

VATO A

Virginia Association of  
Telecommunications Officers and Advisors



# *Franchising in the Era of CST and the Third FCC Section 621 Order*

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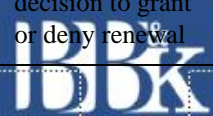
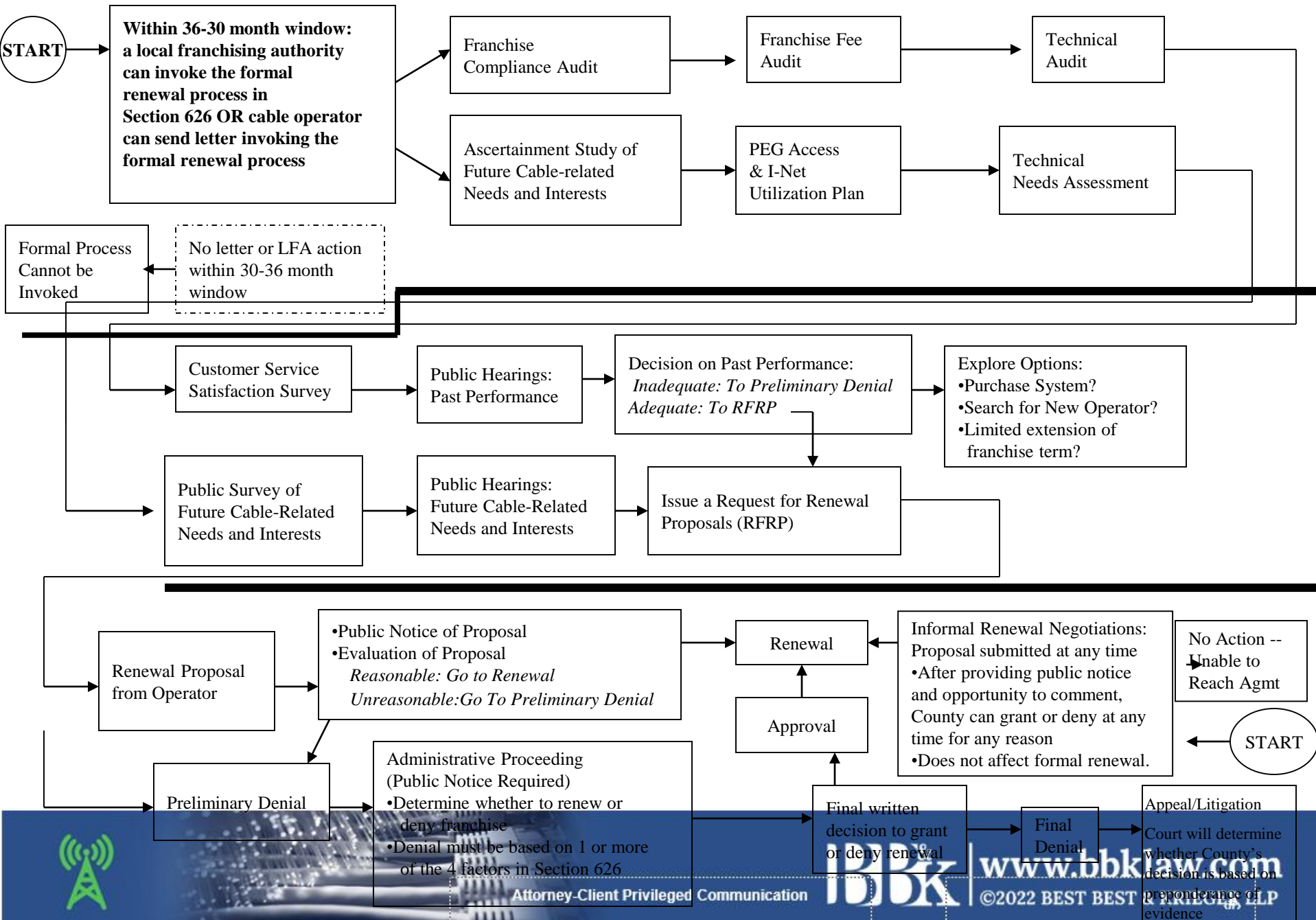
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# Cable Television Franchise Renewal Flowchart



