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Cable franchise renewal - One City's \$60 million contract

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INTRODUCTION

The City of Tacoma, Washington has two wired cable television operators that have each fully built out the entire City - Comcast, the nation's largest cable operator and Click! Network, among the largest municipally owned communications systems in the Country. Effective January 1, 2010 Tacoma completed one of the more lucrative recent franchise renewals in a market that boasts a population of about 200,000 and is part of the 15th largest metropolitan area in the Country. What makes the Tacoma renewal unique is the level of financial commitment obtained by the City to secure local programming, the commitment to offer local programming in high definition format, the continuation of one of the more robust institutional networks anywhere and a host of other regulatory provisions to protect the City's long term interests over the next decade.

This paper will offer an overview of this unique renewal and describe the terms of the agreements, but the process undertaken by the City and sample provisions used to address the key issues negotiated by the parties.

BACKGROUND OF TACOMA CABLE FRANCHISES

In the mid 1990s the City of Tacoma was served by a single cable operator, TCI. The City was not satisfied with the level of service offered by TCI and decided to investigate whether the City's Department of Public Utilities could construct a municipal system to provide a competitive option. TCI lobbied against the City's plans and even sent its CEO to present at a City Council meeting in an effort to dissuade the Council from approving the funding for the project. The presentation by the CEO did not have the impact desired by TCI and instead solidified the Council's support of the project at a cost of nearly \$100 million. The City chose to move forward and began constructing what is now known as the Click! Network ("Click!"). Click! was created as a division of the City's Department of Public Utilities and thus control of Click! rests with the Utilities Board - not the City Council.

In 1998 the City adopted an ordinance which granted a Cable Television Franchise to TCI and that franchise was subsequently transferred to Comcast ("Comcast Franchise"). At that same time, the City adopted a resolution awarding a Cable Agreement to Click! ("Click! Agreement"). Each operator's authorization extended for a term of 10 years that was due to expire in 2008. Renewal negotiations commenced in June of 2008 and each operator's franchise

was extended through December 31, 2009 to allow for the completion of renewal negotiations.

Click! employs about 135 people in the City and supports three commercial products (retail cable TV, wholesale high-speed Internet over cable modem and wholesale high-speed data services over fiber optics). Click! also provides two support functions for city departments: 1) automated meter reading, advanced metering infrastructure and supervisory control and data acquisition for Tacoma Power; and 2) an institutional network for general government.

Comcast has cable systems throughout the region serving Seattle and virtually all other major cities in the state of Washington. Comcast does not provide any institutional services in the City but does offer commercial services to businesses and government for a fee. Comcast provides video, broadband and voice communications. Click! does not provide telephone service in the City. Qwest is the local telephone company which also provides voice, video and broadband service - although the video product from Qwest is essentially a resale of Direct TV satellite service.

CURRENT FEDERAL LAW

In 1984, Congress passed a law that was intended to provide cable operators with a fair opportunity to obtain renewal. To that end, the Cable Communication Policy Act of 1984 - the "Cable Act"¹ - establishes two possible ways a community can respond to a request for franchise renewal: informal renewal negotiations and the statutory formal renewal process.

Under the informal process, Congress contemplated that a city and a cable operator will meet informally and attempt to resolve franchise issues through negotiation.² If the issues are resolved a city can, after providing the public with an opportunity for comment, adopt a renewal franchise. An informal proposal can be rejected at any time.

Alternatively, either the cable operator or the city can invoke the more formal renewal procedures set out at 47 U.S.C. § 546(a)-(g). These "formal" procedures give a cable operator the opportunity for a fair hearing on its renewal proposal. At the same time, the procedures ensure that a city can deny renewal if a cable operator has performed poorly in the past, or is not qualified, or is not willing to make a reasonable proposal for meeting the community's needs and interests for the future. Under the formal process, the city is given authority to define the needs and interests of the community. It is up to the cable operator to then submit a proposal that is reasonable to meet the community's cable-related needs and interests, taking into account the costs of meeting those needs and interests (the

¹ 47 U.S.C. § 521 et. seq.

