

# Will Video Franchise Reform Stick? And Will It Work?

The FCC has the right idea, but the courts and Congress are sure to have a say

By Carl E. Kandutsch ■ *Ph.D., J.D.*

On December 20, the Federal Communications Commission rewrote the rules for video franchises, sharply reducing the ability of local communities to delay awarding franchises and to demand “extras” beyond the 5 percent franchise fee authorized by federal law.

At this writing, the commission has yet to issue a formal order for this. It instead issued a press release announcing the adoption (resulting from a 3 to 2 vote of the Commissioners along party lines) of a Report and Order in the Franchise Reform proceeding initiated in November 2005. That proceeding was initiated largely at the behest of several telephone companies (notably, AT&T and Verizon) in order to remove perceived obstacles (namely, municipal regulatory authority over cable companies’ use of public rights-of-way or “PROWs”) to the telcos’ deployment of local fiber networks capable of delivering video signals to homes in competition with the cable television industry.

The FCC’s Franchise Reform proceeding unfolded at the same time as numerous state legislatures enacted or debated their own franchise-reform bills (providing a streamlined mechanism for video providers to obtain statewide authorizations to use PROWs) and Congress considered but failed to pass a national cable franchise law.

Although the Report and Order is not yet publicly available, the press release, as well as the statements of the individual Commissioners, summarize its

contents. The Commission found that:

1. Franchising negotiations that extend beyond certain time frames (90 days for companies that already have access to PROWs, 180 days for those that do not have such access) amount to an “unreasonable refusal” to award a competitive franchise within the meaning of section 621(a)(1) of the Communications Act of 1934;

2. Requiring an applicant to agree to “unreasonable” build-out requirements constitutes an unreasonable refusal to

award a competitive franchise; and

3. Unless certain specified costs, fees and other compensation required by local franchising authorities (LFAs) are counted toward the statutory five percent cap on franchise fees, demanding them could result in an unreasonable refusal to award a competitive franchise; and,

4. It would be an unreasonable refusal to award a competitive franchise if the LFA denied an application based on the applicant’s refusal to undertake certain unreasonable obligations relating to public, educational and govern-

mental (PEG) and institutional networks (I-Nets);

5. Furthermore, the FCC preempted any local laws, regulations and requirements, including local “level playing field” provisions, to the extent they impose greater restrictions on market entry than the rules adopted in the Report and Order; and finally,

6. The FCC concluded that although the record allows it to determine generally what constitutes an “unreasonable refusal to award an additional competi-

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reform bill at the Federal level. With the Democrats now in control of both houses, the prospects for legislative reform along those lines in 2007 appear dim. Chairman Martin's hurried vote on this item just before year's end may be viewed as an exercise in agency legislation before control was formally handed over to the Democrats this month. As such, the effect of the Order will be to ensure that the issue of broadband/video franchising will be back on the Congressional agenda in 2007<sup>1</sup>.

preempt "most-favored-nation clauses" in existing contracts. Those contracts insured that if a new entrant got a better deal from a franchising authority, the incumbent cable operator also got that deal, and vice versa.

Kyle McSlarrow, chief of the National Cable and Telecommunications Association, said that for the last two years, the policy goals of the cable lobby were clear – a level playing field. "There's no justification for treating the largest telecom companies on Earth better in this

error of its way absent court or congressional intervention. We will look forward to providing them both opportunities."

**Significance of the Order**

In support of the Order, Chairman Martin's statement cites a study by the Phoenix Center (a Bell-funded think tank<sup>2</sup>) concluding that the promise of providing video services drives fiber deployment, and therefore, easing the telco's entry into video markets is the best way to spur investment in fiber-to-the-home. (Editor's Note: This magazine has published numerous articles agreeing that franchise video now drives fiber deployments, at least into the near future, but that its importance may decline over time as competition lowers video prices and as more products are served over broadband.)

Not coincidentally, the FCC simultaneously released its annual report on cable pricing.<sup>3</sup> The Report finds that cable rates have nearly doubled since deregulation in 1996, but that where the incumbent cable operator faces "effective competition," price increases have averaged only 7.9 percent.<sup>4</sup>

As we enter the era of the triple play, an era in which consumers will find it increasingly attractive to purchase bundled packages of voice, video and data, Chairman Martin deserves praise for at least acknowledging the existence of the cable industry's market power, and encouraging competitive entry as the means to restrain that power.

Moreover, because consumer switching costs are likely to increase as customers embrace the triple play (that is, consumers are less likely to switch to a different provider of multiple services than they would to a different provider of any discrete stand-alone service), it is important that competitive entry be facilitated sooner rather than later.

As time passes it will become more difficult to persuade consumers who chose, by default, cable's version of the triple play, to switch to a different provider. Martin is right to sense some urgency in bringing new players to the market.

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**Reactions to the Order**

Clearly, the most significant finding is Number 2 on our list: The FCC has given the telcos the ability to build out their fiber networks without being burdened by locally imposed requirements to invest in neighborhoods where population demographics (including both geographical and economic considerations) make it less likely that the investment can be recovered in the short term.

