Cole, Raywid & Braverman, L.L.P.

ATTORNEYS AT LAW
1919 PENNSYLVANIA AVENUE, N.W., SUITE 200
WASHINGTON, D.C. 20006-3458
Telephone (202) 659-9750
Fax (202) 452-0067
www.crblaw.com

PAUL GLIST

ROBERT G. SCOTT, JR.

LOS ANGELES OFFICE
238 ROSECRANS AVENUE,
SUITE 110
EL SEGUNDO, CALIFORNIA
90245-4290
TELEPHONE (310) 643-7999
FAX (310) 643-7997

OHIO'S NEW MUNICIPAL OVERBUILD LAW: A PRACTICAL GUIDE

June, 2000

This document analyzes the new Ohio law, 123 SB 67, which primarily governs the entry of any local government into the cable television business in competition with an investor-owned cable operator which holds a franchise from that local government. The new law also prohibits any local government from unreasonably withholding consent to a request by a franchised cable operator to transfer, modify, or renew its cable franchise. We provide below a detailed analysis of this new law, with examples demonstrating the potential limits of the law in practical application.

TABLE OF CONTENTS

TABLE OF CONTENTS

PRIVILEGED AND CONFIDENTIAL

I. POTENTIAL BARRIERS TO MUNICIPAL OVERBUILDS

Before the new statute operates to assure fair competition between a municipal overbuild system and an investor-owned system, it maximizes the ability of the incumbent operator and the citizenry to assure that any such overbuild is both lawful and desired by the taxpayers.[1]

A. Municipalities May Not Have the Inherent Authority to Engage In a Competitive Cable Business.

The new law is very careful to point out that it does not explicitly authorize municipal overbuilds, leaving open a potential challenge by a cable operator that a municipality is prohibited under Ohio law from engaging in the cable business. Section 1332.03(b) of the Ohio Revised Code states:

> Nothing in [the new law] confers authority on a political subdivision of this State to own, lease, or operate a cable system or to provide cable service over a cable system; rather, that authority, if any, is as otherwise may be conferred by law.

ORC § 1332.03(b). Likewise, although the state Constitution authorizes Ohio municipalities to operate a "public utility," and to provide utility service, the new law emphasizes that it does not represent "a determination by the general assembly that the provision of cable service over a cable system by a municipal corporation does or does not constitute a public utility." ORC § 1332.03.

[1] The new law uses the term "Public Cable Service Provider" to describe any municipal cable system, and the phrase "Private Cable Service Provider" to describe any cable operator that is not a political subdivision of the state. For ease of reading, however, this memorandum uses the less cumbersome terms "municipal overbuilder" and similar phrases to refer to cable systems held by municipalities, counties, townships, and other political subdivisions, and "investor-owned cable operator," "incumbent operator," "franchised cable operator" and the like to refer to traditional cable systems and their owners.

Read in the light most favorable to municipal overbuilders, the law is neutral regarding municipal authority to operate a cable system. Investor-owned cable operators should read the legislature's explicit caveats on municipal authority as a plain statement that the question is not settled under state law. For example, litigation in South Carolina and Iowa led to rulings that municipalities in those states had no authority to compete in the cable and/or telecommunications businesses. A cable operator facing a municipal overbuild should be prepared to challenge the authority of the local government to engage in the competitive cable business.

B. The Law Requires Special Written Notice To Incumbent Cable Operators of Any Municipal Act That Might Lead to a Municipal Overbuild.

