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To: Moss & Barnett Clients and Interested Parties
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Court upholds FCC's local franchising order.

On June 27, 2008, the Sixth Circuit Court of Appeals upheld the FCC's first order on local franchising (First Order). While the Sixth Circuit decision represents a set back for municipalities and local franchising authorities (LFAs), the long term impact of the decision may not be significant given the adoption of many new state laws and the fact that most competitive providers have chosen not to take advantage of the First Order. The Sixth Circuit decision, however, bolsters the FCC's authority over "cable services" and could lead to even more aggressive rulemaking by the FCC including a determination of whether IPTV services constitute "cable services."

On December 20, 2006, the FCC adopted the First Order which became effective March 21, 2007. The First Order established "broad rulemaking authority to implement the provisions of the Communications Act, including Title VI generally and § 621(a)(1) in particular." In the First Order the FCC concluded that local franchising authorities were "unreasonably refusing to award" competitive cable franchises and established a number of regulations to speed competition and relieve regulatory burdens on competitors. Multiple parties challenged the First Order arguing that the FCC had overstepped its authority.

The Sixth Circuit's decision in *Alliance for Community Media, et al. v FCC*, No. 07-3391 (6th Cir. June 27, 2008), held that the FCC has broad regulatory authority under the Communications Act and found that the FCC may "prescribe such rules and regulations as may be necessary" to carry out the provisions of the Cable Act. As a result of the Sixth Circuit decision, the following provisions from the First Order remain effective:

1. **Shot clock.** LFAs must act on initial franchise applications within 90 days for entities with existing facilities in the right-of-way and within 180 days for all other applicants.
2. **Build-out.** The Court generally held that the build-out guidelines prescribed by the FCC require a "reasonable" period of time for the initial construction of a cable system to serve all households in the franchise area. The Court therefore deferred to the FCC's discretion to prescribe rules to guide an LFA's authority over the manner in which a cable system may be constructed.
3. **Franchise Fees.** The FCC's interpretation of costs that are "incidental to" and therefore not included within, the definition of franchise fees was upheld. Therefore, attorneys fees, consultant fees, application fees and processing fees are not to be considered "incidental" and must be included in the 5% franchise fee calculations.
4. **PEG Capital versus Operational Expenses.** The First Order raised numerous questions regarding whether the FCC intended to limit its definition of "capital costs" to only facilities and not equipment. The Sixth Circuit determined that the requirement that operators provide PEG access capacity extends not only to PEG facilities but to related PEG equipment as well. Therefore PEG capital support paid in excess of the 5% franchise fee should not be in jeopardy, although many expect this issue will likely cause the most debate among cable providers and LFAs. (See below for further discussion on this issue).

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The Sixth Circuit's decision was a blow to municipalities across the country who believe that the FCC had clearly overstepped its authority in adopting the First Order. However, the practical effect of the Sixth Circuit decision may not be significant. The very companies that had lobbied the FCC for regulatory relief, particularly AT&T, have yet to utilize the First Order in any franchise proceedings. Rather, AT&T and other competing cable operators have been pursuing, with great success, amendments to state statutes which streamline the local franchising process. These new state law essentially render large portions of the First Order moot. The more troubling aspect of the Sixth Circuit decision is the fact that the Court appears to have expanded the FCC's regulatory authority under the Cable Act. Rather than the Cable Act representing a delicate balance between federal, state and local regulation of cable operators, the FCC appears to have encroached on state and local authority and the Sixth Circuit has now upheld this expanded role for the FCC.

PEG Fees: Capital or Operational?

Many LFAs across the country collect a 5% franchise fee from cable operators. Often the local franchise defines the "gross revenues" on which the franchise fee is based. Recently many state statutes have created a uniform definition of gross revenues which may now supersede a local franchise definition. In many cases, however, LFAs also collect additional financial support or in kind support for public, educational and governmental ("PEG") programming. The Cable Act permits LFAs to collect PEG financial support over and above the 5% franchise fee cap so long as such payments are considered "capital costs." Capital costs are those that are required by the franchise to be incurred by the cable operator for "public, educational, or governmental access facilities." 47 USC § 542(g)(2)(C).

In the First Order the Commission differentiated between: 1) costs incurred in or associated with the construction of PEG access facilities, which qualify as capital costs and therefore fall into the franchise fee exclusion; and 2) payments in support of the use of PEG access facilities, which do not qualify as capital costs and so are subject to the 5% statutory cap on franchise fees. In the legal challenge to the First Order, municipalities maintained that it was both unreasonable and contrary to congress' intent to interpret the PEG access provisions in this matter. In particular, municipalities argued that the FCC was narrowing the meaning of "capital costs" to only costs related to the construction of PEG facilities. The municipalities argued that many cities received payments from cable operators that are used not just for construction of PEG access studios but also for the acquisition of equipment needed to produce PEG access programming, such as cameras and editing equipment.

