities and only where those actions or practices are not taken pursuant to specific state law. In other words, the new rules do not supersede or otherwise apply to any existing or new laws providing for statewide franchising or for franchising at the local level pursuant to specific requirements imposed at the state level. The FCC reserved the right to consider extending its rules to state-level franchising decisions at some future date, but concluded that the factual record in the proceeding was not sufficient to support application of the rules beyond the municipal level at this time.

## **DISCUSSION**

### **I. LIMITATIONS ON THE AWARD OF COMPETING FRANCHISES**

#### **A. Time Limits for Consideration of Competing Franchise Application**

*Deadline for action on application for competing franchise:* The FCC found that LFAs do not always act on competing franchise applications in a timely fashion, frustrating the development of competition. The agency established the following maximum time frames for LFAs to render a decision on a competing franchise application:

For entities with existing authority to access public rights-of-way: **90 days.**

For entities that do not have existing right-of-way authority: **6 months.**

*Starting date for applying time limit:* The period within which an LFA must act on an application for a competing franchise will begin to run when the LFA receives an application

containing certain minimum information, as well as any other information specified by state or local law. The minimum information that must be provided includes: the applicant's name and the names of the applicant's officers and directors, the applicant's business address and the name and contact information for a contact person, a description of the geographic area that the applicant proposes to serve, the applicant's proposed PEG channel capacity and capital support, the length of the franchise term requested, a statement as to whether the applicant holds an existing authorization to access the public rights-of-way within the franchise area, and the amount of the franchise fee the applicant agrees to pay. Failure to provide the requested information or to respond to a request for information from the LFA will toll the application approval time period. If an applicant voluntarily engages in pre-application negotiations, the time period does not begin to run until the application is filed; moreover, the LFA may not compel the applicant to engage in pre-filing negotiations.

*Remedy for failure to act within the applicable time period.* One of the more controversial elements of the *Order* is the "remedy" adopted for situations in which an LFA fails to grant or deny a competing franchise application within the time periods specified by the FCC. Under the rules adopted by the FCC, if an LFA fails to grant or deny a franchise application within the time period specified by the FCC, the competing application is deemed to be granted on an "interim" basis and the applicant may immediately begin providing service. If the LFA and applicant eventually agree to the terms of a franchise, this new franchise replaces the interim grant based on the application; if the LFA affirmatively denies the application after it becomes effective on an interim basis, the applicant can file a lawsuit in federal district court alleging that the LFA has unreasonably denied its franchise. It appears (but is not completely clear) that the FCC intends for the interim franchise to remain in effect pending a decision as to whether the denial was (apart from its lack of timeliness) unreasonable.

## **B. Limitations on Build-out Requirements**

The *Order* finds that the imposition of certain build-out requirements on new entrants can serve as an impediment to the development of competition. Specifically, the FCC has deemed the following build-out mandates as unreasonable:

- Requiring a new entrant to be able to serve everyone in a franchise area before it can serve anyone;
- Requiring a competing new entrant with existing facilities to build out its plant beyond its existing footprint before providing new service;
- Imposing more burdensome build-out obligations on a new entrant than those applicable to the incumbent operator (*e.g.*, shorter build out deadlines; lower density thresholds).
- Requiring the new entrant to build-out and serve buildings or developments to which access cannot be obtained on reasonable terms; and

- Requiring the new entrant to build out certain areas that cannot be reached using standard technical solutions.

The FCC did acknowledge that it is reasonable for an LFA to consider a new entrant's market penetration in establishing a build-out schedule and to set benchmarks requiring the new entrant to increase its build-out after a reasonable period of time had passed and taking into account its market success. The FCC also distinguished build-out requirements from redlining based on income level, reaffirming that LFAs can enforce the prohibition on redlining. However, the agency elected not to define more specifically what constitutes redlining.

### **C. Franchise Fee Provisions**

The FCC found that certain LFA demands for certain payments by new entrants were inconsistent with the Cable Act's franchise fee rules and thus constituted an unreasonable basis for refusing to grant a competing franchise. In particular, the *Order* clarifies that the revenue base for calculating an operator's permitted 5% franchise fee payment is limited to revenues from cable services. Thus, a cable operator is not required to pay franchise fees on revenues from Internet access service or other non-cable services. The *Order* also clarifies that while certain charges that are "incidental" to the awarding or enforcing of a franchise (such as payments for bonds, security funds, letters of credit, insurance, liquidated damages, etc.) are exempt from the franchise fee limitation, this exemption does not cover processing fees, consultant fees, and attorney fees. The FCC also indicated that application or processing fees that exceed the reasonable cost of processing the application and requirements of free or discounted service also are "non-incidental" and must be counted against the 5% limit.

Other franchise fee-related issues addressed by the FCC include the status of certain "in-kind" payment requirements and payments in support PEG services and equipment. The *Order* states that any requests for in-kind payments that are unrelated to the provision of cable services – such as requirements for payments for municipal projects such as library construction or recreation centers – are subject to the statutory 5% franchise fee cap. Also, LFA-mandated contributions in support of PEG services and equipment are exempt from the 5% limit only if the payments are for PEG capital costs – costs incurred in or associated with the construction of PEG facilities (as distinct from payments in support of the use of PEG facilities, such as payments relating to salaries and training).

