ICLE International Center for Law & Economics

July 18, 2019

<u>VIA ECFS</u>

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street SW
Washington, DC 20554

Re: *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

Dear Ms. Dortch:

We are writing in support of the Federal Communications Commission's (FCC's) proposed rulemaking on the implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984.[1] As the competitive landscape for both the delivery of video programming as well as Internet access has been undergoing revolutionary changes in the last decade, the Commission's careful examination of these issues is welcome and timely.

Congress passed the 1984 Cable Act in order to create a unified national framework for regulating networks for cable networks involving municipalities, cable operators, and the FCC.[2] As described by its primary sponsor, Sen. Barry Goldwater of Arizona, the Cable Act was drafted in order to reduce barriers standing in the way of the adoption of cable technology.[3]

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[1] 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, Second Further Notice of Proposed Rulemaking, 33 FCC Rcd. 8952 (2018) ("Second FNPRM").

[2] *See* 47 U.S. Code § 521(1).

[3] 129 Cong. Rec. S8254 (daily ed. June 13, 1983) (statement of Sen. Goldwater) (stating that the "overriding purpose" of the five percent cap was to prevent franchising authorities from "taxing private cable operators to death as a means of raising . . . revenues for other concerns"); S. Rep. No. 98-67, at 25 (1983) ("The committee feels it is necessary to impose such a franchise fee ceiling because the committee

The Act was passed and later amended in a way that carefully drew lines around the acceptable scope of franchising authorities' de facto monopoly power in granting cable franchises. The thrust of the Act was to encourage competition and build-out by discouraging franchising authorities from viewing cable providers as a captive source of unlimited revenue. It did this while also giving franchising authorities the tools necessary to support public, educational, and governmental ("PEG") programming and enabling them to be fairly compensated for use of the public rights of way.

Unfortunately, since the 1984 Cable Act was passed, an increasing number of local and state franchising authorities (collectively, "LFAs") have attempted to work around the Act's careful balance. In particular, these efforts have created two main problems:

First, LFAs frequently attempt to evade the Act's limitation on franchise fees to five percent of cable revenues by seeking a variety of in-kind contributions from cable operators that impose costs over and above the five percent limit.[4] LFAs do this despite the plain language of the statute defining franchise fees quite broadly as including *any* "tax, fee, or assessment **of any kind** imposed by a franchising authority or any other governmental entity."[5]

Although not nominally "fees," such requirements are indisputably "assessments," and the costs of such obligations are equivalent to the marginal cost of a cable operator providing those "free" services and facilities, as well as the opportunity cost (i.e., the foregone revenue) of using its fixed assets in the absence of a state or local franchise obligation. Any such costs will, to some extent, be passed on to customers as higher subscription prices, reduced quality, or both. By carefully limiting the ability of LFAs to abuse their bargaining position, Congress ensured that they could not extract disproportionate rents from cable operators (and, ultimately, their subscribers).

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is concerned that, without a check on such fees, local governments may be tempted to solve their fiscal problems by what would amount to a discriminatory tax not levied on cable's competitors.").

[4] *See, e.g.*, Deborah Collier, *How to Prevent Local Governments from Abusing Cable Franchise Fees*, MORNING CONSULT (Jan. 30, 2019), https://morningconsult.com/opinions/how-to-prevent-local-governments-from-abusing-cable-franchise-fees/.

[5] 47 U.S.C. § 542 (emphasis added).

Second, LFAs also attempt to circumvent the franchise fee cap of five percent of gross cable revenues by seeking additional fees for non-cable services provided over mixed-use networks (i.e. imposing additional franchise fees on the provision of broadband and other non-cable services over cable networks).[6] But the statute is similarly clear that LFAs or other governmental entities cannot regulate non-cable services provided via franchised cable systems.

In this letter, we analyze the law and economics of both the underlying statute and the proposed rulemaking. For a variety of reasons set forth below, we believe that the Commission is on firm legal and economic footing to adopt its proposed Order.[7] It should be unavailing – and legally irrelevant – to argue, as many LFAs have, that declining cable franchise revenue leaves municipalities with an insufficient source of funds to finance their activities, and thus that recourse to these other sources is required. Congress intentionally enacted the five percent revenue cap to prevent LFAs from relying on cable franchise fees as an unlimited general revenue source.

In order to maintain the proper incentives for network buildout — which are ever more-critical as our economy increasingly relies on high-speed broadband networks — the Commission should adopt the proposed Order.

I. The Commission correctly interprets the Cable Act as treating in-kind obligations as economically equivalent to monetary fees

It is unsurprising that state and local governments would seek to derive as much revenue from cable franchises as possible: raising taxes is never popular, and local governments are perennially strapped for cash. Congress understood this reality when it wrote the Cable Act and calibrated the law to ensure that municipalities received sufficient compensation for the use of public rights-of-way when granting cable franchises, while also restraining their ability to exact excessive revenue from a captive audience.

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[6] *See, e.g.,* City of Eugene v. Comcast of Oregon II, Inc., 359 Or. 528 (2016).

[7] 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, Third Report and Order, MB Docket No. 05-311, *available at* https://docs.fcc.gov/public/attachments/DOC-358439A1.pdf

Yet some municipalities seek to evade the statute and the Commission's rules in order to find new sources of revenue. In pursuit of this goal, LFAs structure their franchising requirements in order to obtain more compensation from cable companies beyond the Cable Act's five-percent-of-cable-revenue cap. They do this in the first instance largely by requiring a variety of in-kind contributions, in addition to the maximum monetary franchise fee payment permitted under federal law.

