Legislative Analysis

Mitchell Bean, Director
Phone: (517) 373-8080
http://www.house.mi.gov/hfa

UNIFORM VIDEO SERVICES
LOCAL FRANCHISE ACT

House Bill 6456 (H-2 Substitute, with Floor Amendment)
Sponsor: Rep. Mike Nofs
Committee: Energy and Technology

First Analysis (11-14-06)

BRIEF SUMMARY: The bill, to be known as the "Uniform Video Services Local Franchise Act," would create a system of uniform local franchising for providers of video service. Currently, a provider seeking to offer cable television (also called video services) must obtain a separate franchise agreement from each local unit of government in which it wishes to operate. Under House Bill 6456, the Public Service Commission (PSC) would develop a standardized 10-year uniform local franchise agreement to be used by providers and local units of government throughout the state. The bill mandates a number of provisions that must be included in the uniform agreement. If presented with a franchise agreement, a local unit of government would have to notify the provider within 15 days whether the agreement was complete. A local unit would have to approve a complete uniform franchise agreement within 30 days of its submission.

FISCAL IMPACT: This bill will increase State of Michigan expenditures for the Michigan Public Service Commission (MPSC) by an indeterminate amount. The MPSC is directed to develop a standard form for local governments to use in authorizing video providers within their jurisdiction. This form is to be issued as an order by MPSC. While the cost of developing the form is not expected to be significant, MPSC will also incur additional costs to administer and enforce the provisions of the bill, and to handle customer complaints. No additional State of Michigan revenue is provided in the bill for monitoring compliance and investigating complaints.

Local government expenditures will increase by an indeterminate amount for localities which have been provided an institutional network, also known as I-NET, at no cost by the incumbent cable provider. These I-NETS connect all the buildings within a local government, and provide the basis for all internal and external communication, including 911 emergencies, telephone, e-mail, as well as video communication. This communication network will need to be replaced immediately when the contract is abrogated under this bill. Local governments will then have to either pay the incumbent provider to use the existing network, or lease T-1 communication lines to create a new network. At this writing, the number of local governments with no-cost I-NETs and the cost of replacement has not yet been compiled. In addition, the bill will require local governments to travel to the telecommunications provider's record-keeping site in order to audit cable fees. Currently, such records are provided at the local government's location.

Local government revenue may decline by an indeterminate amount, even where multiple cable television providers compete. New customer revenue is unlikely because the market for cable television in most jurisdictions has matured to the point that those not receiving this service are either not interested, or use a satellite television provider. There is also the possibility that local revenue will decline because telecommunications companies will receive a five cent credit against METRO Act fees as the bill is written, but, in most cases, pay less per foot.

THE APPARENT PROBLEM:

Currently, cable operators must obtain a franchise from each local unit of government in which they operate. These franchise agreements govern many aspects of cable television service, including access to public rights-of-way, the schedule for a company to build its network throughout the entire service area ("build-out" requirements), customer service provisions, insurance requirements, franchise fees, and the carriage and support of PEG channels. In addition, some franchise agreements also require the building and/or maintenance of institutional networks (I-NETs) or broadband networks connecting municipal buildings and facilities. Some people believe that requiring a cable provider to negotiate franchise agreements in each community in which it wishes to operate is a cumbersome process that discourages new companies from providing services, with the result that many incumbent providers have a de facto monopoly. Some also believe that certain aspects of local franchising, particularly build-out requirements and in-kind services such as I-NETs, should be reduced or eliminated entirely.

Most, but not all, areas of Michigan and the United States have only one cable provider despite the fact that exclusive franchises are generally unlawful and telecommunications providers are permitted under federal and state law to enter the cable television market. Currently, the primary source of competition (other than over-the-air broadcast television) for cable television is from satellite companies. However, in a trend sometimes referred to as "convergence," the distinctions between cable companies, telephone companies, and Internet service providers are blurring. Cable companies also offer Internet and voice services, and telephone companies also offer Internet and have begun offering subscription television services in some areas.

Large telecommunications companies such as AT&T and Verizon, and some smaller ones, have announced plans to build fiber networks and to offer video services in competition with incumbent cable television providers, and have begun doing so in some parts of the U.S. Legislation has been proposed that supporters contend will simplify and streamline the franchising process, thus encouraging more providers to enter the market. More competition, they say, may provide customers with wider choices of services, including video entertainment options, help to reduce monthly bills that have risen at a pace greater than inflation in recent years, and lead to better customer service.

Franchise reform is being considered at both federal and state levels. Congress is currently considering national franchise bills, and the FCC is considering regulatory action. Moreover, several other states have recently modified their cable franchising laws. (See Background Information section.) House Bill 6456 is an attempt to encourage competition for video services and make it easier for new providers to enter the cable video services market.

THE CONTENT OF THE BILL

The following is a condensed summary of the bill. A more detailed summary is available on the Michigan Legislature website at:
http://www.legislature.mi.gov/documents/2005-2006/billanalysis/House/pdf/2005-HLA-6456-8.pdf

- A video service provider would need a franchise agreement with the local governmental unit to offer video services within its boundaries. Agreements would last for 10 years, are renewable for 10 more years, and are fully transferable. Local units of government would have to notify a provider within 15 days whether a uniform agreement it submitted was complete. Complete agreements would have to be approved within 30 days. If these deadlines were not met, the proposed franchise agreement would be deemed approved.

