

MEMORANDUM

To: Board of Directors
From: Greg Stepanicich, General Counsel
Date: February 10, 2005
Subject: Telecommunications Legislation

This memorandum provides the Board with an overview of telecommunications regulatory issues that will be part of the debate on whether federal telecommunications law should be amended.

HISTORICAL BACKGROUND

The Communications Act of 1934 provides the regulatory framework for the federal regulation of telecommunications. This Act did not address cable television franchises in a comprehensive way until 1984 when the Cable Communications Policy Act of 1984 was adopted by Congress. The 1984 placed a number of limits on the manner in which local agencies were permitted to regulate cable systems. This Act, however, also established areas that local agencies were expressly permitted to regulate. The Act expressly granted local agencies the power to require and award nonexclusive cable franchises for the use of the local right of way, authorized a franchise fee of up to 5%, permitted requirements for PEG access and I-Net capital contributions by the cable operator, and authorized the adoption of local customer service standards that could exceed the minimum standards established under federal law. The 1984 Act established the formal and informal renewal processes. Ironically, the intent of the formal renewal process was to protect the rights of the cable operator to a renewal. Provided that the cable operator timely asserts its rights to the formal process, a cable franchise renewal cannot be denied without going through the formal process. As you know, most recently, the formal renewal process has been invoked more often by local agencies dissatisfied with the renewal proposals made by incumbent cable operators. Significant limits on local regulation imposed by the 1984 Act include prohibiting specific programming requirements, allowing a cable operator to deduct PEG operational funding requirements from the franchise fee, and prohibiting rate regulation except in isolated communities.

In 1992, Congress adopted the Cable Television Consumer Protection and Competition Act of 1992. The 1992 Act, which was enacted in response to sharply increasing cable rates, authorized

the FCC to establish more stringent rate regulations. The FCC established regulations which permitted local agencies to regulate the basic service tier only. The FCC had the sole authority to regulate the rates of all other tiers of service. The local regulation of basic service tier rates are subject to federal regulations that provide little discretion in the review of these rates. The regulations are largely a mathematical calculation that in practice have not had a significant effect on rate levels.

In 1996, Congress adopted the Telecommunications Act of 1996. This Act was the most comprehensive amendment to the Communications Act of 1934. Until this Act, telecommunications providers were placed in high regulated categories that effectively prohibited cross competition. The purpose of the 1996 Act was to eliminate these barriers to competition with the goal of accelerating the delivery of more advanced technologies at a cheaper cost to the public. The 1996 Act permitted local and long distance telephone companies to compete against each other, preserved local zoning power over the location of wireless facilities (cellular antenna sites) but prevented cities and counties from adopting regulations that prohibited or had the effect of prohibiting wireless services, and preserved the power of cities and counties to regulate their local rights of way but prevented cities and counties from using this power in a way that prohibited or had the effect of prohibiting the delivery of telecommunications services. Regarding cable television regulation, the 1996 Act eliminated cable rate regulation for all service tiers except the basic tier and permitted telephone companies to provide video programming as competition to the incumbent cable operators. The 1996 Act also made it clear that cities and counties had no power to regulate direct broadcast satellite providers such as Direct TV.

While each of these federal acts placed limits on local regulation, a key common premise of the 1984, 1992 and 1996 Acts is that cities and counties have an inherent authority to regulate their local rights and way and to require compensation (subject to limits) on the use of the right of way by private telecommunications providers. It is this basic premise that likely will be subject to attack in upcoming legislation.

THE CURRENT REGULATORY PROBLEM

Although the 1996 Act attempted to eliminate barriers to competition between different types of telecommunication companies, different regulations continue to apply to the same type of service depending upon the type of company that is providing the service. Cable companies are required to obtain a cable franchise, pay a franchise fee, and provide PEG access support. Satellite TV is exempted from all local regulation, does not have to pay a franchise fee and has no PEG access support obligations. Telephone companies providing video programming over the Internet are claiming that as an Internet provider of video programming they should not have to be subject to local regulation. There is a valid argument that current regulations have not kept up with the

changed world of telecommunications. Regulating companies that are providing the same service in different ways is a questionable policy. I believe it is a mistake for cities and counties to insist that the current regulatory status quo must be preserved without change. I believe the better approach is to be receptive to regulatory reform provided that the power of cities to regulate the use of their local right of way and to require compensation for its private use is preserved.

Although the 1996 Act limits the local regulation of telecommunications services, a compromise was struck by Congress that still preserved key aspects of local control. Unfortunately, the FCC currently is very hostile to local regulation, particularly with respect to Internet provided services. Although Congress historically has been sensitive to the interests of local public agencies (and in particular the right to manage the local right of way), the current composition of Congress likely will be more receptive to the arguments of the telecommunications industry. One thing that may be helpful to cities and counties in this fight, however, is that the competing providers of video programming (cable companies, telephone companies and satellite companies) themselves have competing interests which will complicate any attempt to radically amend federal telecommunications law.