In responding to this challenge, the FCC argued that its interpretation did not signify that the term "capital costs" necessarily excludes equipment. The FCC instead argued that the central test for determining whether an expense is a capital cost is whether it is "incurred or associated with the construction of PEG access facilities." The definition, the FCC argued, could potentially encompass the cost of purchasing equipment, as long as that equipment relates to the construction of access facilities. In reviewing this question, the Sixth Circuit looked at the legislative history of the Cable Act and found that Congress had explained that channels designated for PEG use "may include vans, studios, cameras, or other equipment relating to use of public, educational, or governmental channel capacity."

The Sixth Circuit held that the unambiguous expression of Congress confirms that “PEG access capacity” extends not only to facilities but to related equipment as well. The Court found that based on the clear congressional intent, coupled with the fact that the FCC concedes that its definition of “capital costs” covers the cost of equipment as long as it is incurred in or associated with the construction of PEG access facilities,” municipalities’ further attempt to create a arbitrary distinction between facilities and equipment is unnecessary.

AT&T’s U-verse TV is a cable service.

AT&T has long argued that it is not a cable operator and that its U-verse video service is not a “cable service.” Therefore AT&T generally argues that its is not governed by the Cable Act nor should it have to obtain a local cable franchise. Not surprisingly, both LFAs and incumbent cable operators disagree with AT&T’s position. So far only one court has directly addressed the question of whether AT&T’s U-verse service is a “cable service.” Judge Janet Bond Arterton of the U.S. District Court for the District of Connecticut issued a decision on July 26, 2007 that held that AT&T was a “cable operator,” operating a “cable system” and providing “cable service.”

AT&T petitioned this same U.S. District Court for the District of Connecticut seeking to have Judge Arterton’s decision overturned. AT&T argued that since July 2007, the Connecticut legislature approved a new state franchising bill which allows AT&T to serve the whole state as a “video service provider.” As a result of the new state legislation, AT&T argued that the July 2007 ruling was now moot. AT&T basically was attempting to get the decision dismissed solely to avoid the adverse legal precedent since the case no longer had any practical impact on AT&T’s business in Connecticut.

In a July 10, 2008 decision, the U.S. District Court refused to amend its prior decision stating that while the new Connecticut franchising law addressed certain issues, there remained questions to be answered by the FCC or a court whether provisions of the Cable Act apply to AT&T’s video service. For now Judge Atherton’s July 2007 decision remains the only reported case answering the question whether AT&T’s U-verse service is a “cable service.” The question now becomes whether the FCC will attempt to solve this issue before a new administration takes office.

Who is winning video subscribers in 2008?

By the end of the first quarter of 2008, AT&T, Qwest and Verizon, the three remaining regional Bell operating companies (RBOCs), collectively served approximately 5.5 million video subscribers. Nearly three-quarters (75%) of those video subscribers came from partnerships which the RBOCs had with DirecTv and Dish Network. However that percentage is decreasing as Verizon and AT&T continue to build out their networks to provide video services directly to their customers without reliance on satellite services. So far Qwest has not chosen to engage in widespread system construction but has instead focused on its satellite partnerships to provide video services. More recently, the weak economy and aggressive competition from incumbent cable operators have slowed the subscriber growth for video services for RBOCs. With billions of dollars being

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invested in new infrastructure, the question remains whether the RBOCs can gain new video and data customers fast enough to offset the loss of traditional telephone customers.

Next battleground: pole attachment fees.

In the fall of 2007, the FCC issued a notice of proposed rule making which concluded that attachments to utility poles used for broadband internet services should be subject to the same pole attachment rates applicable to other providers under FCC regulations. The FCC is also considering requests from the industry to apply a single rate for the use of a pole. Presently the cable industry has the lowest prescribed rate for pole attachments at 7.4% of the annual pole cost, while phone companies such as competitive local exchange carriers (CLECs) designated rate averages 11.2%. Many industry observers question whether the FCC may attempt to implement rules to “level the playing field” for pole costs as the FCC has tried to do in so many other areas.

Pole attachment rates is an issue of particular importance to municipally owned utilities which have generally not been subject to the FCC’s pole attachment formula but have often used the formula as a guide for establishing rates. In many rural communities across the country pole attachment rates are generally far lower than industry standards and the industry has effectively lobbied municipalities to maintain these low rates, arguing that any increase would simply be passed onto subscribers resulting in higher cable television or telephone rates. Recently municipal utilities are far less influenced by these industry arguments in an era where competition from satellite wireline providers justifies that pole attachments be priced at market rates. This issue also presents municipal utilities with an opportunity to update antiquated pole attachment agreements to address issues regarding the number and size of attachments to municipal poles, backup power supply, conduit use agreements and related matters which may not be addressed in the existing pole attachment agreement, some of which were drafted as much as 25 years ago.

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The materials in this [Municipal Communications Law Update](#) have been compiled from a variety of sources and address only a portion of the relevant issues contained within hundreds of pages of regulations and decisions. We have not addressed many important points that may apply to your situation. You should consult with legal counsel before taking any action on matters covered by this [Municipal Communications Law Update](#).

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