



## FCC's Proposed Third Report and Order and Initial Effects on PEG

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The FCC released its draft Third Report and Order in the Section 621(a)(1) cable franchising FNPRM proceeding. The short summary is that the Order would allow cable operators to deduct from franchise fees the fair market value of cable franchise requirements other than PEG capital costs (the definition of which has been *expanded* in the Order); build-out requirements; customer service obligations; and possibly other provisions that are “an essential part of the provision of cable service to subscribers”. Non-capital PEG-related obligations are franchise fees, but the Commission does not decide whether PEG channel capacity is a capital or non-capital cost and thus it cannot be deducted from franchise fees under this Order. We believe the Commission is merely deferring action on this issue; it is not settled and we should anticipate further action.

Here is a link to the draft Order: <https://docs.fcc.gov/public/attachments/DOC-358439A1.pdf>.

### “In-Kind Contributions”

- The draft concludes that “most cable-related, in-kind contributions are encompassed within this definition and thus must be included for purposes of calculating the statutory five percent cap on such fees.”
- “In-kind contributions” are defined as: “any non-monetary contributions related to the provision of cable services provided by cable operators as a condition or requirement of a local franchise agreement, **including but not limited to free or discounted cable service to public buildings, non-capital costs in support of PEG access, and costs attributable to the construction of I-Nets**. It does not include the costs of complying with terms of the franchise agreement that are an essential part of the provision of cable service to subscribers, including but not limited to build-out and customer service requirements.”
  - NOTE: The description of what is excluded has changed from the FNPRM. Rather than looking at whether the provision benefits the LFA, the new test is whether the provision is “an essential part of the provision of cable service to subscribers.” The Order concludes build-out and customer service obligations are “an essential part ...”.
- The Order proposes a new definition of “capital costs”: “[T]he term ‘capital cost’ in section 622(g)(2)(C) should be given its ordinary meaning, which is a cost associated with the acquisition or improvement of a capital asset. ... [T]he exclusion for capital costs under section 622(g)(2)(C) **could include equipment that satisfies this definition, regardless of whether such equipment is purchased in connection with the construction of a PEG access facility**. This is a welcome change to the more restrictive definition the Commission previously adopted.
- Though the Order finds that non-capital PEG-related franchise provisions are franchise fees, the Order **does not allow the offset of PEG channel capacity at this time**. The Order finds “the record is insufficiently developed for the Commission to determine whether the provision of PEG channel capacity is included within section 622(g)(2)(C)’s exclusion for capital costs.”

- The Order finds the installation of “PEG transport facilities” are capital costs that are exempt from the five percent franchise fee cap, and that maintenance of those facilities are operating costs that count toward the cap. “PEG transport facilities” are “facilities that LFAs use to deliver PEG services from studios or other locations where the programming is produced to the cable headend.”
- Franchise obligations considered “franchise fees” under the Order are to be valued at fair market value, as proposed in the FNPRM.
- The Order clarifies that it is prospective only; cable operators cannot recoup past franchise fee payments. However, the Order is clear that it applies to existing franchise agreements.
- The process for modifying a franchise to comply with the Order will follow the franchise modification procedure in Section 625 of the Cable Act, which means that, after the Order takes effect (assuming it is adopted), a cable operator may request modification of the franchise agreement and the LFA will have 120 days to make a final decision about the cable operator’s request. “If the LFA rejects the cable operator’s request or disputes the value that the cable operator assigns to an in-kind contribution, the cable operator may bring suit in a state court or federal district court that has jurisdiction over the parties.”

Effects of the order will differ from state-to-state and community-to-community because of the nature of local and state franchising and differing business strategies of cable operators. You should analyze what possible in-kind contributions could be included as an offset to franchise fee support.

For example, if live drop and headend transport are obligations under your agreements, their initial installation will **not** be associated with a franchise fee offset, but their maintenance and operating costs **could be**. This is an incentive for you to own your own transport, and perhaps use PEG capital to acquire it, rather than rely upon the cable provider.

The same can be said for Institutional Networks – construction, maintenance and operation could be counted against franchise fees. Similarly, operating costs of PEG facilities that are operated by cable companies could be counted against the cap.

Another example of impact would be free cable drops to schools and other sites in your community. Each box could be valued at market rate and could count against franchise fee support in your area.

The order does not specify what is and is not a service “essential” to cable subscribers that can be exempted from the cap. Whether Interactive Program Guides fall in this category remains to be determined. Some local authorities have been hesitant to negotiate for HD channels because of the potential cost to franchise fees (i.e., the capacity would be more valuable than an SD channel). HD channel capacity would not be subject to an offset under this Order.

Because the order leaves open the question of what is “essential,” you should be prepared in the modification process to evaluate not only the fair market value a cable operator proposes to offset from franchise fees, but also the franchise provisions they have deemed to be subject to the cap.

Finally, if the Commission adopts this draft order, it can, and often does, make substantive changes to an order after the vote. We will not know the final details of the order until a final report and order is released, which generally occurs within a few days after the Commission meeting. We will provide an update to highlight any substantive revisions to the order that impact the summary and analysis provided above.