KEY ISSUES

1. Preserving the Franchise Fee. Whether a company is providing video programming directly through wires (a cable system) or over the Internet with wires that occupy the right of way (as is being proposed by the telephone companies), the local right of way is being used. The local right of way is a public asset. Both federal statutes and case law have long recognized the right of cities and counties to require compensation from private parties that want to use this public asset for private profit. The elimination of the franchise fee for cable operators and others who use the right of way to deliver video programming would have a huge adverse financial effect on cities and counties.

2. Clarifying That The Franchise Fee Applies To Cable Modem (Internet) Services. In 2002, the FCC issued an order that cable modem services were not a cable service but an information service that is not subject to the cable franchise fee. Until this order was issued, cable companies paid the cable franchise fee on these services. Cable companies did so since if these services are treated either as a cable service or an information service, cable companies were not required to open their cable systems to competing Internet providers (which they would have to do if such services are treated as a telecommunications service under federal law). This issue is pending before the United States Supreme Court. The public agency argument is that if the cable system is being used to deliver other services, all services that are using the public right of way should be

subject to the franchise fee. Regardless of how the Supreme Court decides this issue under the current law, Congress has the power to enact legislation that could dictate whether all services provided over a cable system are subject to a cable franchise fee.

3. Preserving PEG Access Support Requirements. The 1984 Act established uniform federal rules for local agencies requiring PEG Access support. Prior to 1984, cities and counties were able to require both capital and operational financial support from cable operators. Requirements for the support of PEG has been a standard provision of cable franchises since the first franchises were negotiated in the 1970's and early 1980's. It is important to emphasize in any discussion of this issue, that PEG access has always been considered an essential part of cable franchises as it provides the means for local communities to create local programming that serves local needs that would not be met by commercial programming produced at the national or regional level. It also promotes an informed local community who are given improved access to their local public officials through the broadcasting of local legislative body meetings.

The 1984 Act provides that local agencies may require PEG capital support and the allocation of PEG channels. PEG operational support, however, is treated differently. The 1984 Act gives cable operators the right to deduct any PEG operational support required by the franchise from the franchise fee. This provision creates a significant disincentive for PEG operational support requirements. The result is that local agencies have a difficult time raising sufficient monies to support PEG operations, particularly with the serious financial problems facing local public agencies at the present time. An amendment to the law that allows cities and counties to require PEG operational support by the way of subscriber pass-throughs that would not be deductible from the franchise fee would provide significant assistance to the establishment and on-going operations of PEG programming. Comcast has taken a hardline position that it will not voluntarily agree to operational support pass-throughs and that it would deduct any such requirements from the franchise fee.

The legislative threat to eliminate all PEG support, however, is likely to be based on an argument from the cable industry that it is unfair to require cable operators to provide PEG support and channels when the satellite companies (their chief competitors) are not required to do so. This argument will be strengthened significantly if telephone companies are permitted to provide video programming over the Internet without obtaining a local franchise (discussed below).

4. Ensuring That Video Over the Internet Is Subject to the Cable Act and Local Franchise Requirements. This past year, Verizon and SBC announced that they were launching video programming that would be provided over the Internet. The telephone companies argue that since they already are located in the public right of way and are authorized to provide telephone and data services, they should not have to get a cable franchise for their video programming.

Despite this argument, Verizon has proceeded to seek cable franchises in the communities where it is planning to deliver this new service. SBC, on the other hand, appears to be proceeding on the assumption that a franchise cannot be required by cities and counties.

The argument that a franchise cannot be required is based on the FCC ruling that cable modem services involving the transmission of data and information is not a cable service and the more recent FCC ruling that VOIP (telephone over the Internet services) is not subject to local regulation. The counter argument, which we believe is the correct statutory interpretation, is that federal law defines cable service as the one way transmission of video programming without regard to how the video programming is delivered. Thus, when the telephone companies deliver video programming over the Internet, our argument is that they are providing a cable service as defined by federal law that is subject to the requirement of a local franchise.

It is likely that the telephone companies will seek a change in the law that will exempt them from obtaining a cable franchise. If this occurs, it likely will have a cumulative effect since it will give the cable operators a stronger argument that they are being treated unfairly as only cable operators would be subject to the 5% franchise fee and PEG requirements. An alternative, compromise legislative approach that may be taken by the telephone companies is to eliminate the local franchise requirement for telephone companies, but still require telephone companies to pay a franchise fee on video programming and make a substantially equivalent PEG contribution as the local cable operator.

Thus, it is very important that telephone companies be required to obtain local franchises or at least be required to make equivalent financial contributions as cable companies. Otherwise, the door will be open to the deregulation of all video programming even though such programming is being provided over the local right of way.