# OVERVIEW

- The Basic Laws
- State of Renewals and Cable Laws
- Key Questions



# CABLE BASICS

- Local Cable Franchise Agreement is a real estate contract. City provides authority to use public assets to provide cable service over a cable system and operator pays compensation.
  - Art is usually in defining compensation and basis for same.
    - In Virginia --Communications Sales & Use Tax (“CST”)
    - PEG and I-Net
  - Local governments must abide by Federal, state and local laws when conducting franchise renewal process. Examples
    - Franchise is non-exclusive – Federal
    - Access to building tenants – Commonwealth (Va. Code Ann. § 55-248.13:2)
    - Procurement rules – City Code & cable operator



# CABLE BASICS

- Public input is a critical part of franchise renewal process
  - Needs Report has identified real needs from public and government users.
- Renewal process is central to determining what future services citizens will receive in the future.
  - Required
  - Requested
    - It's OK to obtain requested compensation in side letters, but ensure consideration is present. Needs Assessment paper provides that consideration.
- Electeds (Executive and Council) must act as a team for the residents.
  - Good vs. Bad Cop is OK if coordinated.



# THE BASIC LAWS

## Federal Law

- 47 U.S.C. Sec. 521 et seq. (the “Cable Act”), esp. Sec. 546

## State Law

- § 15.2-2108.1:1;15.2-2108.21

## City or County Laws

- Charter, Franchise, Ordinances



# CABLE ACT

Prescribes renewal process (Sec. 546)

- Two processes – “informal” and “formal”
- State Level -- 15.2-2108.1:1 and Ordinance franchises
- Informal process =
  - Agree at any time
  - Must hold hearing where public can comment
  - Otherwise, the process is done





# CABLE ACT – FORMAL PROCESS

- How it starts: City or cable operator can start it; operator can start it by submitting a request for renewal 30-36 months before franchise is scheduled to expire
- What happens when it starts: you then have six months to commence a proceeding in which the public has an opportunity to participate....
- Ordinance Franchise under Virginia Law – see 15.2-2108.21/



# CABLE ACT – FORMAL PROCESS

- What's the proceeding?
  - You are to determine the future, cable-related needs and interests of the community AND
  - Review the operator's past performance
- How formal do I have to be in starting the process
  - Not very – BUT....
- When do I need to end it?
  - No deadline for ending



# THE CABLE ACT – FORMAL PROCESS

How do formal and informal fit together?

- You can assess community needs/past performance until you have a negotiating position with which you are comfortable.
- You can then negotiate informally.
- If negotiations fail, you can then complete the “assessment” process, and move forward formally.



# THE CABLE ACT – FORMAL PROCESS

- What Happens When the Assessment is Completed?
  - Community can issue a request for proposals OR operator can submit a formal proposal without waiting for a Request for Renewal Proposal or “RFRP.”
  - Once operator proposal is received, community has four months to decide to say “yes” or to say “we preliminarily deny the renewal request”
  - If you say no, operator may require community to promptly commence an administrative proceeding (almost like a trial)



# THE CABLE ACT – FORMAL PROCESS

- What Goes On at the Administrative Proceeding? You consider:
  - Whether the operator has complied with its obligations under the franchise and applicable law (notice/cure)
  - Whether the operator has provided adequate service in the past (notice/cure)
  - Whether the operator has the financial, technical and legal ability to perform as promised
  - Whether the operator's proposal is reasonable to meet the future cable-related needs and interests of the community in light of the costs thereof



# THE CABLE ACT – FORMAL PROCESS

- Denial permitted if you find against the operator on any one of those four grounds
- Operator can appeal to court





# OVERVIEW OF STATUS

- Common Franchise Renewal Issues
  - Franchise Fees/CST
  - Cable System Issues
  - Customer Service
  - Institutional Networks
  - Competition and Level Playing Field
  - PEG-Related Issues



# FRANCHISE FEES

- Franchise fees\* cannot exceed 5% of operator's "Gross Revenues" (47 U.S.C. § 542)
- How do you define "Gross Revenues"?
  - Triple play
  - Over the top services
  - Advertising
  - Programming launch fees
  - Application of GAAP

\*no new or renewed **cable franchise** entered into on or after January 1, 2007, shall include a **franchise** fee as long as **cable** services are subject to the **Virginia Communications Sales and Use Tax**, but it can be used for PEG support.