² 47 U.S.C. § 546(h).

focus is the entire community, not just the individual subscriber currently receiving service).

The legislative history of the 1984 Cable Act explains:

The ability of a local government entity to require particular cable facilities (and to enforce requirements in the franchise to provide those facilities) is essential if cable systems are to be tailored to the needs of each community [and the legislation] explicitly grants this power to the franchising authority.³

More specifically, the formal renewal process under the Cable Act is a four-stage process. In the first stage, a City must conduct a proceeding to identify future, cable-related needs and interests of the community, and to review the past performance of the cable operators serving the community.⁴

Once that proceeding is complete, the City may issue a Request for Formal Renewal Proposals (“RFRP”). Because each renewal proposal is evaluated on its own merits, this RFRP cannot simply be a competitive bidding document.⁵ The Cable Act specifically allows the City to establish the following requirements in an RFRP:

- (a) “that channel capacity be designated for public, educational or government use, and channel capacity on institutional networks be designated for educational or governmental use, and may require rules and procedures for the use of channel capacity designated....”⁶
- (b) “for facilities and equipment.” The legislative history explains that this includes requirements for institutional networks, studios, equipment for public, educational and government use, two-way networks, and so on.⁷

The Cable Act also states that “A franchising authority may establish and enforce customer service requirements of the cable operator, and construction schedules and other construction-related requirements, including construction-related performance requirements, of the cable operator.”⁸ Many cities maintain that this

³ 1984 House Report at 26, 1984 U.S.C.C.A.N. at 4663. Congress intended that: “the franchise process take place at the local level where [local] officials have the best understanding of local communications needs and can require cable operators to tailor the cable system to meet those needs.” 1984 House Report at 24, 1984 U.S.C.C.A.N. at 4661. However, the Cable Act does not give local governments unlimited authority to impose conditions on cable operators. For example, it limits local authority to require an operator to carry a specific programming service.

⁴ 47 U.S.C. § 546(a).

⁵ 47 U.S.C. § 546(b).

⁶ 47 U.S.C. § 531(b).

⁷ 47 U.S.C. § 544.

⁸ 47 U.S.C. § 552.

language permits the City to establish these requirements unilaterally in a franchise (or through a regulatory ordinance), along with various other requirements established pursuant to the City's police powers and other governmental authority.

In the next stage of the renewal process, the cable operator submits a renewal proposal in response to the City's RFRP. "Any such proposal shall contain such material as the franchising authority may require."⁹ If an operator submits a timely and proper response,¹⁰ the City has four months to evaluate the proposal, and decide whether to grant renewal based on the proposal or to preliminarily deny renewal.¹¹

Finally, if franchise renewal is preliminarily denied, and a cable operator desires it, the City must commence an administrative proceeding. The four issues that are considered at that proceeding are whether:

- (a) the cable operator has substantially complied with the material terms of the existing franchise and with applicable law;
- (b) the quality of the cable operator's service, including signal quality, response to consumer complaints, and billing practices, but without regard to the mix or quality of cable services or other services provided over the system, has been reasonable in light of community needs;
- (c) the cable operator has the financial, legal, and technical ability to provide the services, facilities, and equipment as set forth in the cable operator's proposal; and
- (d) the cable operator's proposal is reasonable to meet the future cable-related community needs and interests, taking into account the cost of meeting such needs and interests.¹²

The City of Tacoma did not enter the formal renewal process but rather was able to complete renewal proceedings with both Comcast and Click! via the informal process.¹³

⁹ Id.

¹⁰ The proposal must be submitted by a deadline established by the city. If the operator fails to do so, then its rights are ended.

¹¹ 47 U.S.C. § 546(c).

¹² Id.

¹³ 47 U.S.C. § 546(h).

TACOMA RENEWAL PROCESS

In 1998, when the Comcast Franchise was adopted, the City was hopeful that the new Click! Agreement would bring competitive choice to the City's cable subscribers. Over the last decade the City's efforts have been rewarded with robust competition between Comcast and Click! that has resulted in improved service offerings at competitive rates. Based upon this successful history, the City established the following goals for franchise renewal with the cable operators.