- The Public Service Commission would provide a uniform franchising form for the parties to use. (However, the PSC could not regulate providers as public utilities.) Section 3 of the bill specifies numerous features that the uniform agreement must contain including general information about the video service provider, the date on which the provider expects to begin services, a description of the video service area footprint to be served, a requirement that the provider pay video service provider fees and PEG support fees, and a requirement that the provider agrees to comply with valid and enforceable federal and state laws and local regulations regarding the use of public rights-of-way in the delivery of video service, and many other requirements. The uniform franchise form would grant the provider authority to provide video service and to use and occupy the public rights-of way in the service area designated in the agreement, subject to state law and the police powers of the local unit of government.

- An expiring existing franchise agreement *could not* be renewed or extended. At the provider's option, an existing franchise agreement would either be replaced by a uniform agreement (an incumbent provider would have 120 days to file for a uniform agreement) or modified to include only those provisions required under a uniform agreement. (Incumbent providers could continue to operate under the terms of an expired franchise until a uniform agreement takes effect.) On the effective date of the bill, any provisions in existing franchise agreements that are inconsistent with or go above and beyond the uniform franchise agreement would be deemed "unreasonable and unenforceable."

- Local units and video providers could enter into *voluntary* franchise agreements different from the uniform agreements but the local unit of government could not *require* a video service provider to get a separate franchise or impose any fee or franchise requirement other than those included in the standardized form. An example provided in Section 13 of the bill is that a local unit of government could offer a reduction in the franchise fee in return for the provider making available to the franchising entity services, equipment, or other valuable consideration. Deviation from the standard franchise agreement would only be allowed if it was "technologically feasible" and "commercially practicable" for each provider to comply with similar terms and conditions and it is offered to each. Neither party would have an obligation to negotiate for a franchise agreement different from the prescribed standard form.

- A video service provider would pay an annual video service provider fee to the local unit expressed as a percentage of gross revenues as defined in the bill. If there is an existing franchise agreement, the amount of the fee would initially be an amount equal to the percentage of gross revenues paid to the local unit of government by the incumbent video provider with the largest number of subscribers. After that franchise expired, or if there is no existing franchise agreement, the local unit of government could establish a percentage fee applicable to all providers not to exceed five percent.

- A video service provider would be entitled to a credit applied toward its annual video service provider fees for all funds allocated to the local unit of government from annual maintenance fees paid by the provider for use of public rights-of-way under the Metropolitan Extension

Telecommunications Rights-of-Way Oversight (METRO) Act, (PA 48 of 200), *minus any property tax credit approved by the Public Service Commission.* The METRO Act allows telecommunications providers who pay METRO Act fees to apply to the PSC for a Utility Tax credit equivalent to the amount of METRO Act fees paid. The METRO fee credit would apply to annual video service fees, but not to the PEG support fees described below. In general, telecommunications companies pay METRO Act fees, but cable providers do not.

- A video provider must pay to the local unit of government a fee as support of the reasonable capital costs of public, education, and government (PEG) access facilities. If there is an existing franchise on the effective date of the bill, the PEG support fee would be the fee paid to the local unit by the incumbent video provider with the largest number of subscribers. At the expiration of the existing franchise agreement, the fee amount would be the amount required by the expiring agreement not to exceed one percent of gross revenues. If there is no existing franchise agreement, the local unit of government could establish a percentage of gross revenues not to exceed one percent, to be determined by a community needs assessment. (It is unclear whether a community which has an existing franchise agreement which does not contain a PEG support fee would ever be able to obtain PEG support in the future under this language. A community with no existing franchise could establish a PEG fee of up to one percent.)

- A local unit must allow a video service provider to install, construct, and maintain a communications network within a public right-of-way and allow "open, comparable, nondiscriminatory, and competitively neutral access to the public right-of-way."

- A video services provider is free to choose the service footprint in which it wishes to operate, and local units of government are prohibited from imposing any build-out or deployment provisions beyond those of the bill. A provider could not, however, deny service access to any group of potential residential subscribers because of the race or income of the residents, a practice referred to as "redlining."

- There is an affirmative build-out provision only as to providers with more than one million access lines (i.e., AT&T Michigan).[1] The bill requires telecommunications providers with more than one million access lines (i.e., AT&T) to designate its service area in terms of entire wire centers or exchanges. Further, telecommunications companies with more than one million access lines would be required to provide access to its video service to a number of households equal to "at least 25 percent of the households in the provider's telecommunication service area in the state within three years of the date it began providing video service under this act and to a number not less than 50 percent of these households within six years." However, a "video service provider is not required to meet the 50 percent requirement in this subsection until two years after at least 30 percent of the households with access to the provider's video service subscribe to the service for six months."

- Providers would have to file an annual report with the local unit and PSC on access and build-out. The PSC would file an annual report with the Governor and Legislature on video service competition, with recommendations for legislation.

- Video franchise agreements would be fully transferable simply by filing with the local unit within 15 days of the transfer. A provider could terminate its franchise agreement or modify

[1] According to a June 2, 2006 PSC report entitled "Status of Telecommunications Competition in Michigan," at p.5, AT&T Michigan had 3,423,548 access lines in Michigan as of December 2005. The next largest telecommunications company was Verizon with 675,126 lines.

its service footprint simply by submitting notice to the local unit (except when it would produce racial or income redlining or violate the build-out requirements applicable to large telecommunications providers.)