# SYSTEM ISSUES

- System Build-out
  - Density requirements
  - Commercial areas
- System Upgrades:
  - an LFA (Local Franchising Authority) may not use its franchising authority to attempt to regulate non-cable services
  - But many of the services using system capacity are not “cable services”



# INSTITUTIONAL NETWORKS

- Connect public buildings. Transport PEG programming
- Who owns what?
- Dark fiber vs. managed services
- New entrants vs. incumbents



# COMPETITION/LEVEL PLAYING FIELD

- Federal law does not require such provisions
- Virginia repealed former state law level playing field provision in 2006 law and essentially replaced it with Ordinance franchise's opt-in options (subsections 26, 30 of § 15.2-2108.1) and the 'no more onerous' provisions in subsections 20.B and 22.
- Caveats: Beware of Provisions:
  - Defining competitor as OTT or MVPD
  - Opt-out provisions to avoid franchise obligations
  - Allowing operator to unilaterally modify franchise if different than competing franchise



# OTHER ISSUES

- Term / rights on termination
- Precedence of franchise vs. ordinance
- Reporting requirements
- Liquidated damages
- Security for performance
- Audit rights
- Section 621 Offsets





# PEG SUPPORT

- The term “Franchise Fee” does not include:
    - Capital costs which are required by the franchise to be incurred by the cable operator for public, educational, or governmental access facilities. (47 U.S.C. § 542)
  - Ways to Capture PEG support/fee\*
    - Upfront, pay as you go, periodic payments
    - Payments tied to subscriber numbers
    - % of “Gross Revenues”
  - Operating support
    - Must be voluntarily given or subject to offset – “as LFA sees fit.”
- \*Please keep in mind long hold-over franchises.



# PEG CHANNELS

- How do you define channel in a digital world?
- How many?
- What format? HD? Simulcast? What about future advances?
- Channel placement
- Information about channels on Electronic Program Guides



# SUMMARY

- Renewals only happen every 10-15 years
- Franchise renewals deal with a diverse range of issues negotiated over months or years
- Both sides bring issues to the table
- Relative importance of PEG-related issues:
  - What other issues are under negotiation?
  - What have other renewals done lately?
  - How strong is community support for your issues and how do you demonstrate that?
- Support the negotiating team
  - Support can take many forms – just be coordinated on city side
- Timing





# Understanding and Integrating the Sixth Circuit's Cable Order

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# CABLE FRANCHISING ORDER:

- Redefines “franchise fee” to mean that the fair market value of non-monetary franchise requirements must be deducted from the franchise fee (or paid for directly).
  - Residential build out, customer service not counted against the fee; new I-Nets are counted
  - Narrowed what may be collected above the fee as a PEG capital cost –not all PEG transport, reserved channel capacity TBD
- Preempted state and local authority over cable operators’ non-cable services and facilities
  - Preempted Eugene, OR broadband franchise fee; limited authority over I-Nets
- Applied all rules to state franchise regimes





# 6th Circuit Decision

- On May 26, 2021, the 6<sup>th</sup> Circuit:
  - Largely upheld FCC’s “in-kind” decision, but found that the operator was limited to offsetting (or being paid) for the marginal cost of providing the benefit – NOT fair market value;
  - Rejected the FCC’s codified mixed-use rule as written, but in applying the Act appeared to adopt the FCC’s conclusion that a state or local government “cannot do indirectly what it is prohibited from doing directly.”
  - Specifically concluded that the City of Eugene’s broadband franchise fee was not a Cable Act “franchise fee,” but nonetheless found that other provisions of the Cable Act prevent LFAs from charging a cable operator any fee for use of the ROW use to provide non-cable broadband service.





# APPEAL OF FRANCHISING ORDER

- *City of Eugene v. FCC*:
    - Request for Cert pending before the Supreme Court;
- VATO Action Items:
- Monitor litigation and FCC.
  - Consider carefully any requests or franchise agreements made under current FCC ruling...avoid locking in Order as rule may change



# What Is “In-Kind?”

- Regulation appears at 47 CFR § 76.42, “In-kind contributions”
- **Any non-monetary contributions** related to the provision of cable service by a cable operator as a condition or requirement of a local franchise, **including but not limited to:**
  - ...Costs attributable to the provision of **free or discounted cable service** to public buildings, including buildings leased by or under control of the franchising authority;
  - ...**Non-capital costs in support of public, educational, or governmental access facilities;** and
  - ...Costs attributable to the **construction of institutional networks.**
- **But** “In-kind, cable-related contributions do not include the **costs of complying with build-out and customer service requirements.**”