City Goals in the Renewal Process:

In light of competition, the City's primary goals during renewal negotiations were:

- (1) Revise the City Code to create enforceable regulations to govern not only Comcast and Click! but any other competitive cable operators which may seek to provide cable services in the City.
- (2) Revise the City Code to create right-of-way (ROW) regulations governing all cable service providers and all other ROW users consistently.
- (3) Streamline regulation in the Comcast Franchise and Click! Agreement.
- (4) Address digital migration of local government and educational channels.
- (5) Provide for a 1% capital support fee for local PEG channels.
- (6) Maintain the 5% franchise fee as consideration for use of the City's ROW which includes a definition for "gross revenues" that will maximize revenue to the City.
- (7) Modify the institutional network requirements to reflect current practices and restructure the control and consideration associated with the institutional network.
- (8) Reduce multiple institutional network agreements between Click! and the City that had evolved over the past 10 years.
- (9) Renew each provider for a 10 year term to maximize flexibility as the industry changes.
- (10) Adopt enforcement procedures and security to ensure compliance.

The City of Tacoma was faced with the daunting task of negotiating with two separate cable operators simultaneously in an attempt to achieve franchise renewal. Among the City's primary goals was to insure that neither operator obtained a competitive advantage over the other by virtue of the franchise granted by the City. However, the City was concerned that the operators would work together to attack the city's franchise obligations in an effort to minimize the effectiveness of the franchise. To combat this concern, the City chose to meet with each operator separately and negotiate off of a single model franchise. The City held back to back negotiating meetings with each operator for a period of months addressing the key issues with each operator but remaining flexible to alternative language so long as the overall burdens were maintained in a competitively neutral manner.

One tool which proved particularly helpful to the City was to avoid reviewing the model document page by page but rather focusing on the key financial issues first. The City's goal was to achieve agreement on the financial issues in hopes that the regulatory terms and conditions thereafter would fall into place quickly. To accomplish this goal the City entered into an agreement akin to a "letter of intent" which listed the key financial terms in the document and the agreement reached between the parties. This "term sheet" then formed the basis for negotiations thereafter. Among the key issues addressed in the term sheet were the following:

City of Tacoma's Term Sheet

- (1) PEG Capital Funding at 1% of Gross Revenues for Franchise Term.
- (2) Ten Year Term.
- (3) All PEG payments subject to pass through, and for capital purposes only.
- (4) Competitive Equity language.
- (5) 6 PEG Channels initially, 2 additional PEG channels to be provided upon city's request; one in 2011 and one in 2014. PEG Channels may be placed on any tier of service. Total PEG channels not to exceed 8. One of 8 PEG channel's to be provided in HD, so long as Comcast receives an HD signal which complies with FCC technical standards.
- (6) Channels to be provided on the basic service tier.
- (7) 1 PEG Channel to be provided to subscribers in analog format for so long as Comcast maintains an analog tier. PEG content is at City's discretion, so long as non-commercial, and consistent with

applicable law. City shall have the right to cablecast sponsorships and acknowledgements similar to those which appear on PBS stations.

- (8) All other channels to be provided to subscribers in analog or standard digital format.
- (9) City shall provide government channel in standard digital format. All other channels may be provided to Comcast in standard digital or analog format, and Comcast shall be responsible for up conversion or down conversion as required.
- (10) Comcast to continue to provide current live return connections at no cost from Master Control Center to Headend, upon which all PEG channels shall be transmitted.
- (11) Comcast shall group PEG channels either together or with like channels in terms of content. The PEG channels shall not be separated or placed in a distinct location from other commercial channels such as CSPAN, PBS, or other similar channels. City government channel shall be located adjacent to any local broadcast channels carried by Comcast.
- (12) 5% franchise fee, payments monthly.
- (13) City acknowledges and accepts Comcast's right to recoup the costs associated with complying with customer service standards that exceed FCC as permitted under applicable law.
- (14) Utilization of agreed upon Gross Revenues definition, Franchise Breaches/Termination, Liquidated Damages, Books/Records & Confidential/Proprietary Information.
- (15) 50K Letter of Credit.