- A provider would have to establish a dispute resolution process for customers and maintain a local or toll-free telephone number. The PSC would be required to review (1) unresolved disputes between providers and customers, (2) disputes between a provider and a franchising entity, and (3) disputes between providers.

BACKGROUND INFORMATION:

Pertinent federal and state laws.

Federal. Among the stated purposes of federal telecommunications law is to establish national policy concerning cable communications and to "establish franchise procedures and standards which encourage the growth and development of cable systems and which assure that cable systems are responsive to the needs and interests of the local community." In 1992, Congress prohibited the awarding of exclusive franchises and in 1996, Congress took steps to allow telephone companies and electric companies to enter the video services market.

Proposed federal legislation. Congress is considering legislation that would establish a national video service franchising system. On June 8, 2006, the House of Representatives passed H.R. 5252, the "Communications Opportunity, Promotion, and Enhancement Act (COPE) of 2006, available at http://thomas.loc.gov. (A summary of COPE is available online in the form of a Congressional Research Service (CRS) Report for Congress entitled "Cable Franchising Provisions in the House-Passed H.R. 5252, 109th Congress," June 19, 2006.) On September 29, 2006, the Senate Committee on Commerce, Science and Transportation favorably reported out its own version of the legislation. One of the contentious issues tied to the cable franchising issue at the federal level is net neutrality.

FCC proposed rulemaking regarding cable franchising. In November 2005, the Federal Communications Commission opened a proceeding to investigate whether the current local franchising process inhibits competition in the retail market for the distribution of video programming. 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,* Notice of Proposed Rulemaking, 20 FCC Rcd 18581 (2005)(Franchising NPRM). In the Franchising NPRM, the FCC has sought comments on how it should implement Section 621(a)(1) to ensure that local franchising authorities do not unreasonably refuse to award cable franchises to competitive entrants, and what the effect of franchising and other local and state regulation is on video services competition. A large number of individuals and entities have provided comments to the FCC regarding cable franchising.

State laws. Article VII, Section 29 of the Michigan constitution states: "No person, partnership, association or corporation, public or private, operating a public utility shall have the right to the use of the highways, streets, alleys or other public places of any county, township, city or village for wires, poles, pipes, tracks, conduits or other utility facilities, without the consent of the duly constituted authority of the county, township, city or village; or to transact local business therein without first obtaining a franchise from the township, city or village. Except as otherwise provided in this constitution the right of all counties, townships, cities and villages to the reasonable control of their highways, streets, alleys and public places is hereby reserved to such local units of government."

Section 309a of the Michigan Telecommunications Act, (MCL 484.2309a) permits a provider of a telecommunication service to provide cable service *if it has received a franchise agreement from a local unit of government*.

The Metropolitan Extension Telecommunications Rights-of-Way Act (METRO Act), (MCL 484.3101 *et seq*.) was enacted in 2002 as part of a package of bills designed to promote broadband technology deployment throughout the state. The METRO Act established the METRO Act Authority, currently housed within the Department of Labor and Economic Growth, with the right to assess fees on telecommunications providers for access to public rights-of-way. Under the METRO Act, telecommunications providers must obtain permits to use a municipality's rights-of-way (most obtain a unilateral permit form good for up to five years rather than the longer bilateral permits). Annual maintenance fees (and related Utility Tax credits) are established according to formulas set forth in the METRO Act. Fees are based on linear feet and access lines as reported by the providers.

Under the act, the telecommunications provider with the largest number of access lines pays five cents per linear foot in fees and the rest of the ILECs pay the lesser of five cents per linear foot or the access line rate. The access line rate is determined by taking the total fee paid by the largest provider and dividing it by that provider's number of access lines. The 2006 access line rate is $4.469. CLECs, in turn, pay the per linear foot rate of the ILEC in whose territory they reside. In short, not every provider pays five cents per linear foot in METRO Act fees. Most the ILECs pay less, according to the METRO Authority, an average of 0.0394 per linear foot in 2006.

The METRO Act requires cable providers to pay a lower one cent per linear foot fee but cable providers are exempted from paying any METRO fees so long as they have made an aggregate investment in Michigan since January 1, 1996, in facilities capable of providing broadband Internet transport service that exceeds the amount of the METRO Act fee. No traditional cable provider paid METRO Act fees in 2005 or is expected to in the near future because of significant aggregate broadband investments in the past.

For 2006, METRO fees charged to all telecommunications providers total $21,420,633, of which $15,106,658 was billed to AT&T and $3,902,767 was billed to Verizon. Metro Act fees collected by the METRO Authority are allocated to local units of government based on the formula set forth in Section 11 of the Metro Act. 75 percent of the funds collected are disbursed to cities and villages based on the formula found in Section 13 of 1951 PA 51. The remaining 25 percent is distributed to townships based on the number of linear feet in a particular township as a percentage of the total linear feet reported for all townships. If a local unit has not opted into the METRO Act (as is the case with 40 communities), the money they would have received is redistributed to other locales according to the Act.

The METRO Act allows for a tax credit as the sole means by which telecommunications providers can recover the fees paid under the METRO Act; they are not allowed to pass along the METRO Act fees to customers. These tax credits must be applied for and approved by the Public Service Commission. The act allows telecommunication providers to claim a credit against their Utility Property Tax (which is paid to the state General Fund).

Cable franchise reforms in other states. According to the FCC[2], California, Indiana, Kansas, New Jersey, North Carolina, South Carolina, Texas, and Virginia have recently passed cable franchising bills.