As Congress noted in its proceedings prior to the passage of the 1984 Cable Act, these obligations can reach absurd heights.[8] Among the forms of in-kind obligations required by municipalities are demands that cable operators provide free cable and Internet service to local government buildings in exchange for franchise approval.[9] Other in-kind payments can take the form of support for PEG channels and municipal fiber connections.[10] Comments in this docket further demonstrate the wide range of demands that LFAs impose on cable operators, including such far-ranging items as:

> **courtesy accounts with courtesy equipment, I-Net construction, network capacity, channels, grants, sponsorships, specially created programming, local retail facilities, cash "contributions," free advertising and more —** above and beyond the five percent cap on cable franchise fees established by Congress.[11]

LFAs are positioned to impose these extra-legal requirements by virtue of their monopoly control of public rights-of-way, as well as through the cable franchising authority granted in the Cable Act.[12] In much the same way that a private company might try to leverage market power in a regulated market to capture supra-competitive profits in a related, unregulated market, some LFAs are attempting to leverage

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[8] *Options for Cable Legislation: Hearings on H.R. 4103 and H.R. 4229 Before the House Telecommunications Subcomm.*, 98th Cong., 1st Sess. 776 (1983).

[9] *See* Second FNPRM, *supra* note 1 at ¶ 78.

[10] *See* Comments of NCTA – The Internet & Television Association, In the Matter of 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, at 3 (Nov. 14, 2018).

[11] *Id* (emphasis added). The taxation of non-cable services over mixed-use networks is discussed *infra*, at Section II.

[12] *See* 47 U.S. Code § 541, et seq.

their monopoly on cable franchising licenses to capture rents in non-cable services and obligations.

A. Basic economic theory treats in-kind contributions as equivalent to direct monetary fees

Local cable networks are a classic case of the hold-up problem that can arise from asset specificity. This economic concept was pioneered by Nobel economist Oliver Williamson in 1975[13] and further developed by Klein, Crawford, & Alchian in their classic 1978 article, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*:

> The particular circumstance we emphasize as likely to produce a serious threat of this type of reneging on contracts is the presence of appropriable specialized quasi-rents. After a specific investment is made and such quasi-rents are created, the possibility of opportunistic behavior is very real.[14]

For cable networks, once the wires have been installed, the assets in the network are irreversibly tied to the local institutional environment. Ben Klein describes the potential for hold-up in this type of scenario:

> Once a transactor makes a relationship-specific investment, its transacting partner has the ability to take advantage of the specificity to appropriate some of the rents the transactor expects to earn on the investment.[15]

Seemingly recognizing this potential problem, the 1984 Cable Act included explicit language capping franchise fees. Section 622 of the Communications Act of 1934, which was added in the 1984 Cable Act, is clear on this point:

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[13] WILLIAMSON, OLIVER E. MARKETS AND HIERARCHIES. ANALYSIS AND ANTITRUST IMPLICATIONS: A STUDY IN THE ECONOMICS OF INTERNAL ORGANIZATION. (University of Illinois at Urbana-Champaign's Academy for Entrepreneurial Leadership Historical Research Reference in Entrepreneurship, 1975).

[14] Benjamin Klein, Robert G. Crawford, and Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*. 21 J. L. & ECON. 297 (1978).

[15] Benjamin Klein, *Asset Specificity and Holdups*, in THE ELGAR COMPANION TO TRANSACTION COST ECONOMICS 120-126 (Peter G. Klein and Michael E. Sykuta, eds., 2010).

> **(b) Amount of fees per annum**
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> For any twelve-month period, **the franchise fees paid by a cable operator with respect to any cable system shall not exceed 5 percent of such cable operator's gross revenues** derived in such period from the operation of the cable system.[16]

Thus, as originally enacted, Congress authorized LFAs to collect up to five percent of the gross revenues from the operation of a cable system to provide cable, as well as any non-cable services, such as cable modem service (now "broadband").

As part of the 1996 Act, Congress amended Section 622 to limit franchise fees to up to five percent of the gross revenues derived "from the operation of the cable system ***to provide cable services***" only.[17] In doing so, Congress determined that up to five percent of cable services revenues was adequate compensation for use of the public rights-of- way by a cable system. Congress also wanted to encourage the growing use of cable systems to provide broadband and other non-cable services, consistent with the overarching objectives of the 1996 Act to promote greater broadband deployment and intermodal competition.

Congress further understood that local governments have an incentive to change franchise rules after an operator invests in the buildout of a cable network.[18] Once those investments become sunk costs for the cable operators, municipalities are in a position to extract excessive rents from the providers on an ongoing basis.[19]

The in-kind obligations assessed on cable operators in excess of the five percent cap are the exact sort of problem one would expect to arise from the asset-specific investment of cable operators in territories controlled under a municipal cable franchising monopoly. The various obligations, although not nominally "fees," impose the same burdens as direct fees (and offer equally desirable benefits to the LFAs that impose them). Congress was correct to establish a firm limit on such assessments.

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[16] Cable Communications Policy Act of 1984, Pub. L. No. 98-549, § 2, 98 Stat. 2779, 2787 (1984) (codified at 47 U.S.C. § 542(b)) (emphasis added).

[17] Telecommunications Act of 1996, Pub. L. No. 104-104, § 303(b), 110 Stat. 56, 124-25 (1996).