As described above, the City focused significant attention on the institutional network agreement by and between the City and Click!. While institutional network issues dominated the Click! negotiations, the "level playing field" negotiations dominated the renewal process with Comcast.

LEVEL PLAYING FIELD

Over the past several years, Comcast and most cable television operators nationwide, have become increasingly concerned about competitive providers obtaining more favorable cable television franchises to the detriment of the incumbent operator. Historically, cable operators would seek to include in a

renewed franchise, level playing field provisions which attempted to tie a city's hands by stating that the city was prohibited from granting a franchise that was more favorable or less burdensome than the franchise granted to the incumbent operator. In recent years, the FCC and numerous states have taken a dim view of these provisions and the cable industry has grown more concerned with their enforceability.

As a result, the cable industry, and Comcast in particular, have moved towards language that will provide the incumbent cable operator a right to avoid franchise obligations that are not also required of new competitive providers. These so called "opt out" provisions are very controversial and are generally presented by the industry in a one-sided fashion that allows only the incumbent operator the right to opt out with no reciprocal benefit for the city. In addition, operators often seek language which allows it to immediately terminate its obligations under an existing franchise should the state or the federal government permit an alternative franchising mechanism.

The cable industry was particularly concerned by the legislation in Texas several years ago that permitted incumbent operators to obtain statewide franchises while incumbent operators were forced to honor existing franchises until their expiration date. For this reason, Comcast aggressively seeks language in renewed contracts that will allow for the immediate termination of the franchise if Comcast believes a better regulatory model may be available to the company at the state or federal level. Not surprisingly, cities view this issue quite differently and seek language to allow them to continue enforcing contractual obligations until franchise expiration or direct preemption by the state or the federal government.

In the City of Tacoma, this issue was debated and discussed at length with Comcast and the below language was included in the final franchise to address the concerns of each party. While this is certainly not perfect language and not the only way of addressing this issue, it does strike a balance and allowed in this case, for the parties to complete franchise renewal and obtain the necessary approvals from the City Council and Comcast.

Section 2.5 Franchise Non-exclusive

The grant of authority for use of the City's Public Rights of Way, as conferred herein, is not exclusive and does not establish priority for use over other franchise holders, permit holders and the City's own use of public property. Nothing in this Franchise shall affect the right of the City to grant to any other Person a similar franchise or right to occupy and use the Public Rights of Way or any part thereof for the erection, installation, construction, reconstruction, operation, maintenance, dismantling, testing, repair or use of a Cable System within the City. Additionally, the Franchisee shall respect the rights and property of the City and other authorized users of Public Rights of Way. Disputes between the

Franchisee and other parties over the use, pursuant to this Franchise, of the Public Rights of Way shall be submitted to the City for resolution consistent with the requirements of the Code.

Section 2.6 Competitive Equity

- (A) *New Video Service Provider. If any other wireline MVPD enters into any agreement with the City to provide Video Services to subscribers in the City, the City, upon written request of the Franchisee, shall permit the Franchisee to construct and/or operate its Cable System and provide Video Services to subscribers in the City under the same agreement as applicable to the new MVPD. Within one hundred and twenty (120) Days after the Franchisee submits a written request to the City, the Franchisee and the City shall enter into an agreement or other appropriate authorization (if necessary) containing the same terms and conditions as are applicable to the new wireline MVPD.*
- (B) *Subsequent Change in Law. If there is a change in federal, state or local law that provides for a new or alternative form of authorization for a wireline MVPD to provide Cable Service or Video Service to subscribers in the City, or that otherwise changes the nature or extent of the obligations that the City may request from or impose on a wireline MVPD providing Cable Service or Video Service to subscribers in the City, the City agrees that if another wireline MVPD avails itself of such new law and provides Cable Service or Video Service in the City, upon Franchisee's written request, the City shall permit the Franchisee to terminate this Franchise and, subject to Applicable Law, provide Cable Service or Video Service to Subscribers in the City on the same terms and conditions as are applicable to the other wireline MVPD under the changed law. The City and the Franchisee shall implement the provisions of this Section within one hundred and twenty (120) Days after the Franchisee submits a written request to the City.*