- In 2005, Texas enacted a law enabling new video programming entrants to provide service pursuant to state-issued certificates of franchising authority. Upon the submission of a completed affidavit by an applicant, Texas regulators now are required to issue this franchising certificate within 17 business days.
- In 2006, California, Indiana, Kansas, New Jersey, North Carolina, and South Carolina adopted statewide video franchising procedures that require prompt approval of completed applications. In California, the grant must occur within 44 days; Indiana, 15 days; Kansas, 30 days; New Jersey, 45 days; North Carolina, upon the filing of a completed notice of franchise; South Carolina, 80 days.
- In March 2006, Virginia passed legislation that maintains local involvement in franchising but streamlines the process and establishes time limits for approval.

On the other hand, Louisiana's governor vetoed a bill that would have created a statewide franchising structure for cable and video service providers in July, 2006. Other states that have considered cable franchising legislation but where the efforts have stalled or been withdrawn include Florida, Georgia, Iowa, Minnesota, Missouri, New York, and Tennessee.[3]

Cable television industry background. According to the FCC, about 67 percent of American households purchase cable service; and about 17 percent of American homes purchase satellite television service. The remaining households receive over-the-air broadcast television or have no television service. Newer choices include viewing television programs over the Internet[4] or over a cell phone.

FCC data indicate that the average monthly rate cable subscribers are charged for the combined basic and cable programming service tiers rose approximately 84 percent between 1995 and 2004, and that the cost of cable programming service tiers rose more than five percent or almost five times the rate of inflation between 2003 and 2004 alone.[5] Competition for cable television services exists in very few parts of Michigan and the United States with the major exception of satellite television services.

However, the lines between different types of communication companies and services are blurring. Some industry analysts call this trend "convergence." In general, "convergence" refers to the coming together of previously separate communications and entertainment services: fixed and mobile telephone services (traditional landline telephones and cell phones), broadband Internet, and television. As a result, companies that were once in

---

[2] FCC, Notice of Inquiry, October 20, 2006, *In the Matter of Annual Assessment of Competition in the Market for the Delivery of Video Programming*, ¶13.

[3] www.consumers4choice.org/site/PageServer?pagename=legislativeupdate.

[4] For instance, in September 2006, AT&T began offering AT&T Broadband TV in partnership with MobiTV. It is a new subscription video service with feeds of 20 TV channels, including Fox News, Fox Sports, the Weather Channel, and the History Channel, that will be available to broadband users anywhere in the U.S. See https://att.mobitv.com/do/welcome. In addition, websites such as YouTube providing video content over the Internet are becoming increasingly available and popular. Downloads of individual television programs and films are already available from many sources.

[5] Federal Communications Commission, Notice of Inquiry, October 20, 2006, In the Matter of Annual Assessment of Competition in the Market for the Delivery of Video Programming, ¶6.

separate industries—telephone companies, wireless telephone companies, cable television companies, satellite television companies, and Internet-service providers—are now essentially competitors in the same general business—providing some or all voice, Internet, and television services. Cable and telephone companies are currently offering or are moving to offer similar bundles of services. A bundle of Internet, television, and telephone services is sometimes referred to as the "triple play"; if wireless (cell) phone service is also included, the bundle is sometimes called a "quadruple play" or "home run." One of the attractions of bundles for the providers is that there may be lower customer turnover or "churn" among customers who have signed up for bundles, rather than individual services. Customers may benefit from discounts or having one bill instead of three or four.

According to an article in the *Economist* magazine (Oct. 14, 2006), traditional telecommunications companies view bundled services "as a way of protecting their core business of fixed-line voice calls, which still accounts for the bulk of their revenues." A current challenge for telephone companies is that they are losing fixed-line subscribers to cell phone companies, cable companies, and voice over Internet protocol (VoIP) firms such as Skype. Large internet companies including Google, Yahoo! and Microsoft MSN are also launching new services offering free calls over the internet. In contrast, the cable industry sees bundles as a way to protect its core business of television, as cable companies have been losing television customers to satellite television providers and are now facing competition from telephone companies and Internet service providers.

In order for traditional telephone companies to offer high-quality television services over broadband Internet connections, a technology generally referred to as Internet-protocol TV (IPTV), they are upgrading their telecommunications networks. With its FiOS project, reportedly costing $23 billion dollars, Verizon has taken the most costly approach, known as fiber to the premises (FTTP)—running fiber right up to the customer's home. Verizon's new network already includes parts of Texas, Virginia, and Florida. AT&T's fiber project is called "Project Lightspeed." Project Lightspeed uses a combination of fiber to the node (FTTN) in most areas, and fiber to the premises (FTTP) in greenfield areas. AT&T's Internet protocol television (IPTV) service, currently in operation in San Antonio, Texas, goes by the name "U-Verse."[6] The cost of AT&T's project has been reported as $4.6 billion. Fiber to the node or FTTN has been described as running fiber to local exchanges and neighborhood junction boxes, and then, for the final link into the home, using existing or upgraded copper phone lines.

In some areas, AT&T has begun placing new metal junction boxes in rights-of-way easements about one for every 300-500 customers. These boxes come in a variety of sizes but are reportedly often about five feet high, and sometimes described as about the size of a small refrigerator. In Ohio, for instance, AT&T is reportedly in the process of placing about 50,000 of these boxes. The size, appearance, and placement of these boxes have upset some residents in some communities where they have appeared.[7] Some Chicago-area communities have placed temporary bans on the placement of these large boxes, and have been sued by AT&T.