A separate subsection of the statute requires that any municipality must give all franchised cable operators written notice at least 45 days in advance of any municipal consideration of an ordinance or resolution that would authorize the expenditure of "public money" on almost any activity that would lead to a municipal overbuild.[2] Subsection 1332.05(A) requires this written notice, in addition to all notices required by any other law, of any municipal consideration of an ordinance or resolution that would authorize the expenditure of "public money" for any of the following purposes:

- a study or analysis concerning the establishment, acquisition, construction, financing, management, or operation of a cable system or the provision of cable service over a cable system;

[2] "Public money" is defined by the statute to mean any money (1) received, collected or due a public official under "color of office" (because of the office); (2) collected on behalf of a public office; or (3) received by any person from the U.S., the state, a county, a municipality, or any other pubic office for the purpose of performing any governmental function or program authorized by or the responsibility of the U.S., the state, a county, municipality, township, or any other public office. ORC § 1332.01(M). The law is therefore written broadly, and would treat as "public money" any money held by or collected by a municipal electric utility, under any or all of these provisions, depending on how the payments from customers for the service are structured.

- the acquisition, construction, installation, improvement, financing, lease, or agreement for management or operation of facilities capable of providing cable service;

- any agreement for the use of a cable system;

- approval of the terms of a franchise for a municipal cable system, or with any other municipal system to provide cable service over a cable system.

These notice requirements anticipate potential municipal cable overbuild service provided either by a municipality's own electric utility, or by a municipal cable system operated by another municipality or a consortium of municipalities. In each case, the statute requires advance written notice to the incumbent.

C. The Law Requires Complete Disclosure of Financial Plans For Any Potential Municipal Overbuild.

If a municipality passes an ordinance or resolution that authorizes the formation of a municipal cable system, the ordinance or resolution must "include a comprehensible statement of the general plan for financing the acquisition, construction, installation, improvement, or lease of the cable system." ORC § 1332.05(A)(2). In other words, the legislature wants there to be full disclosure of the financial plan for any municipal overbuild, so that the voters can decide whether it is in their best interests to allow the overbuild to proceed, or to delay the effective date of the approval and submit the issue for general approval of all the voters, as discussed below. In the event an overbuild proceeds, the financial plan would become important in gauging the system's actual compliance with the plan of finance on which approval was given.[3]

[3] Both the financial plan and notice of a potential expenditure of public funds apply only the first time a municipality considers or enacts such a proposal, and do not apply to a resolution or ordinance considered or enacted subsequent to an ordinance or resolution that was enacted in compliance with the notice provision. OCR § 1332.05(A)(3). In other words, once a municipal complies with the notice requirements and passes a resolution or ordinance, it need not give such notice for later resolutions that involve expenditure of public funds on the system.

D. A Petition Signed By 10% of Voters Will Delay Any Municipal Overbuild And Subject It to Voter Approval.

Under the new statute, no ordinance or resolution that authorizes a municipal overbuild may become effective sooner than 30 days after its date of enactment. ORC § 1332.05(A)(2). During the 30 day period, if 10% of the voters who voted in the most recent general election sign a petition for a referendum on the ordinance or resolution that approved the overbuild, then "the ordinance or resolution shall not take effect until submitted to the electors and approved by a majority of those voting on it." Of course, those voters will have available to them the financial plan of the overbuild.

In the event that a municipality were to approve an overbuild system, the incumbent cable operator could make sure that interested local activist groups are fully informed of the plan to spend public money (including money generated through an electric utility) on a competitive cable business. The incumbent operator would also be able to supply the kind of detailed history of overbuilds that is essential to any electorate that is about to finance such a business. If the necessary 10% of the voters in the last election sign a petition for a referendum, then the municipal overbuild cannot proceed unless and until a majority of the voters in the next general election approve the overbuild.

E. The Statute Limits the Ability of Municipalities to Provide Cable Service Outside the Municipality, and Through Joint Arrangements With Other Municipalities.

The statute is neutral on whether a municipality has the inherent authority to operate a cable system at all, but assuming that authority exists, the statute clarifies and limits the ability of

two or more municipalities to share the costs of a headend and cable plant, and to deliver service through some sort of joint arrangement.

