



December 1, 2008

MEMORANDUM TO CLIENTS

Re: Illinois Supreme Court Holds that Federal Law Preempts Payment of Franchise Fee on Cable Modem Services

The Illinois Supreme Court, reversing a state appellate court decision issued last year, has held that federal law preempts franchise requirements requiring the payment of franchise fees on revenues received for the provision of cable modem service. This decision is consistent with several earlier federal court decisions in other jurisdictions reaching the same conclusion.

Background. In March 2002, the FCC ruled that cable modem service was an “information service” not a “cable service” and stated that revenue from cable modem service would not be included in the calculation of gross revenues from which the franchise fee cap is determined. Based on that ruling, Comcast and other providers of cable service in the City of Chicago excluded cable modem service revenues from the base on which they calculated their franchise fee payments to the City, prompting the City to seek relief in state court. The case initially was removed from state court to a federal district court, which dismissed the City’s complaint on the grounds that the disputed franchise fee payment was preempted by the Communications Act and by the Internet Tax Freedom Act. A federal appellate court vacated that decision on jurisdictional grounds and returned the case to the state courts. The trial court at the state level came to the same conclusion as the federal district court, dismissing the City’s complaint on preemption grounds. However, the City appealed and, in August of last year, the Illinois Court of Appeals reversed the trial court, rejecting Comcast’s preemption arguments. Comcast then sought review from the Illinois Supreme Court.

Discussion. The state Supreme Court began by reviewing the history of the federal government’s regulation of local franchise fees, starting with the FCC’s adoption of a 5% cap on such fees in the 1970s. In 1984, Congress codified this cap in Section 622 of the Communications Act (47 U.S.C. § 542), providing that the fees paid by a cable operator in a 12-month period shall not exceed 5% of the operators “gross revenues derived in such period from the operation of the cable system.” In 1996, Congress revised Section 542, adding language that limited the collection of franchise fees to 5% of the operator’s gross revenues derived “from the operation of the cable system to provide cable services.” The Court found that this amendment reflected Congress’ intent to limit the scope of the revenues that could be used in calculating the allowable franchise fee.

The Court then turned to the disputed franchise provisions, which it found expressly called for the inclusion of revenues from cable modem service in the annual gross revenues used to calculate franchise fee payments. The Court found that these provisions were in direct conflict with Section 542’s restriction on franchise fees to 5% of revenues from “cable service” revenues

and the FCC's 1992 determination that cable modem service revenues were not to be included in the franchise fee calculation.

In reaching this conclusion, the Court not only cited several similar rulings by federal district courts in other jurisdictions, it also specifically rejected the arguments to the contrary presented by the City (and adopted by the court below). For example, the City claimed that a "franchise fee" was a fee imposed "solely because" an operator provides cable services and thus fees derived from cable modem service revenues are not franchise fees and not subject to the 5% cap. The Court held that this argument was based on a misstatement of the law and that Section 542 applies to fees imposed on cable operators because of their status as such, not merely to fees arising from the provision of cable services. The Court also rejected the City's contention that Section 621 of the Communications Act (47 U.S.C. § 541) contains a "savings clause" that preserves the authority of states to regulate a cable operator to the extent the operator provides a "communications service." Citing the FCC, the Court found that this provision was inapplicable because cable modem service is an "information service" not a "communications service." Finally, the Court rejected the City's contention that it had independent "home rule" authority to impose a fee on cable modem service revenues. The Court found that nothing in the franchise or governing state ordinance gave the City the authority to do more than impose a single "franchise fee" in accordance with the provisions of Section 542 of the Communications Act.

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

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