# In-Kind Issues/Examples

- Cost of maintaining lines used to transport PEG signals from studios to cable operator count against franchise fees; cost of providing lines are capital costs and *do not* count against fees.
- FCC determined that cost of providing PEG capacity *would* count against fee *unless* that capacity was treated as a capital cost...but agency deferred any decision on whether provision of capacity was a capital cost.
- Free service to public buildings counts against fee, but what about senior discounts, and discounts for persons with disabilities?
- Cost of construction of an I-Net counts against fee, but what about costs of I-Net capacity maintenance? Not consistent with build-out decision.
- What falls within the ambit of customer service requirements?
  - PEG listings on program guide?
- Where do ROW requirements/requirements for ROW restoration, relocation and maintenance fit in?



# Mixed-Use Rule & Impact

- An LFA may not regulate the provision of any services other than cable services offered over the cable system of a cable operator, with the exception of channel capacity on I-Nets. (New 47 CFR §76.43) (Sixth Circuit eliminated the rule but the impact remains.)
  - As adopted, rule:
    - Preempts regulation of any facilities and equipment used in the provision of any services other than cable services;
    - Adopts cable operators' argument that a cable franchise authorizes installation of any equipment in ROW, even if it is not used for cable service, including Wi-Fi and small cell facilities;
    - Impedes local authority to ensure consistent regulations apply to providers of similar services using similar facilities.
- FCC also ruled that Eugene's generally applicable telecom fee is a "franchise fee" and preempted by the Cable Act – and that cable operator could only be charged cable franchise fee for use of ROW to provide non-cable services. (Sixth Circuit disagreed on the legal point, but the practical impact is not much changed.)



# What Happens Next? – The Courts & FCC

## *In the Courts*

- Three petitions for en banc and panel rehearing were denied August 3, 2021.
- Supreme Court review is being sought. Cert Petition is subject of conference tomorrow (Feb. 18, 2022).
  - Because of holiday, we won't know status until Tuesday at the earliest.

## *At the FCC*

- Clarifications possible, timing fluid.
- Current leadership does not fully support the FCC's order – dissents originally, but at a 2-2 tie – stuck with status quo.



# Possible FCC Steps

Goals could include:

- Making clear “customer service obligations” reach issues like compliance with customer service standards, privacy, EEO, or any rule affecting customer-cable operator relationship which would remove them from the franchise fee;
- Clarifying treatment of PEG capacity to treat it as capital cost;
- Clarifying no cost associated with construction, operation or maintenance of the cable system counts against franchise fee;
- Re-construing the Act to clarify that if a fee is not a “franchise fee”, it is not preempted by the Cable Act.





# How Should You Respond to In-Kind Now?

- **Rules might change: protect yourself by ensuring you can take advantage of future changes.**
- No need for LFA to raise issue – FCC rules contemplate notice before offsets.
- If you agree to an offset, you may be bound by offset even if the FCC/courts change course. *Possible: include provisions for terminating/altering offsets.*
- Know the rules! Costs limited to marginal costs – seek proof, where appropriate. Unless the amount proposed is small, do not take operator’s word for it.
- Remember that Cable Act requires any costs recovered through franchise fee offset (i.e., a reduction in franchise fees) must be passed through to subscribers.
- Be careful not to lock in current fee rule to franchise agreement, or to agree *not* to regulate non-cable services.
- Understand rule gives operators incentives to shift revenues to “non-cable” services. This may be a significant issue to watch for in franchise fee audits.



# How Should You Respond to “Mixed Use” Now?

- Rules do not prevent settlements of past performance/franchise non-compliance issues that provide benefits, which are not a “franchise fee.”
- Rules do not address what happens where a capital obligation is imposed, but operator is given voluntary option of satisfying obligation through provision of a service: e.g., rather than build a line to carry PEG programming, operator provides funds or services that allow for more cost-effective transport. *Alternative performance requirements may not trigger offsets.*
- Because operators are including WiFi and true wireless radios on strand, it is important to ensure your franchise does not exempt any portion of the system from ROW/zoning rules as applicable – and to make sure your wireless rules take into account the position taken by the operator with respect to
  - Whether additional franchises/fees may be required;
  - Whether additional regulatory approvals may be required before installation.



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