[18] *See* statement of Sen. Goldwater, *supra* note 3.

[19] Benjamin Klein, *supra* note 15.

From the perspective of a cable company (and its customers), the costs of such obligations are equivalent to the marginal cost of providing those "free" services and facilities, as well as the opportunity cost (i.e., the foregone revenue) of using its fixed assets in the absence of a franchise obligation.[20] Further, any such costs incurred will, to some extent, be borne by customers as higher subscription prices, reduced quality as a result of reduced investment in infrastructure and service improvements, or both.[21]

Even the municipalities challenging the Commission's proposals appear to reluctantly acknowledge the underlying equivalence of in-kind obligations and direct fees. In one comment from a coalition of LFAs, the municipalities acknowledge that including both in-kind and direct assessments together as part of the calculation against the five percent cap would force a difficult economic decision upon them:

> [Treating in-kind obligations as equivalent to direct fees] would, in practice, deny many communities basic communications infrastructure that benefits education, public safety, and consumers of all kind. **If implemented, local governments around the country would be forced to make difficult decisions about reductions in service** (i.e., coverage of governmental meetings, community media, and broadband to schools) **or increases in local revenue sources in order to ensure their communities can compete in the 21st century.**[22]

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[20] The nominal value of an in-kind obligation may not be the actual economic burden of the requirement, but merely its "sticker price." The actual burden is much more difficult to compute as it is dependent on the competitive outlook of providing services in the relevant area. This doubly supports the Commission's established position that in-kind obligations cannot be imposed upon cable providers in excess of the five percent cap in order to obtain a franchise.

[21] *See, e.g.,* Laurence J. Kotlikoff and Lawrence H. Summers, *Tax Incidence, in* 2 HANDBOOK OF PUBLIC ECONOMICS 1043-1092, 1088 (A.J. Auerbach and M. Feldstein, eds., 1987) ("Tax incidence's basic lesson that real and nominal tax burdens are not necessarily related means that taxes on capital may be borne by workers, that investment incentives may be injurious to capitalists, that taxation of foreigners may simply represent indirect domestic taxation, and that generations alive many decades in the future may be supporting those currently alive.")

[22] Comments of Anne Arundel County et. al at 3, Implementation of Section 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, at 3 (Nov. 14, 2018) (emphasis added) (hereinafter "LFA Comments").

In other words, the municipalities acknowledge that the in-kind obligations confer benefits that they would otherwise have to purchase on the open market using revenues generated by franchise fees or other revenue. The decision between foregoing consumption to decrease expenses or preferring consumption of services but retaining less revenue is indeed a difficult one. It is a basic law of economics that affects everyone, not just municipalities searching for revenue sources or convenient ways to fund services without having to ask for taxpayer permission. But it is not incumbent upon cable providers to serve as a solution for this difficulty, and Congress determined that this is precisely the choice that franchising authorities must make by including provisions in the Communications Act that ensure that cash-strapped municipalities would not be able to treat cable providers as municipal-revenue-generation machines.

Indeed, Congress intuitively understood that in-kind obligations were essentially equivalent to direct fees, and it chose to limit *both* forms of franchising assessment together. In the Cable Act, "franchise fee" is broadly defined to cover *any* "assessment of any kind imposed by a franchising authority":

> **(g) "Franchise fee" defined**
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> For the purposes of this section—
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> (1) the term "franchise fee" includes any tax, fee, ***or assessment of any kind*** imposed by a franchising authority or other governmental entity on a cable operator or cable subscriber, or both, solely because of their status as such;

Congress also made a clear distinction between pre-1984 franchise fees and post-1984 franchise fees and excluded from the post-1984 definition of "franchise fee" a narrower category of payments:

> (2) the term "franchise fee" does not include—
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> * * *
>
> (B) in the case of any franchise in effect on October 30, 1984, **payments** which are required by the franchise to be made by the cable operator during the term of such franchise for, or in support of the use of, public, educational, or governmental access facilities;

> (C) in the case of any franchise granted after October 30, 1984, **capital costs** which are required by the franchise to be incurred by the cable operator for public, educational, or governmental access facilities.[23]

As the plain language shows, franchise fees in place prior to enactment — that is, the fees capped at five percent of gross cable revenues — did not include "payments" made in support of PEG programs. But for franchises granted *after* the effective date, only *capital costs* for the construction of PEG facilities are excluded from the definition of franchise fee — a much narrower, more-specific exception.

Thus, after the effective date, anything that is a "payment" *but not a capital expense* in support of PEG programs — for instance, a grant to create local programming, or a provision of local production services to broadcast municipal meetings — is no longer excluded from the definition of a franchise fee. It is clear that Congress intended to sweep in a much broader class of payments that would count toward the statutory cap.

Demanding additional assessments over and above the statutory five percent cap in *any form* other than the very narrow exceptions that apply for franchises granted after the effective date — whether as in-kind payments or other obligations — is disallowed. This is to say that Congress understood that, from the perspective of the cable providers and their customers, in-kind requirements are equivalent to explicit fees, and therefore are subject to the five percent cap.