Shared headends. Specifically, subsection 1332.04(C) states that jointly owned and operated headends are not prohibited, so long as all costs are prorated by population. Each municipality that participates in a jointly owned headend must pay a percentage of the headend cost equal to the total population of each municipality that has a cable system served by the headend divided by the population of that municipality. For purposes of cost-sharing, headend costs must include, at minimum, the "full costs of owning and operating such head-end equipment, including, but not limited to, the costs of construction, acquisition, installation, improvement, enhancement, modification, financing, maintenance, repair, and operation . . . " The law requires that the costs be determined "annually or with such frequency as such [municipal] cable providers otherwise agree."

Service outside municipal limits. If a municipal overbuild extends its facilities outside the geographic territory of its municipality, the statute limits the number of customers that may be served outside the community to 50% of the number of customers that reside within the geographic limits of the municipality. As with the general authority of a municipality to own and operate a system, the statute does not decide one way or other whether a municipality has the inherent authority to provide service outside its geographical limits.

II. EXISTING MUNICIPAL OVERBUILDS ARE NOT GRANDFATHERED, AND MUST COMPLY WITH THE NEW LAW.

The bill does not exempt any municipal overbuild from its provisions, and therefore applies equally to existing and future municipal systems. The various requirements analyzed in

detail in this memorandum were written by the legislature in absolute terms. For example, the statute declares that municipalities that compete with investor-owned cable systems "shall" or "shall not" do the various things in the law, and the requirements of the law extend specifically to "any cable service provider that is a political subdivision of this state." ORC § 1332.01(K). The extremely limited exceptions in the law do not mention existing municipal systems.

In fact, Subsection 1332.04(A) of the law emphasizes that "No political subdivision of this state shall provide cable service . . . whether bundled with other services or unbundled, except in accordance with" every provision of the new law. First, the law states, with no qualifications, that the municipality may not be in the cable business unless it complies with the bill. Second, the references to "bundled services" are not defined, but obviously refer to the practice of electric utilities that offer electric service combined with video and perhaps other services. The statute therefore already addresses a potential claim from municipal electric systems that their existing cable services are not covered by the law because they are so intertwined with their traditional electric services that the law couldn't apply.

Moreover, the broad public policy pronouncements of the bill – to "ensure fair competition in the provision in this state of cable service . . . ," and to "ensure that all cable service . . . is provided in this state within a comprehensive and nondiscriminatory federal, state, and local scheme," ORC § 1332.02, can only be served by universal application of the law.

Of course, a cable operator that already competes with a municipal system should be prepared for the municipality to claim that the law does not apply retroactively, and to raise other claims to try to protect its current way of doing business outside of this law.

III. THE LAW REQUIRES NON-DISCRIMINATORY REGULATION BY MUNICIPAL OVERBUILDERS.

In the event a municipal overbuild system is approved and established, or already exists, the key provision of the municipal overbuild law prohibits any local government from: giving its municipal cable system any preference or advantage by any means; discriminating against any investor-owed cable system; excusing itself from any local regulation or requirement imposed on the incumbent cable operator (including all franchise obligations), and; failing to pay the same local fees that the incumbent cable operator must pay (including franchise fees, permit fees, pole attachment fees, or the equivalent of such fees). Just as important as the requirements for essentially equal regulation, the statute declares that the incumbent is automatically relieved from any obligation to comply with the rule or regulation that is the source of the violation, and entitles the operator to equivalent treatment, rights, or benefits. ORC § 1332.07. This remedy and others are detailed in a subsequent section of this memorandum.

The non-discrimination requirement is contained in Section 1132.04 (B)(1), which states:

> No political subdivision of this State that is a public cable service provider or contracts with a public cable service provider for cable service over a cable system shall, by any means, do any of the following:
>
> (a) Prefer or advantage any public cable service provider or discriminate against any private cable service provider in any material matter affecting the provision, within the jurisdiction of the political subdivision, of cable service over a cable system;
>
> (b) Fail to apply any private cable service regulation without discrimination to a public cable service provider within the jurisdiction of the political subdivision;
>
> (c) Fail to pay all applicable fees, including, but not limited to, franchise fees, permit fees, pole attachment fees, or the equivalent of any such fees.