CODE REVISIONS

One of the goals of the City was to ensure that each cable operator would be held to the same right-of-way ("ROW") requirements as any other ROW user so that the City did not have different rules in place for the same ROW application. As is the case with many renewals, existing franchises often create a separate set of ROW rules and obligations applicable to the cable operator that are not generally applicable to other ROW users. While separate ROW provisions in a cable franchise perhaps made sense when cable systems were initially constructed, there is often little or no reason to now have two separate regulatory

approaches for similarly situated ROW users. In fact, in many cities' public works directors, charged with issuing permits and handling ROW inspections, have very limited knowledge of unique provisions that may be contained within cable franchises.

For this reason, the City of Tacoma chose to largely eliminate ROW requirements from the renewed cable television franchises and instead place those requirements in the City Code. The problem for the City was that the existing code was itself woefully out of date and not consistent with the City's current practices for ROW permits. Once the City began to consider adding cable operators to this portion of the Code, a complete re-draft of ROW enforcement was deemed necessary. This process involved the City's public works departments and subsequent meetings with all ROW users including gas, electrical, water, telephone, cable, home builders and general contractors. However, by working with these various groups the City was able to document its current practices for ROW management and restoration and address industry concerns so that the final Code revision set forth clear and acceptable regulations for all users.

With respect to Comcast and Click!, the City was able to assure the providers that they would be treated no differently than any other similarly situated ROW user but instead would be subject to all ROW permitting, insurance and indemnification obligations, and restoration requirements.

INSTITUTIONAL NETWORK

The 1998 Comcast Franchise and Click! Agreement each contained sections regarding obligations to build a separate "institutional network" to connect schools and public buildings in the City to allow for voice, video and data communications. When it came time to construct the institutional network, the City recognized that only one institutional network was needed and so the City sought proposals from both operators to construct, operate and maintain this network. Click! was chosen to construct the institutional network while Comcast agreed to provide the City cash consideration to avoid any future responsibility for the network.

Construction of the institutional network began in 1999 and thereafter two additional agreements were entered into between the City and Click! to govern the ongoing construction, operation and maintenance of the institutional network. Over the past decade this group of institutional network documents governed the relationship of the parties and resulted in the City spending over \$3,500,000 in capital investments to construct the institutional network and over \$750,000 in ongoing maintenance costs.

The City's new institutional network agreement ensures that this network will serve the City for the next 10 or more years and includes an "irrevocable right of use" that will provide long term protection for the City's investment in the

institutional network. The agreement also clarifies exactly how operational and maintenance costs are to be calculated and paid under the City's accounting systems using a carefully articulated definition for "direct costs" incurred by Click!. This cost allocation model allows the City to establish pricing for its public sector users in an orderly manner consistent with the City's budgeting process. The responsibilities of Click! have also been more clearly set forth so that compliance can be easily tracked and enforced.

CONCLUSION

When one considers the compensation to be paid to the City of Tacoma by virtue of the 5% franchise fee, the 1% PEG capital fee, the nearly \$5,000,000 invested in the institutional network and other related franchise obligations in the renewed contracts, the value to the City of this franchise renewal was approximately \$60,000,000. When compared to other similarly sized cities around the Country, Tacoma's franchise renewal compares very favorably. While the City spent considerable time and effort developing these franchise documents and negotiating mutually acceptable provisions with the operators, the City is well positioned to adapt to changes in the cable industry over the next decade and has strong regulatory enforcement tools available to it should either Comcast or Click! fail to perform.

Note: All of these documents referred to in this paper are available on the City of Tacoma website <http://www.cityoftacoma.org/page.aspx?nid=149> should you desire additional information. Brian Grogan represented the City of Tacoma in the franchise renewal proceedings with both Comcast and Click! and can address any specific questions regarding this renewal. Ken Fellman of Kissenger and Fellman represented the City on its code revisions. Jeff Leuders and Carol Mathewson led the City's renewal team.

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