1. *LFA comments have misconstrued different Cable Act rights and obligations*

The LFA Comments again inadvertently support the foregoing view of the Cable Act. Their comments question the logic of Congress including a limitation on the aggregate of franchise fees and in-kind obligations, while also authorizing other requirements that cable providers must comply with in order to qualify for a franchise:

> If the Commission's view were correct … some of the Cable Act's rules would make no sense. For example, why would Congress have preserved a locality's authority to enforce requirements for the provision of "broad categories of video programming" or "other services" in a franchise (conditions designed to ensure that an adequate level for service is provided

23 47 U.S.C. § 542(g) (emphasis added)

> to subscribers), if the locality had to pay to do so. Or, why would Congress, in the context of a renewal, say that an operator's proposal must be "reasonable to meet cable-related needs and interest in light of the cost of meeting the needs and interests," but then suggest that virtually all the costs associated with meeting those needs and interests are to be paid for by the locality out of franchise fees. Congress could have easily written that the parties are free to negotiate a price for such services, or simply remained silent on the topic. Finally, why would Congress have provided for itemization of costs on the cable bill, if Congress intended that the costs be deducted from the franchise fee?[24]

The LFA Comments erroneously conflate what the Cable Act authorizes LFAs to require in a franchise with whether Congress intended the associated cost to be imposed on cable operators and their subscribers *in addition* to a monetary franchise fee payment. As the FCC observed in its Second FNPRM, "[t]he fact that the Act authorizes LFAs to impose such obligations does not . . . mean that the value of these obligations should be excluded from the five percent cap on franchise fees."[25] As noted above, Congress adopted a broad definition of "franchise fee" with only narrow exceptions for PEG capital costs, fees of general applicability (such as a general sales taxes), and incidental franchise-related costs (such as reasonable insurance requirements).[26] Through this limiting principle, Congress meant to protect cable subscribers from excessive taxation in the form of unlimited franchise fees while excluding the possibility of vesting an open-ended regulatory power over cable providers in LFAs.

To take one example, Congress granted LFAs the authority to require capacity on institutional networks.[27] Although LFAs are generally forbidden from regulating non-cable services (discussed further *infra*, at Section II), both the FCC and the Sixth Circuit have acknowledged that "the [Cable] Act makes clear that local franchising

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[24] LFA Comments, *supra* note 22, at 11.

[25] Second FNPRM, *supra*, note 1 at ¶ 20.

[26] *See* 47 U.S.C. § 542(g).

[27] 47 U.S.C. § 531(b).

authorities can regulate I-Nets."[28] Thus, if community needs and interests justify a franchise requirement that I-Net capacity be provided to the LFA or its designee, the LFA can condition a franchise grant or renewal on the cable operator's provision of that service. That does not mean, however, that the cable operator must provide that I-Net capacity for "free" in addition to a five percent franchise fee. As the Second FNPRM observes, the Cable Act definition of "franchise fee" "carves out only limited exclusions [e.g., for PEG capital costs] . . . [but] makes no mention of an I-Net-related exclusion."[29] If an LFA requires I-Net capacity for its own use as part of a franchise agreement, that requirement is an "assessment" on the cable operator and an in-kind contribution subject to the franchise fee cap.

In contrast, other franchise conditions may impose costs on the cable operator that are not taxes, fees, or assessments for the benefit of the LFA. The Cable Act authorizes LFAs to prevent "redlining" through reasonable construction requirements "to assure that access to cable service is not denied to any group of potential residential cable subscribers because of the income of the residents of the local area in which such group resides."[30] But as the FCC has observed, "build-out obligations (unlike I-Net facilities) involve the construction of facilities that are not specifically for the use or benefit of the LFA or any other entity designated by the LFA, but rather are part of the provision of cable service in the franchise area."[31] Consequently, the cost of cable line extensions to provide service to new subscribers is beyond the scope of the statutory definition of franchise fees and the five percent cap. The FCC has correctly distinguished between costs of providing cable service to a community and costs that must count toward the franchise fee cap as non-monetary compensation to LFAs or their designees.

It is not unreasonable, of course, for municipalities to prefer to be compensated with in-kind contributions instead of direct fees. But it would make no sense for the LFAs'

[28] Montgomery Cty., Maryland v. Fed. Commc'ns Comm'n, 863 F.3d 485, 492 (6th Cir. 2017) (noting the FCC's position that "its mixed-use ruling was not meant to prevent local franchising authorities from regulating institutional networks").

[29] Second FNPRM, *supra*, note 1 at ¶ 20.

[30] 47 U.S.C. § 541(a)(3).

[31] Second FNPRM ¶ 21.

choice of the *form* of compensation to supplant Congress' express limitation on the *amount* of compensation that LFAs may extract from franchisees.

2. *The Commission correctly interprets the Cable Act by including in-kind obligations in the five percent franchise fee cap*

Not only do in-kind requirements above the five percent cap violate economic logic and the terms of the Cable Act, but they also run afoul of Commission rules enacted and upheld across multiple administrations. Most recently, in 2015, the Obama-era FCC reconsidered its earlier orders on cable franchise fees and not only affirmed that in-kind obligations would count toward the five percent statutory cap, but also confirmed that the cap did not "exempt[] in-kind payments only when such in-kind payments are unrelated to cable service."[32] Instead, the Commission clearly stated that:

> Consistent with the First Report and Order, the Second Report and Order also notes that non-incidental in-kind fees must count toward the 5 percent franchise fee cap, and does not limit the franchise fee exemption to in-kind payments that are unrelated to cable service.[33]

The LFAs' comments to the Commission on the proposed Order attempt to hold up the Sixth Circuit *Montgomery County* case as evidence that the Commission is not permitted to treat in-kind obligations toward the five percent cap.[34] But they do so largely based on a misreading of the case.

