Cohen Law Group

Summary of the FCC's Recent Third Report and Order Regarding Cable Franchise In-Kind Benefits
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On August 1, 2019, the Federal Communications Commission ("FCC" or "Commission"), in a 3-2 vote, approved its Third Report and Order, formally titled "In the Matter of Implementation of Section 621(a)(1) of the Cable Communications Policy Act" ("Order"). This Order will have a significant impact on our clients with respect to their cable franchise benefits and obligations. The Order is the result of a notice and comment proceeding in which numerous local governments, national municipal organizations, cable operators, and cable industry associations participated. Our law firm submitted comments on behalf of several clients. The following is a brief summary of the salient issues in the 85-page Order.

The underlying premise of the Order is that all in-kind, non-capital cable company contributions to local governments fall within the five percent (5%) franchise fee and therefore must be offset against franchise fee payments. The Order defines "in-kind cable-related contributions" as "…any non-monetary contributions related to the provision of cable services provided by cable operators as a condition or requirement of a local franchise, including but not limited to, free or discounted cable service to public buildings, non-capital costs in support of PEG access, and costs attributable to the construction, maintenance, and service of I-Nets. It does not include the costs of complying with build-out and customer service requirements." (Fn. 42) The key practical effects of ruling are as follows:

PEG Channels and PEG Financial Support

The Order finds that the "costs associated with PEG channel capacity" are in-kind costs that fall within the definition of franchise fees. (¶42) In other words, the cost of the PEG channels themselves, separate from financial support for PEG channels, may be offset against franchise fee payments. In contrast to the Commission's Notice of Proposed Rulemaking ("NPRM") that commenced this proceeding, however, the FCC declined to decide whether PEG channel capacity is a capital cost and, if so, what valuation method to use to determine the cost. The Order states: "While we find that the costs associated with the provision of PEG channel capacity are cable-related, in-kind costs that fall within the definition of 'franchise fee', **we find that the record is insufficiently developed** to determine whether such costs should be excluded from the franchise fee as a capital cost under the exemption in Section 621(g)(2)(C)." (emphasis added) This is good news, at least in the short term, for municipalities that have active PEG channels.

With respect to PEG financial support, the Commission maintains its longstanding rule, derived from Section 611 of the Cable Act, that contributions for PEG capital costs are exempt from franchise fees and may not be offset against franchise fee payments. The definition of "capital costs" in the Order is actually a slight improvement over the FCC's old definition, in that it describes such costs as "costs incurred in acquiring or improving capital assets for PEG access facilities." (¶33) This appears to include all equipment used to support PEG channels and the production of local programming: "[W]e believe at the present time that the definition of 'capital costs'… includes equipment purchased in connection with PEG access facilities, even if it is not purchased in conjunction with the construction of such facilities." Id. Cable operator financial support used for PEG operations, on the other hand, may be offset against franchise fees.

Finally, there was some question as to whether the costs of transport facilities for PEG channel signals may be offset against franchise fees. The Commission found that they may not: "[T]he installation of transport facilities dedicated for long-term use by a PEG provider for the transmittal of recurring programming to a cable headend or other point in the cable system—PEG transport—does not count toward the five percent franchise fee cap… Although we agree that the costs associated with the use of transport lines for 'episodic' or 'short-term' PEG programming is an operating cost that is subject to the franchise fee cap, we decline to establish a fixed quantity of PEG transport return lines that is 'adequate' under section 621(a)(4)(B)." (¶49)

Institutional Networks or I-Nets

Unlike PEG channel capacity and PEG capital costs, the Order finds that the value of I-Nets may be offset against franchise fee revenue at this time. The Order states: "We find that the costs associated with the construction, maintenance, and service of an I-Net fall within the five percent cap on franchise fees. Such costs are cable-related, in-kind contributions…" (¶55) The Commission acknowledges that I-Nets are a benefit to their communities, but it concludes that "such benefits cannot override the statutory framework, which carves out only limited exclusions from franchise fees." Id. With respect to the method for determining the value of the offset, the FCC lands squarely on the side of fair market value. It states the following:

> We must address the value of other in-kind contributions, however, including free service to public buildings and I-Net contributions. We believe that fair market value, where there is a product in the market, is the most reasonable valuation for in-kind contributions because it is easy to ascertain—cable operators have rate cards to set the rates they charge customers for services they offer. Moreover, a fair market valuation reflects the fact that, if a franchising authority did not require an in-kind assessment as part of its franchise, it would have no choice but to pay the market rate for services it needs from the cable operator or another provider. (¶61)

How fair market value is actually determined remains to be seen and will certainly be a source of contention between local governments and cable operators. For local governments that currently have I-Nets provided by their cable operator(s), however, the Order is bad news indeed.

Courtesy Cable Services

The Order confirms and restates that so-called "free cable services" to municipal facilities, schools, and public libraries may be offset against franchise fees. It states: "We find that costs attributable to franchise terms that require a cable operator to provide free or discounted cable service to public buildings, including buildings leased by or under control of the franchise authority, are cable-related in-kind contributions that fall within the five percent cap on franchise fees." (¶26) As with its discussion of I-Nets, the Order concludes that any such services must be offset against franchise fees based on their fair market value. (¶61)

The FCC outlines the options available to local governments when it comes to these services: "The local franchising authority may wish to either (1) continue to receive the existing free cable service and a monetary payment of five percent minus the fair market value of that service, or (2) discontinue service and receive a monetary payment of five percent, or (3) reduce the free cable service to select municipal buildings and receive a monetary payment of five percent minus the fair market value of the reduced service." (Fn. 251) The FCC is clearly driving home its position that local governments cannot receive free cable service in addition to franchise fees.

Implementation and Conclusion

The Order is prospective and may not be applied retroactively. (¶62) For those current franchise agreements that conflict with the Order, the Commission "encourages the parties to negotiate franchise modifications within a reasonable period of time." Id. In footnote 247 to the Order, it concludes that 120 days "should be, in most cases" a reasonable period of time. What happens if the parties cannot agree on changes to the franchise agreement? Here the FCC assumes that any failure to reach agreement will be the fault of the local government: "If a franchise authority refuses to modify any provision of a franchise agreement that is inconsistent with this Order, that provision is subject to preemption under Section 636(c)." (¶62) Section 636(c) states simply that any franchise term that is inconsistent with the Cable Act will be deemed to be preempted. 47 U.S.C. 556(c) While the FCC may believe that this provides clear guidance as to how the Order will be implemented in practice, many questions remain.

Finally, in comments to the Commission prior to the Order, the National Association of Telecommunications Officers and Advisors (NATOA) asked the FCC to clarify that cable operators are not *required* to modify franchise agreements to comply with the Order, but rather may voluntarily choose to keep intact current franchise provisions. In response to this request, the Commission states: "We reject the request of NATOA that we clarify that this Order is 'permissive not mandatory.' Complying with the terms of the statute is not optional." (Fn. 251)

The Order will take effect 30 days after its publication in the Federal Register. There is no specific timeline for Federal Register publication, but it could occur as early as mid-August. There is no doubt that the Order will be legally challenged by many local governments and municipal associations. In our judgment, most of the conclusions of the Order are not sustainable under federal law. We will be sure to address the legal issues on appeal in future client correspondence. This concludes our summary of the Order. Please feel free to contact me directly if you have any questions or concerns.

Dan Cohen
Cohen Law Group
dcohen@cohenlawgroup.org
(412) 447-0130 x11