Direct broadcast satellite companies, such as DIRECTV and EchoStar (Dish Network), and to a lesser degree, large home satellite dish companies, are currently the most significant

[6] More information about U-Verse is available at http://www.sbc.com/gen/u-verse?pid=7871&cdvn=custom.
[7] See, e.g., "Unsightly Big Boxes Herald New Technology," *The Columbus Dispatch*, 10/18/2006, http://www.columbusdispatch.com/news-story.php?story=dispatch/2006/10/18/20061018-A1-03.html.

competitors to the incumbent cable companies. A 2005 GAO report found that direct broadcast satellite companies subscription rates have been and remain highest in rural areas, but that since 2001, growth has occurred most rapidly in urban and suburban areas.[8] Currently, satellite companies do not pay video franchise fees to local units of government and they remain exempt from doing so under House Bill 6456. Satellite television services are sometimes bundled with high-speed Internet services. For example, in July 2006, AT&T began offering a service called "Homezone" in Ohio in which it partners with Dish Network to offer bundles of telephone, broadband, and satellite services.[9] This will allow it to offer television service in areas where it has not upgraded its network to support U-verse. In some parts of the country, states have moved to impose fees on subscription television services whether provided by satellite or cable.

Other new technologies currently deployed in Michigan include broadband over power line (BPL) service, in Grand Ledge and St. Johns, Michigan, and various types of wireless broadband services. It does not appear that these companies are currently offering television services, only high speed Internet services. However, with the advent of VoIP telephone services and new Internet television services, it is becoming increasingly possible to obtain Internet, voice, and some degree of television services using virtually any broadband connection. Another technology on the horizon is the convergence of fixed and mobile telephones in which a single handset works as a cell phone when outside the customer's home or business but connects to a regular home network for cheaper and possibly clearer calls inside the customer's home or business.

ARGUMENTS:

For:

Supporters of the bill have made the following arguments.

<u>The bill will streamline and speed up the franchising process, encouraging new providers to enter the market</u>. Requiring a video service provider to obtain a separate franchise agreement from each community in which it wishes to operate is a cumbersome process that discourages competition. Making cable franchise agreements uniform and easy to obtain within a short period of time should make it significantly easier for new companies to offer video services in Michigan. Under the bill, a company submitting a complete franchise agreement can receive a franchise in as little as 30 days. This should ease the entry of new competitors, particularly telecommunications companies, into the cable television/video services market. Cable franchising reform will make Michigan a more inviting location for the deployment of advanced fiber networks capable of delivering high quality television services. Although in many parts of Michigan, people have a choice between cable and satellite television, in very few areas of Michigan do people have a choice between two cable providers.

<u>Increased competition may help drive down prices, promote a wider range of services, and improve customer service</u>. Consumers should be the direct beneficiaries of more head-to-

---

[8] GAO, *Telecommunications: Direct Broadcast Satellite Subscribership Has Grown Rapidly, But Varies Across Different Types of Markets*, April 2005, quoted in FCC, Notice of Inquiry, October 20, 2006, *In the Matter of Annual Assessment of Competition in the Market for the Delivery of Video Programming*, ¶42.
[9] See AT&T's press release about this service: <u>http://att.sbc.com/gen/press-room?pid=5097&cdvn=news&newsarticleid=22403</u>.

head competition in the market for video programming. Several studies have shown that competition puts downward pressure on monthly bills, including one GAO study finding that monthly cable rates in markets where there is one more than one cable provider are approximately 15 percent below similar markets with no competition. (Competition from satellite television alone does not appear to drive down prices to the same degree.) Some evidence suggests that where Verizon's FiOS TV is competing with incumbent cable providers in Texas, Florida and Virginia, some customers are seeing lower bills. (In some cases, the advertised price may not drop but customers threatening to switch to a different provider are offered better deals.)

Moreover, if telecommunications providers or other companies are encouraged to enter and invest in new fiber networks in Michigan, consumers and businesses should benefit from being able to choose from a wider range of communications services and a wider range of providers.

Increased competition should also spur companies to improve customer service as a way of attracting or retaining customers.

<u>The high capacity networks that may be built by telecommunication companies to provide video services provide a basis for short-term and long-term economic growth</u>. To the extent the bill encourages telecommunications companies and others to build expensive new fiber networks and make other infrastructure improvements, these investments should boost Michigan’s economy. New infrastructure investments should create not only short-term jobs, but upgraded fiber networks or other infrastructure improvements will support Michigan's long-term economic growth. Cable reform may make Michigan an attractive location for the building of these new fiber networks and for earlier deployment of higher speed and more technologically advanced services. Clearly, new networks that will support much higher speed Internet services and more advanced services would be a boon to economic development.

Some people have suggested that Michigan should position itself to attract telecommunications companies to build new fiber networks here earlier rather than later. The fiber projects are very expensive and Michigan should try to be near the front of the line in case the telecommunications firms run out of money before the whole country is wired. Others have noted that large telecommunications firms tend to have unionized workforces and to provide good benefits and training for their workers. They suggest that the jobs created if telecommunications companies choose to build new fiber networks here will be good jobs for Michigan workers.