In *Montgomery County*, the Sixth Circuit noted that in 2007 and again in 2015 the Commission adopted an interpretation of the Cable Act that clarified the sorts of fees that LFAs could charge to both incumbent cable providers as well as new entrants.[35] On review of the 2015 Order, the Sixth Circuit affirmed the threshold principle that "'franchise fee' as defined by § 542(g)(1) can include noncash exactions,"

[32] Implementation of Section 621(A)(1) of the Cable Communications Policy Act of 1984 as Amended by the Cable Television Consumer Protection Act of 1992, Order on Reconsideration, 30 FCC Rcd 810, ¶ 13 (2015).

[33] *Id.*

[34] LFA Comments, *supra* note21, at 13.

[35] Montgomery Cty., Maryland v. Fed. Commc'ns Comm'n, 863 F.3d at 488.

while also noting "[t]hat the term . . . can include noncash exactions, of course, [but that] does not mean that it necessarily does include every one of them."[36] Thus, the court did not address the *merits* of which in-kind assessments count toward the franchise fee cap. Rather, in remanding the case, the court merely found that the Commission had insufficiently explained what it meant by "in-kind" fees and directed that

> the FCC should determine and explain anew whether, and to what extent, cable-related exactions are "franchise fees" under the Communications Act.[37]

Thus, the Second FNPRM was undertaken in order to comply with the APA and the Sixth Circuit's command. By adopting and setting forth the statutory and other grounds for its tentative conclusions, the FCC will be on firm legal and economic footing in its order on remand.

II. The Commission is within its authority to forbid taxation of non-cable revenue derived from mixed-use networks for both incumbents and new entrants

The Cable Act and associated legislative history are clear that LFAs may not tax non-cable revenue derived from the operation of cable systems, including from services such as Voice over Internet Protocol (VoIP) and broadband. Nonetheless, LFAs have been leveraging their monopoly over access to public rights-of-way in order to tax non-cable revenues and thus further circumvent the five percent of *cable service* revenues statutory limit imposed by Congress as part of the 1996 Act.[38]

And this problem is only increasing. In 2016, for example, the Supreme Court of Oregon upheld fees on non-cable revenue imposed by the city of Eugene under the guise of a 'telecommunications tax' on cable providers that ran mixed-use networks.[39] In reaching its conclusion, the Oregon Supreme Court erroneously read the language

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[36] *Id.* at 491.

[37] *Id.* at 492.

[38] *See, e.g.*, City of Eugene v. Comcast of Oregon II, Inc., 359 Or. 528 (2016).

[39] City of Eugene v. Comcast, 359 Or. at 557-58. The tax in question was a nine percent tax on the provision of telecommunications services by the City of Eugene Oregon. *See* Eugene, Oregon, Municipal Code § 20083.

of the Cable Act to allow such fees so long as they also apply to any other non-cable entity that wished to provide telecommunications services.[40]

Following the *City of Eugene* case, cities across Oregon began imposing new fees and regulations on cable operators for the provision of non-cable services. Corvallis, Oregon, for example, imposed a five percent fee on voice service revenues on top of the maximum cable franchise fee.[41] The city also recently attempted to extract additional payments from Comcast in exchange for allowing the cable operator to install Wi-Fi equipment as part of its cable system in public rights-of-way, even though the cable operator's franchise already granted it the requisite rights to undertake such activity.[42]

Although most acute in Oregon, this problem is not isolated to that state. New local regulations on non-cable services in some cities — Upper Arlington, Ohio,[43] for example — require cable providers to obtain — and pay for — separate authorizations to use the ROW in addition to their cable franchises. These fees are particularly pernicious because they impose an additional tax to fund precisely the same services — maintenance costs for the public rights-of-way — that the cable franchise fees are already supposed to cover.

As we detail below, however, the taxation of non-cable revenue from mixed-use networks violates both the plain language of the Cable Act and the Commission's relevant interpretations of the Act.

A. A brief review of the Commission's interpretation

In its first Section 621 Report and Order in 2007, the Commission clarified its interpretation of the Cable Act's fee limitation with respect to new entrants:

> [A] cable operator is not required to pay franchise fees on revenues from non-cable services. Section 622(b) provides that the "franchise fees paid

[40] City of Eugene v. Comcast, 359 Or. at 555.

[41] Ord. 2001-20, § 1, (Dec. 17, 2001); Ord. 70-99 § 2 (1970).

[42] James, Day, Corvallis, *Comcast feuding over wi-fi boxes*, COVALLIS GAZETTE-TIMES (Aug. 9. 2018) *available at* https://www.gazettetimes.com/news/local/corvallis-comcast-feuding-over-wi-fi-boxes/article_15e05cfb-3432-5d21-8c09-5955a2b1a0d0.html; *see* 47 U.S.C. § 541(a)(2) ("Any franchise shall be construed to authorize the construction of a cable system over public rights-of-way, and through easements, which is within the area to be served by the cable system . . . .").

[43] *See* Upper Arlington, Ohio Municipal Code §§ 777.13(A), 933.05(A), 933.24(E)(1).