ORC § 1332.04 (B)(1). The basic prohibition on municipal favoritism of its own cable system is thus written in extremely broad language. Each of these subsections is analyzed in greater detail in the following sections.

A. Municipal Overbuilders Must Comply With All Franchise Requirements and Municipal Requirements Imposed on Investor-Owned Cable Operators.

The most unambiguous component of the nondiscrimination law is Subsection 1332.04(B)(1)(b), which requires a municipal overbuilder to comply with all regulations and obligations that the local government applies to the franchised cable operator. Specifically, this provision states that no municipal overbuilder shall "[f]ail to apply any private cable service regulation without discrimination to a public cable service provider within the jurisdiction of the political subdivision." ORC 1332.04(B)(1)(b). "Private cable service regulations" are defined broadly to include:

> Any regulation, rule, requirement, or restriction of or by a political subdivision of the state that applies, by resolution, ordinance, rule, regulation, franchising agreement, or otherwise, to the terms and conditions of service, conditions of access to public property, permits for pole attachments, or any other matter concerning or affecting the provision of cable service over a cable system by a private cable service provider.

ORC § 1332.01(J). Under this definition, a franchised cable operator has ample basis to claim that any municipal requirement of any kind applied to a franchised operator must be applied to the municipal cable system.

Option to Reduce Regulation. It should be noted that the municipality will have the potential ability and incentive to reduce regulatory obligations rather than to make the municipal system meet the existing requirements. The basic laws of competition would support such a

reduction in regulation, to allow the market to discipline competitors, and to begin to phase out local service regulation requirements. Requirements for customer service, record keeping and reporting, and PEG and institutional network requirements are prominent examples of specific local requirements that could, and likely should, be reduced for the incumbent upon the introduction of a municipal competitor. Existing municipal overbuilders could see an immediate reduction in regulatory obligations as a quick way to bring some of their operations into compliance with the new law.

Practical Scope of Regulatory Parity. Investor-owned cable operators will espouse a plain reading of this parity provision. Such a reading requires that all obligations of the investor-owned cable operator's franchise, and any other cable-specific ordinances or regulations, must be met by the municipal overbuilder. It should be noted that the law does not appear to require a municipal overbuild system to meet the incumbent's performance if it *exceeds* the minimum requirements of the franchise and local law. The regulatory parity requirement includes, but is not limited to, the requirements listed below:

- System design and channel capacity, and other technical requirements must be at least equivalent. Municipal overbuilds ordinarily will satisfy this requirement by building some form of the current highest technology available. The incumbent should insist that the municipal system transmit programming over at least the same number of channels as required by the franchise, however the tiers may be configured, so that there is at least a rough equivalency in the costs of the headend and programming.

- System construction requirements, such as mapping, notice, and street repair. These nuts and bolts are all potentially subject to competitive advantage or abuse by the municipal system. The best way to minimize any such advantage would be to insist that the municipal system comply with the same requirements.
- System build-out to geographic areas must be at least as demanding as the original operator's franchise requirements. Cream skimming is the overbuilder's creed because it avoids the significant cost of building the less profitable areas of any jurisdiction. With build out requirements in particular it is important to distinguish between the density served by the cable system and the minimum density, if any, required to be served under the franchise.

- Line extension requirements after the basic system is constructed must be at least as rigorous as the incumbent's for the same reasons that initial build-out requirements must be the same.

- PEG access channels, capital and other support must be at least equivalent. At one end of the spectrum, the incumbent could argue that the municipal system must make the same expenditures at the same points in the franchise as the incumbent made. For example, good arguments exist that the construction of an additional, equivalent studio at the beginning of the franchise provides valuable public benefits. Periodic payments made by the incumbent are easy to identify and match. Even if duplicate facilities are not desired, the overbuilder should be required to incur similar costs as the incumbent did at the same time in its franchise, with payments to support the existing PEG activities. There may be mutual benefit, however, in applying the PEG level playing field requirement in a manner that essentially reduces the cost of the incumbent by dividing costs among both investor-owned and municipal systems rather than insisting on a dollar for dollar match of the incumbent's original obligation. In such a sharing arrangement, for example, the overbuilder could pay the incumbent one half of the value of all of the incumbent's investment to date in establishing and maintaining PEG facilities, plus one half of all payments made to date under the franchise. Municipal overbuilders might assert that PEG payments pro-rated by subscribers are "equivalent," but that is logical only if the incumbent operator's initial PEG obligations were calculated on a per-subscriber basis.