<u>The bill prohibits redlining and requires build-out by large telecommunications companies</u>. Some have expressed concern that the bill would allow telecommunications companies to bypass low-income or minority neighborhoods. The bill specifically bans providers from denying access to service to any group of potential residential subscribers because of the race or income of the residents in the local area in which the group resides.

Moreover, the bill requires a provider with one million or more access lines in Michigan (i.e., AT&T Michigan) to designate its service footprint in terms of entire wire centers or exchanges. This requirement limits AT&T's ability to pick and choose its service footprint on a house by house basis. If it wants to include any home or business covered by a wire center or exchange, it would presumably have to include the entire wire center or exchange in the service footprint. Moreover, the bill requires AT&T to provide access to at least 25 percent of the households in the provider's chosen service area in the state within three years of beginning video service, and to at least 50 percent within six years (but no earlier than two years after it achieves a market share of 30 percent for six consecutive months.)

No further build-out requirements are necessary because they would discourage new entrants. The bill strikes a reasonable compromise between having no build-out requirements at all, as advocated by some, and having build-out requirements so stringent that they would serve as an obstacle for new companies to enter the market. If new services are popular with consumers, providers will have market incentives to build-out their networks widely.

<u>The bill requires the carriage of local broadcast signals, including digital where required by federal law, the carriage of PEG channels, and emergency alerts</u>. Although some people would have liked an even more streamlined or deregulated franchising process, others argued certain things need to be required to create a more level playing field for industry competitors or to serve the public interest. The bill’s requirement that local broadcast signals be transmitted, without degradation, is an important requirement in the age of high definition digital television. The bill also requires video service providers to carry local PEG channels, an important source of local information, particularly about local governments and schools. The bill also requires that all video providers carry the emergency alerts that cable providers are required to carry under federal law.

<u>The bill is designed to preserve as much local control as possible while still streamlining the system to encourage more competition and broadband investment</u>. The bill was designed to strike a balance between preserving as much local control as possible while still streamlining the franchising process enough to accomplish the goals of the legislation. Under the current version of the bill providers obtain local franchises (rather than statewide franchises), fees are paid to local units directly (rather than disbursed from the state), right-of-way authority under the current METRO Act was preserved, carriage of PEG channels is continued and PEG funding is continued at the preexisting level until the expiration and up to one percent thereafter. Although some would have liked to abandon the concept of PEG channels and funding altogether, a balance was struck in the bill.

<u>Institutional networks are a cost of running local government and should be paid for accordingly.</u> House Bill 6456 does not protect a local unit of government's ability to require an I-NET, or other types of in-kind services, in return for a cable franchise. Although I-NETs may be essential to local units of government, and they may be "free" to the local unit of government under the terms of existing franchise agreements, the provider likely passes the cost of the I-NET onto cable subscribers. Therefore, cable subscribers are paying for the I-NETs. It is not fair to require cable subscribers to pay for the cost of a broadband network for municipal governments.

Against:

Opponents of the bill have made the following arguments.

<u>The bill is unnecessary as existing franchises are not exclusive and local units of government would welcome new entrants to the market.</u> Since 1992, it has been generally unlawful under federal cable law for local units of government to grant exclusive franchise agreements or to unreasonably refuse to award a competitive franchise. Local units of government say

they would welcome new providers of cable or video service to their communities. Many have offered expedited and streamlined franchising negotiations to telecommunications companies.

The current process is not as difficult as critics make it seem. In the late 1990's, Ameritech, operating as Americast, obtained cable franchises without significant difficulties and competed for a few years with incumbent cable operators in approximately 30 to 40 communities in the metro Detroit area. (Ameritech's cable operations were subsequently obtained by a provider called Wow! which continues to offer Internet and cable services in many communities outside of Detroit, an example of a part of Michigan where cable competition already exists (with very little downward effect on rates, according to some)). In other parts of the U.S., Verizon has obtained about 160 franchises and recently told its investors that local franchising laws were not holding back its deployment of video. In short, current franchising laws are not a serious obstacle to telecommunications companies offering video services. Telecommunications companies are rolling out television services in some states that have *not* passed cable franchise reform.

<u>The bill is unnecessary because there is a strong possibility of federal action in the near future</u>. Congress is considering legislation that would establish a national video service franchising system. On June 8, 2006, the House of Representatives passed H.R. 5252, the "Communications Opportunity, Promotion, and Enhancement Act (COPE) of 2006, available at <u>http://thomas.loc.gov</u>. On September 29, 2006, the Senate Committee on Commerce, Science and Transportation favorably reported out its own version of the legislation. Federal legislation may preempt state cable franchising laws. In addition, the Federal Communications Commission (FCC) has proceedings underway that could impact video franchising.

<u>The redlining prohibition and build-out provisions are weak and riddled with loopholes</u> Although the bill states that providers would be prohibited from denying access to service on the basis of income or race, it allows providers to freely choose where they do and do not wish to offer services. It would be very difficult to prove that the intent of a business plan was to discriminate on the basis of race or income, and the bill provides an easy defense to any allegation of redlining on income or racial grounds--a company could rely on the fact that 25 percent of the households with access to its services are low-income households, defined in the bill as households with average annual income of less than $35,000 within three years of beginning to offer services, or 30 percent of the households with access to the service were low-income households thereafter. This would be likely be an easy defense to mount as Michigan's statewide median household income rate was only $46,038 in 2005, and several cities including Detroit, Flint, and Pontiac, had median household income rates of under $30,000. Building out in one large lower-income urban area might forever insulate the provider from any redlining concerns. It could then continue to "cherry-pick" the rest of the state wiring more densely populated and affluent areas only.