> by a cable operator with respect to any cable system shall not exceed 5 percent of such cable operator's gross revenues derived in such period from the operation of the cable system to provide cable services." … The Commission determined in the Cable Modem Declaratory Ruling that a franchise authority may not assess franchise fees on non-cable services, such as cable modem service, stating that "revenue from cable modem service would not be included in the calculation of gross revenues from which the franchise fee ceiling is determined." … Thus, Internet access services, including broadband data services, and any other non-cable services are not subject to "cable services" fees.[44]

In 2015, the Commission extended this rule to cover incumbent providers as well.[45]

A year later, the Oregon Supreme Court decided the *City of Eugene* case, which contradicted the FCC's 2015 order without actually referring to the Order itself.[46] In reaching its conclusion, the Court misread the relevant legislative history. In particular, it acknowledged that the legislative history indicates that "cable operators are permitted under the provisions of [the Cable Act] to provide any mixture of cable and non-cable service they cho[o]se,"[47] but the Court then went on to declare that, nonetheless, the "legislative history establishes, at most, that the Cable Act *does not prohibit* a cable operator from providing noncable services."[48]

This focus on whether the Cable Act "permits" or "does not prohibit" the provision of non-cable services misses the point. The Cable Act requires that a cable franchise conveys a right to construct and operate a "cable system" in the public rights of way,[49] and the Commission has long since confirmed that its legislative history establishes that this right is not limited by which services are provided from the operation of the

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[44] In the Matter of Implementation of Section 621(a)(1) of the Cable Commc'ns Policy Act of 1984 as Amended by the Cable Television Consumer Prot. & Competition Act of 1992, Report and Order and Further Notice of Proposed Rulemaking, 22 F.C.C. Rcd. 5101, ¶ 97 (2007).

[45] Implementation of Section 621(A)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection Act of 1992, Order on Reconsideration, 30 F.C.C. Rcd. 810, ¶ 11 (2015).

[46] *Supra* note 38.

[47] *Id.* at 546.

[48] *Id.* at 547 (emphasis added).

[49] *See* 47 U.S.C. § 541(a)(2).

cable system.[50] If a cable operator has already obtained the right to construct and operate its cable system from the LFA through a franchise agreement, the cable system may be operated to provide both cable and non-cable services. The LFA cannot purport to subsequently convey that very same right to the very same cable operator a second time for the provision on non-cable services in exchange for an additional fee.[51]

Changes to the Cable Act in 1996 lend additional support to this reading. There, as explained above, Congress changed the franchise fee cap so that only *cable service* revenues are taken into account, as opposed to revenues from the operation of the cable system as a whole.[52] The congressional intent here was to ensure that cable operators could offer broadband and other non-cable services from the operation of their cable systems without facing new regulatory burdens imposed by LFAs. After all, the central purpose of the 1996 Act was to boost competition by encouraging providers to supply new services in the most efficient ways possible, including by deploying new services over networks already in place.[53]

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[50] *See* H.R. Rep. No. 98-934, at 44, *as reprinted in* 1984 U.S.C.C.A.N. at 4681 ("The term 'cable system' is not limited to a facility that provides only cable service which includes video programming. Quite the contrary, many cable systems provide a wide variety of cable services and other communications services as well. A facility would be a cable system if it were designed to include the provision of cable services (including video programming) *along with communications services other than cable service*.") (emphasis added); Heritage Cablevision Associates of Dallas, L.P. v. Texas Utilities Electric Co., Memorandum Opinion and Order, 6 FCC Rcd. 7099 ¶ 24, *aff'd,* Tex. Utils. Elec. Co. v. FCC, 997 F.2d 925 (D.C. Cir. 1993) ("[T]he House Report accompanying the Cable Act clearly defeats [the] claim that a cable operator's facilities cease being a 'cable system; merely because they carry non-cable communications services in addition to video entertainment.").

[51] *See* Liberty Cablevision of Puerto Rico, Inc. v. Municipality of Caguas, 417 F.3d 216, 221 (1st Cir. 2005) ("The [LFA], in granting a franchise to [the cable operator], enables [the cable operator] to use the public 'rights-of-way' within the municipalities. Therefore, the municipalities' attempts to assess fees for use of these same rights-of-way are inconsistent with the Cable Act and are necessarily preempted.").

[52] *See supra* notes 15-16 and accompanying text.

[53] *See* Promotion of Competitive Networks in Local Telecommunications Markets, Notice of Proposed Rulemaking and Notice of Inquiry and Third Further Notice of Proposed Rulemaking, 14 FCC Rcd. 12673 ¶ 12 (1999) ("Incipient and potential challenges to the incumbent LECs may come from several sources. . . . [C]ompanies offering or planning to offer two-way broadband services to residential consumers include cable television companies using 'cable modems.' . . . We note that Congress apparently contemplated this variety when it included provisions in the 1996 Act to promote competition to the incumbent LECs from entities that have not traditionally offered telecommunications services."); *id.* ¶ 25 ("[C]ompetitive providers must be free to provide services in the manner that will enable them

The current proceeding was initiated in light of the 2016 *Montgomery County* ruling by the Sixth Circuit that held that the Commission had insufficiently substantiated its 2015 Order.[54] But, contrary to the assertions of the LFAs, the Sixth Circuit ruling was not directly on the merits of the Commission's decision. In fact, as we detail below, the Commission is on solid statutory and economic ground in its present proposal to extend its mixed-use rule to incumbent cable operators.