### **D. PEG and I-Net Requirements**

Citing Section 621(a)(4) of the Cable Act, which provides that LFAs may require "adequate assurance" that a cable operator will provide "adequate" PEG capacity, facilities and financial support, the FCC ruled that it has the authority to define what is "adequate" in this context and to prohibit LFAs from imposing PEG obligations that go beyond what is "satisfactory or sufficient." For example, the FCC specified that it is unreasonable for an LFA to

impose on a new entrant more burdensome PEG obligations than those imposed on the incumbent. The FCC also deemed unreasonable PEG and I-Net obligations that would require the new entrant to duplicate facilities constructed by the incumbent. While acknowledging that a certain level of I-Net redundancy may provide additional capability or functionality (thereby providing a public benefit), the FCC indicated that the LFA should consider whether such additional functionality can be achieved by requiring the new entrant to supplement existing facilities with financial support rather than by requiring the construction of new facilities.

Of particular interest to incumbent operators is the fact that the FCC found that it not only is unreasonable for an LFA to require a new entrant to provide PEG support in excess of the incumbent's obligations, but also that an interconnection and *pro rata* cost sharing approach is a reasonable means for a new entrant to meet its obligation to provide adequate PEG facilities.

#### **E. Regulation of "Mixed Use" Networks**

The *Order* clarifies that, to the extent an applicant for a cable franchise provides non-cable services and/or operates non-cable facilities (*e.g.*, Internet services, telephony, etc.), it is unreasonable for an LFA to demand that the applicant subject its non-cable services to local regulation as a condition for obtaining a franchise. For example, the FCC deemed it unreasonable for an LFA to require an entity that already has authority to access the public rights of way (such as an incumbent local exchange carrier) to obtain a video franchise for the purpose of upgrading its network unless and until that entity actually is proposing to offer cable services over the upgraded network. Thus, if a LEC seeks to upgrade its plant with fiber cable that is capable of providing both cable and non-cable services, the deployment of the fiber does not alone trigger the obligation to obtain a cable franchise. An LFA also may not demand that a LEC obtain a franchise before it installs curbside boxes that house the infrastructure to be used for cable and non-cable services.

Similarly, the *Order* finds that it is unreasonable for LFAs to attempt to use their authority to grant cable franchises to regulate any non-cable services offered by video providers. Thus, LFAs may not claim authority to impose customer service regulation on the operator's entire network or on non-cable services. The FCC also confirmed that a facility that provides only "interactive on-demand services" is not a cable system subject to cable franchising; however, the FCC declined to address whether particular services (such as ATT's "U-Verse" service) constitute "interactive on-demand services" or whether video services transmitted using Internet Protocol are "cable services."

## **II. LOCAL LEVEL PLAYING FIELD PROVISIONS AND PREEMPTION**

According to the FCC, locally-adopted regulations that require a competing franchise applicant to comply with substantially the same franchise terms imposed on incumbent cable operators (*i.e.*, "level playing field provisions") are unreasonable. In addition, the *Order* states that any other local laws and regulations that conflict with the FCC's interpretation of Section

621(a)(1) also are preempted. These would include local laws that authorize an LFA to exceed the specified time limits for granting or denying a competing franchise application or that allow an LFA to impose unreasonable build-out requirements, collect excessive franchise fees, or impose unreasonable PEG/I-Net obligations.

This aspect of the *Order* is not without some ambiguity. For example, it would appear that notwithstanding the *Order*, a franchising authority can enforce build-out, PEG and I-Net requirements that would otherwise be preempted if the competing applicant voluntarily agrees to be bound by those requirements. On the other hand, the 5% limit on franchise fee payments arguably is not subject to waiver and thus even voluntary agreements to make payments in excess of those limits are not enforceable. Also, the FCC's statements exempting state-mandated requirements from the restrictions adopted in the *Order* would appear to suggest that level playing field provisions adopted by state legislatures are not preempted. Finally, the *Order* does not expressly set forth any procedures for the filing or resolution of complaints alleging that an LFA is seeking to impose unreasonable terms on an applicant for a competing franchise.

### **III. FURTHER RULEMAKING (INCUMBENT OPERATORS)**

The limitations on the franchise process and the imposition of specific franchise terms adopted by the FCC are expressly limited to "competing" franchise applicants and do not apply to incumbent cable operators. However, the FCC recognized that some of its findings are relevant to incumbents as well as new entrants. Thus, the FCC has issued a *Further Notice* which tentatively concludes that the findings in the *Order* should apply to incumbent operators in their negotiations for franchise renewals. The *Further Notice* requests comment on this tentative determination and on the issue of whether the FCC has the authority to address the terms of franchise renewals. The *Further Notice* also requests comment on the effect, if any, its rulings regarding competing franchises will have on incumbents who have "most favored nation" clauses in their franchises. Finally, the *Further Notice* seeks comment on the FCC's tentative conclusion that the Cable Act gives broad authority over customer service regulation and that the FCC can neither preempt customer service requirements that exceed the FCC's standards nor prevent LFAs and cable operators from agreeing to more stringent standards.

The FCC stated that it intends to complete action on the *Further Notice* and release a decision addressing incumbent operator franchise issues within six months. Comments in response to the *Further Notice* will be due 30 days from the publication of the *Further Notice* in the Federal Register; reply comments will be due 15 days after the initial comment deadline.

#### **IV. EFFECTIVE DATE**

The rules and guidelines contained in the *Order* will become effective 30 days after the *Order* is published in the Federal Register. It should be noted that petitions for reconsideration and/or judicial challenges to the *Order* are considered likely. The *Order* was adopted by a narrow 3-2 vote, with Commissioners Capps and Adelstein dissenting. (Commissioner Adelstein in particular argued that the FCC lacked the authority to intrude so deeply into the local franchising process and predicted that the *Order* would be struck down by the courts). Local LFAs and organizations representing LFAs may seek a stay of the rules pending appeal. NCTA has not yet indicated what action it intends to take in response to the adoption of the *Order*.

We would be pleased to respond to any questions regarding this matter.

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