Not surprisingly, the phone companies wasted no time in offering a New Year's toast to the FCC. In a statement, Susanne Guyer, a Verizon senior vice president for federal regulatory affairs, said the agency "is standing up for consumers who are tired of skyrocketing cable bills and want greater choice in service providers and programming." The decision will help Verizon meet an "aggressive" schedule for rollout of its FiOS TV service, Guyer added.

On the other hand, the cable industry expressed skepticism at the FCC's decision, which appears to make incumbent video providers wait until their current franchise agreements expire to get the same terms as new entrants.

The FCC also says its new order will

marketplace .... If they had the authority today to provide conditions for new entrants, they had the authority to provide for all."

The real losers are the local governments, whose regulatory oversight over telco video deployments in their communities is reduced to little more than a rubber stamp. Indeed, if the FCC was concerned that LFAs are not negotiating franchise conditions in good faith, the Order's solution is, in effect, to eliminate the incentive to negotiate (and thereby negotiation itself) altogether. Because an LFA's failure to approve a franchise within 90 days results in an automatic award of the franchise on the same conditions proposed in the company's application, an applicant that doesn't like the LFA's conditions need only stonewall for three months to achieve the result it seeks.

Libby Beatty, executive director of the local franchise authorities' lobby in Washington (NATOA), vowed to challenge the Order in court and in Congress: "Today, the FCC played Scrooge to local governments when they changed the agency from a regulatory to a legislative body .... Unfortunately, unlike Scrooge, it's highly unlikely the FCC will see the

### Is This the Best Way?

The question, however, is whether or not the method chosen in the FCC's Franchise Reform Order – namely, federal preemption of local franchising authority – is the best way to achieve the desired result. Most notably, there are serious questions surrounding the Commission's legal authority to take such action, and as the quotation from Libby Beatty suggests, the FCC's Order will almost certainly be challenged in the courts.

In the first place, as Commissioner Adelstein's eight-page dissenting statement indicates, the Order appears to rely on arguably sparse anecdotal evidence, supplied by the telephone companies, for its finding that certain LFA practices (such as extending franchise negotiations beyond 90 days) constitute per se "unreasonable refusals" to grant a competitive cable franchise justifying a fundamental rollback of municipal regulatory authority by rule.

Second, and more seriously, Federal court jurisprudence has made it clear that some more-or-less explicit Congressional authority is required for preemption of local home rule authority by an administrative agency. In this case, Section 621(a)(1) provides that an LFA "may not unreasonably refuse to award an additional competitive franchise," and goes on to state: "Any applicant whose application for a second franchise has been denied by a final decision of the franchising authority may appeal such final decision" in the Federal courts."

Those challenging the FCC's Franchise Reform Order will surely argue

(among other things) that this statutory language indicates Congress's intention (consistent with the local nature of PROW management) that the exclusive authority to determine the reasonableness of granting a competitive franchise resides with local government, subject to judicial review on a case-by-case basis – an intention that is inconsistent with the FCC's usurpation of that authority by rulemaking.

As the late 1990s proved, nothing discourages telecom investment like the confusion and uncertainty associated with protracted legal wrangling over the precise contours of the regulatory landscape. Everyone, regardless of their industry affiliation, should hope that recent highly politicized policy-making on cable franchising and other matters does not signal a return to a scorched earth litigation environment wherein lawyers wage wars of attrition while everyone else takes cover on the sidelines.

In light of the legal vulnerabilities associated with its chosen approach, it is somewhat surprising that Chairman Martin didn't find a different route to the same goal. For example, the Commission's still-pending IP-Enabled Services NPRM<sup>5</sup> raises the question of whether video over Internet protocol should be considered an "information service" exempt from regulation as a "cable service."

The Supreme Court's recent Brand X decision suggests that a Commission decision that telco video is an information service, not subject to local regulation at all, would be upheld in the courts.

Finally, on a purely speculative note,

it is worth noting that the FCC's action on franchise reform may well produce some unanticipated backlashes on seemingly unrelated issues. For example, it could turn out that the federalization of the cable franchising process, and the consequent rollback of local authority to require build-outs and institutional networks, ends up injecting new vigor into the municipal broadband movement, as local governments react to their loss of regulatory authority by taking matters into their own hands. **BBP**

### About the Author

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### References

<sup>1</sup> The day before the vote, Rep. John Dingell (D-Mich), wrote in a February 19 letter to the FCC: "It would be extremely inappropriate for the Federal Communications Commission to take action that would exceed the agency's authority and usurp congressional prerogative to reform the cable television and local franchising process." He has promised, as head of the House Telecommunications Subcommittee, to review the FCC's Order in early 2007.

<sup>2</sup> Technology Daily, 7/26/2006.

<sup>3</sup> Report on Cable Industry Prices, In the matter of: Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, MM Docket No. 92-266 (rel. Dec. 27, 2006).

<sup>4</sup> Interestingly, the Report confirms that the existence of competition from direct broadcast satellite operators does not have a significant restraining effect on cable pricing, whereas the existence of a wireline video competitor results in a 17 percent reduction in cable prices.

<sup>5</sup> In the Matter of IP-Enabled Services, Notice of Proposed Rulemaking, WC Dkt. No. 04-36, FCC 04-28 (rel. March 10, 2004).



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