B. The Commission's proposed rule is justified by the legal and economic realities underlying the Act

Despite assertions to the contrary in the LFAs' Comments,[55] the *Montgomery County* decision did not deny the Commission's authority to prevent LFAs from taxing non-cable services of incumbent providers. The Sixth Circuit, instead, questioned whether the Commission had sufficiently elaborated on the basis for that authority and remanded the case for clarification of the issue.[56] Although the FCC did not rely on this analysis in its Second Order, the answer to the Sixth Circuit's query is within the plain language of the Cable Act:

> [T]he franchising authority, to the extent related to the establishment or operation of a cable system … may establish requirements for facilities and equipment, but **may not … establish requirements for video programming or other information services**.[57]

And although the term "information services" was not explicitly defined in the 1984 Act, the legislative history does contain evidence that illuminates its meaning:

> All services offered by a cable system that go beyond providing generally-available video programming or other programming are not cable services … In general, services providing subscribers with the capacity to

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most efficiently to offer the services, or combinations of services, that consumers desire. We anticipate that the most successful future networks may be those that are the most highly functional and flexible. Achieving this functionality and flexibility may involve the use of a variety of transmission technologies."); *see also* 141 Cong. Rec. H8294 (Aug. 2, 1995) (statement of Rep. White) ("Under this bill, the market, not the government, is going to tell us what the next wave of technology is.").

[54] Montgomery Cty., Maryland v. Fed. Commc'ns Comm'n, 863 F.3d at 493.

[55] LFA Comments, *supra* note 21, at 36.

[56] Montgomery Cty., Maryland v. Fed. Commc'ns Comm'n, 863 F.3d at 491-92.

[57] 47 U.S. Code § 544 (emphasis added).

> engage in transactions or to store, transform, forward, manipulate, or otherwise process information or data would not be cable services.[58]

Particularly given that this legislative history is consistent with the statutory definition of "information service" subsequently added to the Communications Act[59] — a definition the Commission has determined to apply to broadband Internet access[60] — it seems clear that Congress intended to exclude the regulation of non-cable services like broadband Internet access offered over mixed-use networks.[61]

In addition, the Cable Act provides that a franchising authority "may not impose any requirement under this subchapter that has the purpose or effect of prohibiting, limiting, restricting, or conditioning the provision of a telecommunications service by a cable operator.[62] To the extent that cable providers offer telecommunications services subject to Title II of the Communications Act, the prohibition on LFAs' taxing non-cable services on mixed-use networks is even more clear. As the Commission observed in the present proceeding, the *Montgomery County* case does not disturb the Commission's authority to prevent such taxation.[63] The Commission's proffered analysis of its authority in this regard is sound:

> Under Section 3(51) of the Act, a "provider of telecommunications services" is a "telecommunications carrier," which the statute directs "shall be treated as a common carrier under this Act only to the extent that it is engaged in providing telecommunications services." Thus, an incumbent cable operator, to the extent it offers telecommunications service, would be treated as a common carrier subject to Title II of the Act. Section 602(7)(C) of the Act, in turn, excludes from the term "cable system" "a facility of a common carrier which is subject, in whole or in part, to the provisions of Title II of this Act, except that such facility shall be

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[58] H.R. Rep. 98-934, 60, 1984 U.S.C.C.A.N. 4655, 4697.

[59] 47 U.S.C. § 153(24).

[60] Restoring Internet Freedom, Declaratory Ruling, Report and Order, and Order, 33 FCC Rcd. 311 ¶ 20 (2018).

[61] Second FNPRM, *supra* note 1 at ¶ 27.

[62] 47 U.S. Code § 541(b)(3)(B).

[63] Second FNPRM, *supra* note 1 at ¶ 26.

> considered a cable system … to the extent such facility is used in the transmission of [cable service]."
>
> Accordingly, to the extent that any incumbent cable operators offer any telecommunications services… they are covered under the common carrier exception in Section 602(7)(C), and thus can be regulated by LFAs only to the extent they provide cable service.[64]

Further, basic economic reasoning offers strong support for the proposed rule. In the 2007 Second Report and Order, the Commission found that in order to speed broadband deployment, it needed to remove barriers to entry for new broadband providers.[65] Over the last twelve years, although there has been disagreement about how best to accomplish the goal, it has hardly been controversial that reducing barriers to entry would accelerate the rollout of cutting-edge broadband networks.

In the face of ever-growing network demand, moreover, there is little economic sense in arbitrarily distinguishing between new entrants and incumbents. If the taxation of new *broadband* entrants under cable franchising rules would decrease their incentive to deploy, then the taxation of incumbent *cable* providers offering broadband services would similarly decrease their incentive to expand, upgrade, or make other broadband network investments. To meet the growing demand for broadband, network investment is needed; it is immaterial whether it is offered by incumbents or new entrants. To meet its statutory obligations to accelerate the deployment of Internet connectivity, the FCC is well within its authority to prevent LFAs from taxing the non-cable services provided via already-franchised cable systems.

Some of the problems incident to deploying fixed broadband are analogous to those faced by firms deploying 5G small cells. As the Commission noted in its Wireless Infrastructure Order in 2018:

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[64] *Id.*

[65] *See* 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, Second Report and Order, 22 FCC Rcd. 19633, Appendix ¶ 2 (2007).

> [T]he requirement that compensation be limited to a reasonable approximation of objectively reasonable costs and be non-discriminatory applies to all state and local government fees paid in connection with a provider's use of the ROW to deploy Small Wireless Facilities. [66]

The Commission then noted how fees have become untethered from maintenance costs: "Crown Castle, for example, describes 'excessive and unreasonable' 'fees to access the [rights-of-way] that are completely unrelated to their maintenance or management.'"[67] In other words, excessive fees are implicitly a revenue-generating mechanism for government services unrelated to managing cable network infrastructure. And this revenue generation inevitably means delaying or preventing additional network build-out.

