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TO: Interested Parties

FROM: Miller & Van Eaton, P.L.L.C.

RE: FCC's Second Report and Order on Local Franchising – As Released

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At its October 31, 2007, meeting, the FCC voted 3-2 (Commissioners Copps and Adelstein dissenting) to adopt a Second Report and Order ("Second R&O") on local franchising.<sup>1</sup> The text of the document was released late on November 6, 2007. It is available on the FCC's Web site at:

[http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/FCC-07-190A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-07-190A1.pdf)

**I. Effective Date**

The Second R&O is not yet effective. It will become effective thirty days after publication in the Federal Register. Second R&O at ¶ 39. Federal Register publication may be expected approximately ten to fifteen days after the November 6 release.

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<sup>1</sup> 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, *Second Report and Order*, FCC 07-190 (Nov. 6, 2007).

## **II. Immediate Application of Earlier Rulings to Incumbent Cable Operators**

In the March 2007 Further Notice of Proposed Rulemaking (the “FNPRM,” [FCC 06-180](#)) at ¶¶ 139-143, the FCC proposed to extend its new rulings on local franchising to incumbent cable operators when they negotiated renewal agreements with local franchising authorities (“LFAs”). *See* FNPRM at ¶ 140. The cable industry, however, lobbied aggressively to gain the benefit of those rulings at once. The FCC agreed to this approach in the Second R&O, although it appears to have required cable operators to take affirmative steps to apply the rulings to existing contracts.

The Second R&O notes that many of the rulings in the preceding Report and Order and Further Notice of Proposed Rulemaking (“First R&O”)<sup>2</sup> represented interpretations of the meaning of various statutory provisions of the Cable Act, “and these interpretations are valid immediately.” Second R&O at ¶ 19. Moreover, the FCC goes out of its way to add that these interpretations are valid “through the nation.” *Id.* at ¶ 19 n.60. The latter statement suggests that, while the First R&O exempted actions taken according to state franchising laws, the rulings discussed in the Second R&O are subject to no such limitation. Thus, cable operators may argue that franchises granted according to state laws, as well as local franchises that may continue in existence in states that have adopted state franchising, are subject to these rulings.

The Second R&O does not apply to incumbents all the rulings made in the First R&O. The breakdown is:

Time limits (“shot clock” for franchise action): do not apply to incumbents (§ III.A)

Build-out limitations: do not apply to incumbents (§ III.B)

Franchise fees: (§ III.C)

Revenues from non-cable services: applies to incumbents

“Incidental” costs: applies to incumbents

Projects unrelated to cable service: applies to incumbents

Payments for operation of PEG facilities: applies to incumbents

PEG and I-Nets: (§ III.D)

Non-capital costs as franchise fees: applies to incumbents

No greater burden for new entrants: does not apply to incumbents

Duplicative networks and nonexistent I-Nets: does not apply to incumbents

Mixed-use networks: applies to incumbents (§ III.E)

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<sup>2</sup> 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, *Report and Order and Further Notice of Proposed Rulemaking*, FCC 06-180, 22 FCC Rcd 5101 (adopted Dec. 20, 2006, released March 5, 2007).

These issues are discussed in greater detail below, in the sections of this memorandum indicated in parentheses above.

### III. The FCC's Specific Rulings

#### A. Time Limits ("Shot Clock")

The 90/180-day "shot clock" period within which a franchising authority must act on a new franchise application does not apply to incumbents. Their renewal procedure is governed by the deadlines in Section 626 of the Act, 47 U.S.C. § 546. Second R&O at ¶ 8.

#### B. Build-Out Limitations

The discussion of "unreasonable" build-out requirements in the First R&O does not apply to incumbents. The underlying rationale for the FCC's rulings (promoting competitive entry), and their alleged statutory basis in § 621(a)(1) of the Act, are inapplicable to incumbents.

