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## **Cable Franchise Transfers and Sales** **Municipal Rights, Risks and Opportunities**

**Introduction:** Cable systems, franchises and companies are often transferred or sold. When this happens, municipalities can often obtain significant benefits for themselves and their residents by making sure that prior to the sale current problems are corrected, and that there are adequate assurances that the municipality and its residents will be no worse off after the sale than before. Usually this can be done at no cost to the municipality, because the cable companies reimburse all costs. Cable company claims that in a transfer municipalities are limited to reviewing only the legal, technical and financial qualifications of the purchaser are incorrect. And there is a significant risk of lost rights if municipalities fail to take action on proposed transfers. Specifics on all this and the transfer process area as follows.

**Overview:** Cable companies and cable systems are often sold or "transferred" as part of (1) a long term consolidation of cable companies in the U.S., (2) larger companies selling off systems (often in smaller communities) that are not a "good fit" with their operations, (3) the breakup of joint ventures between several cable companies, (4) management "buyouts" of cable companies or (5) the bankruptcy of a cable provider. Other transfers occur as cable companies "swap" systems so that only one cable company will serve an entire metropolitan area. This provides some efficiency--but it also removes the ability to compare one cable company in an area against another that is literally across the street.

Some of the transfers are "sales" of the franchise--an asset sale where the company legally franchised to serve an area changes. Others are changes in "control"--the local cable company technically doesn't change, but through sales of stock or otherwise the entity controlling it changes. In either case, for practical

purposes the cable company changes hands, and often personnel and operations may change, too, potentially for the worse as far as municipalities are concerned.

Whether a municipality has the right to review, approve, condition or reject a proposed transfer depends on whether its cable franchise or ordinance so provides. Many franchises provide for such review and approval. Typically a municipality can request a wide range of information and impose a wide range of conditions to assure (for example) that it and its residents are no worse off after the transfer than before, that existing problems are corrected before the transfer occurs, and that there are adequate protections for the municipality and its residents. The claims of cable companies that Federal laws limit municipal rights to obtain these protections are incorrect, and have been rejected by the courts.

Occasionally a cable franchise renewal will occur concurrent with a transfer.

We have represented over 100 municipalities in connection with the sale or "transfer" of the cable system serving them to a different company. Among the items we have addressed in the transfer process are getting assurances that the municipality and its residents will be no worse off after the transfer than before, resolving outstanding disputes, ensuring adequate customer service after the transfer, and protecting against undue increases in rates.

Procedure: The 1992 Cable Act and the associated FCC rules provide a municipality with 120 days to act on an application for consent to a transfer. Otherwise, the transfer is automatically deemed approved.<sup>1</sup> The 120-day period generally starts with the delivery to the municipality of a complete (see below) "FCC Form 394 Application for Franchise Authority Consent to Assignment or Transfer of Control of Cable Television Franchise" and attachments which provide information on the transaction and purchaser/transferee.<sup>2</sup>

Often the Form 394 delivered to a municipality is incomplete (e.g. many or most exhibits missing). Cable companies usually contend that a municipality has only 30 days to object for lack of completeness—although this is incorrect, municipalities are well advised to raise objections within the 30 days to avoid disputes on this point.

Scope of Review: Contrary to cable industry arguments, municipal review of a transfer application is generally NOT limited just to the financial, legal and technical qualifications of the proposed purchaser. Although the cable industry has made this argument for some time (presumably to limit municipal ability to conduct reviews and obtain results such as those set forth below), it has been rejected by the courts which have affirmed municipalities legislative discretion in this regard. This is because the substantive standard for reviewing a transfer is set by the municipality's franchise, cable ordinance and charter. Both Congress and

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<sup>1</sup> Use of the Form 394 is optional for the cable company. However, it is generally used by cable companies because of the 120-day approval period it triggers.

<sup>2</sup> In February 1999, the FCC ruled that at its option a cable company can file a hard copy of the Form 394 with a municipality and post the (usually lengthy) exhibits electronically on the web. As clarified in a subsequent order, a municipality within 10 days of receipt of the Form 394 may request (for any reason) hard copies of the exhibits from the cable operator. The FCC also ruled that if a municipality requests hard copies of the exhibits, then the statutory 120 day period for municipalities to act on Form 394 transfer requests does not start until the municipality receives them. These rulings do not appear to be valid due to the failure of the FCC to follow the procedures prescribed by Congress for adopting Form 394 rules. However, to be cautious municipalities may not wish to act as if they are invalid until there is a ruling on this.

the FCC were direct in saying that the 120-day time period and related requirements imposed by Congress and the FCC in 1992-93 are procedural, not substantive.

Costs Reimbursed: Typically the seller (or the buyer) will reimburse the municipality all its costs (including legal fees) in connection with reviewing the transfer. Often this will be by side agreement.