Moreover, it not just income or racial redlining that is of concern. A variety of different reasons could cause one neighborhood to be perceived as a more attractive place for a video service provider to build than another--population density, infrastructure issues, geographical features, or demographics to name a few. Build-out requirements are a matter of fairness--in return for use of valuable public rights-of-way in a local area, cable companies are required to make cable service available to everyone in the community whose rights-of-way it is using, not just the neighborhoods the company thinks will be most highly profitable or which are most convenient for the provider to serve.

There is nothing in this bill to require a company to offer services to all residents of a municipality in which it is operating, to operate in all parts of the state, or to encourage build-out in rural areas. AT&T has told its investors it primarily intends to serve "high-value" customers—those who spend more on monthly services. Providers would be free to avoid lower density areas of the state, such as rural areas, and any area that it would expect to be less profitable or more difficult to wire for any reason. All citizens, of any race or income level, and whether living in urban, suburban, or rural areas, would be better protected by strong build-out language requiring build-out throughout the service area (or at least the entire service area of sufficient density). The bill expressly prohibits local units of government from requiring any build-out or deployment provisions more stringent than those contained in the bill.

Current cable franchise agreements require cable companies to build out their network to allow the entire service area access to cable within a set and relatively short period of time. In essence, in return for use of the public rights-of-way in a given local unit of government cable companies have been required to make cable service available to everyone in the community (or in some cases, to at least to all areas that have a minimum of 20-25 homes per linear road mile or some other formula). Michigan and its citizens have benefited tremendously from build-out requirements because they have made not only cable television but also broadband Internet service via cable modem widely available.

The bill only imposes *affirmative* build-out requirements on video service providers with more than one million telecommunication access lines in the state and these are weak and riddled with loopholes. Further, the fines for not meeting the limited build-out requirements are so small (up to $20,000 for first offense and up to $40,000 for second or subsequent offenses for the largest companies) as to be insignificant to the larger telecommunications companies. Stronger build-out requirements would create more jobs and would provide a more solid foundation for Michigan's economy.

<u>Aspects of the bill may be unlawful or unconstitutional</u>. The bill would allow incumbent cable companies to terminate their existing franchise agreements prior to expiration. Cable contracts were negotiated in good faith between local units of government and cable companies, and should be honored until they expire. Both the federal and state constitutions prohibit laws that impair contracts. Moreover, the Michigan constitution clearly places franchising and right-of-way control in the hands of local units of government. To the extent the bill erodes local franchising and right-of-way authority, as it does in a variety of ways—requiring the issuance of franchises, dictating the terms of the franchise agreements, and preventing local governments from protecting its communities with build-out or other requirements—the law conflicts with the Michigan Constitution.

Local officials also caution that the bill may have Headlee implications in that the contract abrogation may impose a variety of increased costs at the local level, including costs associated with renegotiating existing franchises and relocating lines during roadwork.

The provision allowing METRO Act fees to be offset from the video service provider fees would appear to conflict with the METRO Act's statement that the property tax credit available under that act be the only way for a provider to recoup its METRO Act maintenance fees. This bill would offer telecommunications providers a second method of recouping its fees.

The bill threatens PEG programming in Michigan. The bill does not adequately support PEG channels and funding. The bill would allow a community that already has PEG stations to retain the existing number of active channels under a new provider. It is silent as to future expansion (as may be necessary in a growing area). Under the H-2 version of the bill, communities that currently do not have PEG channels would be precluded from ever getting them.

As to funding, the maximum amount that a community can receive for PEG channels after the expiration of any existing franchise, is one percent of gross revenues. If a community has an existing franchise that currently has a PEG fee of less than one percent (some have no PEG fees), it is arguably locked into that lower rate, or even zero PEG fees, forever. For other communities, one percent of gross revenue is about what they currently receive and their funding will remain about the same. Some communities will be faced with a significant decrease. A community with no current franchises will be able to establish a maximum of one percent based on a community needs assessment. The bill should be amended to "do no harm" to PEG funding, i.e. to at least retain PEG funding at existing levels. Also, communities with less than one percent funding should be allowed to increase their level to one percent.

PEG fees should not be limited to for the amount of "reasonable capital costs." PEG operators say that after their facilities are built, their largest need is for administrative and operating expenses. Although not entirely clear, the bill could be interpreted as restricting the use of PEG fees only for capital costs.

Section 4(3) of the bill unfairly imposes significant new interconnection technology and cost burdens on local units of government, requiring the local government to ensure that all PEG programming is provided in a format acceptable to the provider compatible with the technology or protocol utilized by the provider. This item presents a serious issue for PEG centers in Michigan.

The bill eliminates critical local emergency alerts. Under Section 2(3)(j) of the bill, providers would have to comply with all FCC requirements involving the distribution and notification of emergency messages over the emergency alert system applicable to cable operators. Local officials say that this would not preserve *local alert systems* provided for in some local franchise agreements. An example given was that Alma has issued local "boil water" alerts in the past. The perceived need to streamline franchise reform is no reason to eliminate public safety and health protections.