#### C. Franchise Fee Rulings

The FCC made a series of "findings" about cable franchise fees in the First R&O. The Second R&O states that these rulings were statutory interpretations and therefore apply to incumbents. It enumerates four such rulings:

(1) **Revenues from non-cable services.** "[A] cable operator is not required to pay cable franchise fees on revenues from non-cable services." ¶ 11 & n.31, *citing* First R&O, 22 FCC Rcd 5146-47 (apparently ¶ 98). This limitation has been in place since the 1996 amendment to 47 U.S.C. § 542(b). The most well-known example is that of cable modem revenues, when the FCC ruled in 2002 that cable modem service was not "cable service." In this respect, the Second R&O does make a useful distinction: "This finding, of course, does not apply to non-cable franchise fee requirements, such as any lawful fees related to the provision of telecommunications services." ¶ 11 n.31. Thus, neither order affects LFAs' rights to require compensation for non-cable use of the public rights-of-way *outside* a cable franchise, rights which vary by state and jurisdiction.

(2) **"Incidental" costs.** The Cable Act says that costs "*incidental to the awarding or enforcing of the franchise*" do not count against the 5% franchise fee cap. 47 U.S.C. § 542(g)(2)(D). In the First R&O, the FCC interpreted this to mean "small costs," and limited the exception to the examples listed in the statute ("payments for bonds, security funds, letters of credit, insurance, indemnification, penalties, or liquidated damages") and "other minor expenses." First R&O at ¶ 103. The FCC specifically included in the category of franchise fees "attorney fees and consultant fees," "application or processing fees that exceed the reasonable cost of processing the application, acceptance fees, free or discounted services provided to an LFA, any requirement to lease or purchase equipment from an LFA at prices higher than market value, and in-kind payments

as discussed below.” First R&O at ¶ 104.<sup>3</sup> The Second R&O applies these rulings to incumbents. ¶ 11 & nn.32-33, *citing* First R&O at 5148-49 (apparently ¶¶ 103-104).

(3) **Projects unrelated to cable service.** The First R&O counted as franchise fees what it called “[i]n-kind payments unrelated to provision of cable service” or “[m]unicipal projects unrelated to the provision of cable service.” First R&O at ¶¶ 105, 108. The examples cited by the FCC included “municipal programs such as libraries, recreation departments, detention centers” (quoting from the legislative history), traffic light control and traffic monitoring systems, scholarships, a “video hookup for a Christmas celebration,” and wildflower seeds.<sup>4</sup> First R&O at ¶¶ 106-108. The Second R&O applies to incumbents the ruling that “any municipal projects requested by LFAs unrelated to the provision of cable services that do not fall within the exempted categories in Section 622(g)(2)” are franchise fees. Second R&O at ¶ 11, *citing* First R&O at 5150 (apparently ¶ 108).

(4) **Payments for operation of PEG facilities.** Because the Cable Act excludes from franchise fees “*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(g)(2)(C) (emphasis added), non-capital costs such as operating expenses have generally been assumed to count against the 5% franchise fee cap. In the First R&O the FCC described such costs as “PEG support payments” and gave “salaries and training” as examples. First R&O at ¶ 109. There has been considerable discussion as to whether the FCC’s first order seeks to make an improper distinction between “costs incurred in or associated with the construction of PEG access facilities,” First R&O at ¶ 109, and capital costs for facilities or equipment generally, whether or not associated with studio construction. Whatever the correct interpretation of the FCC’s earlier ruling on PEG costs, the Second R&O applies it to incumbents: “payments made to support the operation of PEG access facilities are considered franchise fees and are subject to the 5 percent cap, unless they are capital costs.” Second R&O at ¶ 11, *citing* First R&O at 5150-51 (apparently ¶ 109).

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

The Second R&O addresses three significant rulings related to PEG and I-Nets.

(1) **Non-capital costs as franchise fees.** This appears to be the same point as in section III.C(4) above: “PEG support payments” that are not capital costs count as franchise

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<sup>3</sup> As the FCC noted, the fact that such costs count against the 5% franchise fee cap does not automatically mean that they cannot be charged. A community receiving a lower percentage of gross revenues than 5% in franchise fees may also be able to receive items in the FCC’s list without exceeding the 5% cap. *See* First R&O at ¶ 104 n.349.