Risk of Loss of Rights: There is a significant risk for municipalities in transfers as follows: Cable companies contend that under the 1984 Cable Act in a transfer the "slate is wiped clean" as to any defaults by the prior cable company. Unless this contention is specifically negated as a part of a transfer, the municipality may find that it has lost significant rights and claims, such as claims for damages or underpayment of franchise fees. The risk is increased because under Federal law, if a municipality does not act on a complete Form 394 within 120 days of receiving it, the transfer is automatically deemed approved.

The combination of "approval by lapse of time" and the cable company contention creates a risk that municipalities can easily lose rights in a transfer.

Timing/Practice Pointers: When a cable company transfers its franchises as part of bankruptcy proceedings, there may be additional complications due to claims that the bankruptcy court has jurisdiction over franchise defaults, and potentially even over transfers. This paper does not examine these issues in detail, but municipalities should be aware that deadlines may be shortened for municipalities to object that the bankrupt company has not cured franchise defaults prior to assumption of the franchise (as an executory contract) and transfer of the franchise to the new operator as part of the bankruptcy proceeding. While municipalities can claim that a franchise is a personal service contract which cannot be transferred by the bankruptcy court without their approval, they should also have documentation prepared to demonstrate to the bankruptcy court evidence of any defaults under the franchise.

Even for transfers outside of the bankruptcy context, in practice the 120-day time limit to act is quite short, after you back out the time necessary for a municipality to get started on reviewing a proposed transfer and the date documents first have to be on a council agenda (especially if there is a two reading requirement). Although the 120 days can be extended, cable companies are generally reluctant to do this.

Thus municipalities need to start work promptly after receiving a request from a cable company to approve a proposed transfer. Two practice pointers--Sometimes the filing by the cable company to get a transfer approved goes to the wrong person at a municipality, or it sits on someone's desk for days or weeks. Either way the municipality loses valuable time. To avoid this, municipalities can write the cable company a formal letter telling them whom to file with (and perhaps specifying the municipal attorney or manager as a cc). The notice provisions of a franchise may bear on this. And they can notify all persons at the municipality who might get the filing, telling them to be on the lookout for it, and to immediately send anything they get to a specified person.

Substance and Results: Two of the guiding principles in transfers are to get problems corrected, and to make sure the municipality and its residents are not worse off after the proposed transfer than before. In this respect, a transfer is analogous to a mini-franchise renewal, except that the focus is more limited, it occurs much more quickly, municipalities often have more bargaining power, and costs are generally reimbursed.

We have assisted municipal attorneys and their municipalities in many states on transfers. Some of the results which can be obtained in transfers, and which we have obtained, include the following. What can be achieved for any specific municipality is highly dependent on its specific facts and situation:

- Where appropriate (such as where the purchaser is a newly formed cable company, or a very small company) a review of the qualifications and background of the proposed purchaser.
- Resolve pending disputes (and clearly preserve municipal rights against "slate is wiped clean" claims as to disputes which could not be resolved in the short time frame for considering proposed transfers).
  - For example, we resolved a multi-year dispute on cable company provision of replacement equipment for city and school channels with a \$565,000 grant which was not passed on to subscribers in rates.
- Franchise fee underpayments favorably resolved.
- Cable company agreement to maintain the current level of customer service, including agreement not to change office locations, hours or staffing levels.
  - In some instances, agreement to have a local office in the municipality.
- Agreement by the purchaser to comply with FCC customer service standards with local enhancements, provision of quarterly reports on compliance, and agreement on liquidated damages for non-compliance.
- A rebuild of the cable system, with more channels, higher speed Internet service and more services than the prior operator had proposed.
- Cable service extended to the downtown, commercial area of a city.
- Assurances of continuation of the current level of support for PEG channels (such as where the existing operator had been doing more than the franchise required).
- Protections against the municipal channel being moved to a different channel number.
- Direct lines to various municipal locations from which live broadcasts can originate on PEG channels.
- Protections added against franchise fees unduly diminishing if the cable company offers discounts for customers purchasing cable modem service or telephone service in addition to cable (prevents the cable company from allocating the discount solely to cable service—"free cable service if you take cable modem and telephone service from us"—which would wipe out franchise fees).
- Updating and strengthening insurance provisions so the municipality and its residents are better protected.
- Municipal ability to obtain fiber lines, cable modems or data transmission free or at discounted rates.
- Resolution of EEO issues, such as correcting underutilization of women or minorities in certain job categories, implementing affirmative action plans with specific action steps to increase the flow of qualified applicants, annual impact analyses and the like.
- In some instances, concurrent renewal of the cable franchise on favorable terms, such as where the cable franchise is nearing expiration.
- In some instances, limited protections against rate increases, such as preventing rate increases from occurring immediately following a transfer.



Conclusion: The purchase and sale of cable systems poses both risks and opportunities for the municipalities. Both are complicated by the short, 120-day Federal timeline in which to act.

Communications Practice, Questions: Varnum LLP is one of Michigan's largest and oldest law firms. Varnum is a business law firm with a national communications law practice representing municipalities, property owners and others on Federal aspects of cable, cell tower, and communications matters.

If you have questions about franchise transfers, contact John Pestle or Tim Lundgren

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