It may be the case that municipalities *should* be entitled to compensation to maintain public rights of way from *any* services provided over infrastructure so deployed: After all, as cable television revenue diminishes, it might someday plausibly be the case that cable-revenue-based franchise fees are insufficient to cover this expense. But it is by no means clear that municipalities should raise this revenue in the form of a tax on services. In fact, the decline of cable-revenue-based fees suggests that such financing should be *unrelated* to revenues: If these kinds of fees regularly fluctuate for reasons that do not correspondingly increase or decrease the cost of accessing and maintaining rights of way, then they are bound to be problematic as a source of funds to cover such relatively fixed costs. But regardless of the mechanism, there is no question that such fees should nonetheless be subject to reasonable constraints in order to protect against the problem of opportunism in the context of asset-specific sunk costs.

In any case, this is a matter for Congress to decide. If cable service revenue is no longer the appropriate basis for calculating the five percent franchise fee cap, the municipalities are well within their rights to lobby Congress to change the franchise

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[66] *See* Accelerating Wireless Broadband Deployment by Removing Barriers to Infrastructure Investment; Accelerating Wireline Broadband Deployment by Removing Barriers to Infrastructure Investment, Declaratory Ruling and Third Report and Order, 33 FCC Rcd. 9088, ¶ 69 (2018), ("Wireless Infrastructure Order").

[67] Letter from Kenneth J. Simon, Crown Castle, to Marlene H. Dortch, FCC, WT Docket No. 17-79 (Aug. 10, 2018).

fee provisions of the Cable Act. But simply ignoring the Cable Act and the Commission's authoritative interpretation thereof is not only bad public policy, it is potentially illegal.

III. Conclusion

In the absence of an effective limitation on the strategic behavior of municipalities exacting excessive fees, cable providers, anticipating the extraction of rents, have a reduced incentive to invest in network quality and, especially in markets with limited competition, are likely to pass on these higher fees to consumers.[68] In rural markets where profit margins are narrower, excessive franchise fees might even prevent networks from being built at all.[69] By capping franchise fees at five percent of gross annual cable revenues, Congress determined to enforce time-consistent behavior to reach a more economically efficient outcome for all parties.

In-kind obligations above the five percent cap on franchise fees decrease cable operator return on investment and therefore also decrease the incentive to invest in new infrastructure.[70] The same is true when cable operators face duplicative fees and requirements for non-cable services offered over cable networks. And from economic theory, we know that even where a portion of such costs are not an impediment to investment because they are passed on to consumers, the resulting higher prices also increase deadweight loss. Jerry Brito and Jerry Ellig (former FCC Chief Economist), for example, found that "consumers pay an extra $8.4 billion annually in the form of higher rates and fees as a result of video franchise regulations" and "these price increases generate $2 billion in 'deadweight loss'" after accounting for nonprice concessions and franchise fees.[71]

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[68] Jonathan E. Samon, *When 'Yes' Means No: The Subjugation of Competition and Consumer Choice by Exclusive Municipal Cable Franchises*, 34 SETON HALL L. REV. 747 (2004).

[69] *See* Joan Engebretson, *Economists Put the Tab at $61 Billion to Bring Fiber Broadband to Rural U.S.*, TELECOMPETITOR (July 11, 2018), *available* at https://www.telecompetitor.com/economists-put-the-tab-at-61-billion-to-bring-fiber-broadband-to-rural-u-s/.

[70] *See, e.g*, AVINASH DIXIT & ROBERT PINDYCK, INVESTMENT UNDER UNCERTAINTY (1994).

[71] Jerry Brito and Jerry Ellig. *Video Killed the Franchise Star: The Consumer Cost of Cable Franchising and Proposed Policy Alternatives*, 5 J. TELECOM. & HIGH TECH. L. 1999 (2006).

Further, duplicative franchise fees place cable operators at a competitive disadvantage vis-a-vis their broadband competitors, who do not face equivalent burdens. Thus, as these fees continue to increase, competition is further diminished. By reversing this trend, we can potentially increase entry into the broadband market, reduce prices, increase efficiency, and increase network buildout from incumbents.[72]

The proposed Order would restore the proper operation of the guardrails on LFA opportunism put in place by Congress. These guardrails were designed to ensure a balanced regime that facilitates both the creation of cable systems and the protection of the legitimate interests of municipalities. Protecting this congressionally calibrated regime will lead to lower prices, higher investment, and more competition in cable video services and broadband markets.

Respectfully submitted,

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[72] A study by the Government Accountability Office (GAO) concluded that telecommunications service prices were 15 to 41 percent lower in cities with new entrants from broadband service providers than in cities without. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-04-241, TELECOMMUNICATIONS: WIRE-BASED COMPETITION BENEFITED CONSUMERS IN SELECTED MARKETS (2004). A separate GAO study found that cable prices were about 15 percent lower in cities with wireline video competition. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-257, DIRECT BROADCAST SATELLITE SUBSCRIBERSHIP HAS GROWN RAPIDLY, BUT VARIES ACROSS DIFFERENT TYPES OF MARKETS (2005). And Tom Hazlett found that "rules that induced nationwide competition in video would produce impressive social gains, driven by the empirical observation that prices are consistently lower in areas of wireline rivalry." Hazlett quantified the potential consumer gains at the time from increased competition at about $9 billion, $3 billion of which would be attributable to efficiency gains. *See* Thomas W. Hazlett, *Cable TV Franchises as Barriers to Video Competition*, 12 VA. J.L. & TECH. 1 (2007).