<sup>4</sup> Projects such as the *construction* of a library or recreation center should be distinguished from the provision of *cable service or I-Net connectivity* to such a site. The FCC appears to be talking about the former under this head.

fees. As noted above, the FCC's rulings on this point do apply to incumbents. Second R&O at ¶ 13.

(2) **No greater burden for new entrants.** In the First R&O the FCC concluded that it would be unreasonable for an LFA to impose on a new entrant greater PEG carriage or support obligations than it imposed upon the incumbent. First R&O at ¶¶ 114, 120. The Second R&O states that this conclusion does *not* apply to incumbents. Second R&O at ¶ 14. Apparently the new entrant may have *lesser* burdens than the incumbent, but not greater.<sup>5</sup>

(3) **Duplicative networks and nonexistent I-Nets.** The First R&O included somewhat puzzling prohibitions against “completely duplicative PEG and I-Net requirements,” where duplication was not useful to ensure redundancy, and against requiring an applicant to “pay the face value of an I-Net that will not be constructed” – puzzling because it is not clear under what circumstances a LFA would wish to make such requests. First R&O at ¶ 119. Whatever these prohibitions mean, in the Second R&O the FCC concludes that they appear to have no application to incumbents. However, the FCC expresses willingness to take another look at the matter if an incumbent can show that these prohibitions ought to apply to them. Second R&O at ¶ 14.

The FCC states that incumbents are bound by the FCC's earlier *refusal* to impose two other regulations on LFAs, relating to “standard terms for PEG channels” and ongoing PEG support requirements for new entrants. Second R&O at ¶ 13.

The Second R&O takes the position that LFAs need not worry that PEG support will be “frozen at current contribution levels” by its rulings. Apparently the FCC believes that new entrants and current incumbents alike will be subject to the normal renewal process and that this will allow a community to negotiate increased PEG support based on its needs and interests. Second R&O at ¶ 15.

#### **E. Mixed-Use Networks**

In the First R&O, the FCC stated: “We clarify that LFAs' jurisdiction applies only to the provision of cable services over cable systems.” First R&O at ¶ 121. The Second R&O, however, adds an important qualification: “LFAs' jurisdiction **under Title VI** over incumbents applies only to the provision of cable services over cable systems.” Second R&O at ¶ 17 (emphasis added). In other words, the FCC's new language allows for the fact that LFAs may have authority from sources other than the Cable Act (which is Title VI of the Communications

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<sup>5</sup> “Requiring an established incumbent operator to have a greater PEG carriage obligation or provide greater PEG support than a fledgling new entrant may very well be reasonable under the circumstances, and we see no statutory provision that categorically precludes such an approach.” Second R&O at ¶ 14. The Second R&O also notes that *pro rata* matching arrangements are neither reasonable nor unreasonable *per se*. *Id.* at ¶ 14 n.43.

Act). For example, they may have general authority to make consumer protection rules under their police powers. Such other authority is not necessarily constrained by the FCC's attempt to limit LFA jurisdiction to cable services.

**IV. Other Issues**

The Second R&O makes the following additional rulings:

- As noted in section II above, the Second R&O does not appear to allow cable operators to unilaterally change the terms of their franchise agreements pursuant to the FCC's order. Rather, it indicates that the operator must take affirmative steps to apply the FCC's rulings to existing contracts. Second R&O at ¶ 19.
- "Most favored nation" clauses giving incumbents the benefit of new entrants' franchise terms remain in effect. Second R&O at ¶ 20.
- Local customer service rules are not preempted, but the FCC seeks to restrict them to cable service. Second R&O at ¶¶ 26, 31, 33.
- The FCC declines to require that gross revenues be determined according to generally accepted accounting principles (GAAP), as Time Warner requested. Second R&O at ¶ 23.