The bill threatens I-NETs on which local units of government rely. Under the bill, existing cable franchise agreements could either be terminated early or modified to include only uniform provisions. Non-uniform provisions such as specific in-kind services negotiated by a particular community would no longer be enforceable. Local governments will lose in-kind services such as I-NETs immediately *even if no new provider enters the area or does not do so for a matter of months or years.* There is no justification for abrogating current contract provisions before a new provider has appeared on the scene.

Reportedly, in many areas the cable company "owns" the I-NET under the terms of the local franchise agreement, although in some areas—Southfield, for example—the I-NET may be jointly owned by the municipality and the incumbent cable company. Once the bill became effective, a cable company could, in effect, turn off the I-NET, at least where it "owns" the I-NET. If a local unit of government needs to preserve its I-NET, it would have to purchase the existing I-NET from its cable owner or install a new network, plus pay for ongoing operations of the I-NET. A preliminary estimate in October 2006 by local government representatives concluded that in-kind service losses from just eight communities examined totaled 25 million to 35 million dollars.

I-NETs are critical to the functioning of many modern municipalities. A municipality's facilities, including schools, courts, administrative offices, libraries, senior centers and others, may be interconnected for voice, video, and data by a fiber network. Functions handled through I-NETs vary by community but may include 911 services, video arraignments (saving money and increasing public safety), Internet phone services(saving municipalities telephone bills), and others. At less cost to the cable provider than it would cost a municipality to replace similar services, governments have been able to negotiate arrangements that help meet the needs of their communities under current local franchising rules.

<u>The bill jeopardizes fees relied on by local units of government</u>. The bill arguably jeopardizes franchise fees relied on by local units of government in at least two ways: (1) the METRO Act credit provision threatens fees received by local governments in a variety of ways; and (2) the auditing provision in the bill is weak.

First, the METRO Act credit provision in Section 6(11) might lead to revenue losses for local government in several ways:

- The bill would allow a telephone provider to deduct the METRO Act fees it paid attributable to a local area, *minus a utility property tax credit that may be granted by the PSC under the METRO Act*, against the video service provider fees it owes that local area. If the PSC did not grant this full METRO Act credit (there have been years in which certain providers did not get credits in accordance with certain settlement agreements with the PSC), or if the telephone company did not apply for the credit because of a change in tax laws or any other reason, the telecommunications provider could simply deduct the amount of its METRO Act payments attributable to a given area from the franchise fees it owes that community. Under this scenario, the local unit of government would suffer a loss in fees.

- The last sentence of Section 6(11) would appear to grant a provider a five cents per linear foot credit, even if the amount that a provider pays under the METRO is less than five cents per linear foot. According to the METRO Authority, most ILECs and CLECs pay under five cents per linear foot in METRO Act fees. Why should a provider get a METRO Act credit larger than the METRO Act fees it actually pays?

- Another more subtle issue concerns definitions under both the METRO Act and the bill. In some contexts, telecommunications companies providing video services have attempted to argue that they are not cable companies and do not need franchises. On the other hand, to the extent they receive franchises to provide video services, would they be able to argue that they are no longer subject to the up to five cents per linear foot METRO Act fees paid by telecommunications providers, but only the one cent per linear foot fee to which cable companies are theoretically subject (but do not pay because of offsetting credit provisions in the METRO Act)? This position has already been taken by a small telecommunications company in Michigan providing bundled services in an unresolved matter before the METRO Authority.

- Forty communities that never opted in to the METRO System–and are therefore ineligible from receiving METRO Act payments—might also lose out on franchising fees under this section if it is interpreted as permitting the METRO Act fees attributable to that municipality or township from being deducted from franchise fees, even if the local unit did not receive any METRO Act payments.

Second, the auditing provision may make it difficult or costly for a local government to make sure that it is receiving the proper amount of fees. For example, the bill would require local auditors to travel to where the records were ordinarily kept to have access to necessary records and auditors would be limited to looking at the previous 24 months only.

<u>The bill might require expansion of the PSC staff to handle the large number of customer complaints currently handled by local units of government</u>. Representatives of local governments currently field customer complaints about cable service or construction causing damage to their property. Under the bill, responsibility for these calls will be transferred to the Public Service Commission. This could require the PSC to hire additional staff to field the calls. It could also lead to less satisfactory resolution of customer complaints. Local elected officials are in the best position to handle consumer complaints about service, construction, or rights. These are local concerns best handled by local government who can do so in a timely manner and who have experience doing so. The bill also requires the PSC to handle provider-provider disputes and provider-local government disputes.

POSITIONS:

AT&T supports the bill. (9-25-06)

Communications Workers of America – District 4 supports the bill. (9-25-06)

Fiber to the Home Council, Washington, D.C., supports the bill. (9-25-06)

Michigan AFL-CIO supports the bill. (9-22-06)

Michigan Association of Broadcasters supports the bill. (9-25-06)

Michigan Retailers Association supports the bill. (9-22-06)

Telecommunications Association of Michigan supports the bill. (9-25-06)

Verizon supports the bill. (9-25-06)

Charter Communications is neutral on the bill. (9-25-06)

Michigan Cable Television Association is neutral on the bill. (9-22-06)

AccessVision, Battle Creek, Michigan, opposes the bill. (9-26-06)

Michigan Chapter of the Alliance for Community Media opposes the bill. (9-26-06)

Michigan Municipal League opposes the bill. (9-25-06)

Michigan Townships Association opposes the bill. (9-25-06)

Legislative Analyst: Shannan Kane
Fiscal Analyst: Richard Child

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.