- Institutional network commitments must be equivalent. The same analysis as for PEG commitments applies. An incumbent operator could argue that the municipal system must spend the same capital, and incur the same operational costs, by creating a parallel I-Net. It may not always make sense, however, to require a duplicate plant. In some situations it may make sense for the municipal system to pay, at the outset of the franchise, the value of one-half the incumbent's investment in providing the I-Net, and then the two systems would split the annual costs thereafter.

- The municipal system must provide the same free drops and free cable services to government and/or school buildings as the incumbent is required to provide. Truly voluntary free services, however, would not be covered by the law, and in fact could be terminated if desirable. We note also a practice among overbuilders such as Ameritech New Media of over-valuing free drops, especially those for Internet service, as a way of creating an appearance of greater equality in value.

- Customer service requirements must be the same. If the municipality insists on maintaining a local regime that micromanages the customer relationship with the investor-backed operator, it will be required to satisfy every one of the same requirements in its own operation. The advent of a competitive system operated by the local government, however, would seem to render such rules irrelevant, since any customer should be able to cancel service of either service provider if the customer does not find the total package of price and service to be acceptable.

- Reporting and record keeping must be the same. As with customer service rules, most reporting and record keeping should be eliminated or reduced to reflect the ability of competition to discipline service. In fact, because certain records or reports present a serious concern to fair competition when the regulator is also the competitor, a cable operator should consider withholding some information that would otherwise be required on the theory that the simple act of turning over such information provides the municipal system with a preference or advantage in violation of Section 1332.04(B)(1)(a), as described in greater detail below.

- Periodic evaluation or public hearings on the quality of services must be identical. Such service-oriented hearings fall into the same category as customer service and reporting, and should be reduced with competition.

- Public notice requirements for rates, services, and changes in rates or services must be the same.

- Term of years of a franchise. A straightforward application of the "parity" requirement would require that the municipal system not give itself a longer franchise term, or a less demanding formula for any extensions, than in the investor-owned operator's franchise. If, however, the incumbent has an older, less demanding franchise, which is coming up for renewal, the municipal overbuilder could give itself the same franchise for the same term of years as in the expiring franchise, and then try to insist on increased demands and a shorter term for the incumbent's renewal franchise. We believe such a scheme would violate the letter of the "parity" provision, and it would certainly be in violation of the "no preference or advantage" rule, discussed in the following section.

- Rate regulation: to the extent the municipality requires the investor-owned cable system to justify its rates under the federal formula, it must justify its own rates. More importantly, as discussed in greater detail in the following section, rate regulation by a competitor is so against fundamental notions of fairness that, even if allowed under federal rules, the Ohio law can be read to render such regulation unenforceable and void as an unfair preference or advantage to the municipal system.

- Pole attachment permitting process. In the most conservative reading, this explicit requirement means that the investor and municipal systems must use the same form, and have the same turnaround time and standards for issuing permits. Delay beyond the time it takes to issue permits for the municipal system would be a facial violation. More aggressively, investor-owned cable operators should argue that this provision gives them a right to obtain access to the municipal utility poles. Pole issues are discussed in more detail below.

A reading of this provision that most favors the incumbent operator would require an item-for-item equality of regulation in all of these matters and every other municipal regulation that affects the provision of cable service.[4]

Municipal Perspective. A municipal overbuilder would likely argue that the statute does not require *equal* application of all local franchise requirements, but rather, only the application of regulations and obligations "without discrimination." A municipality could conceivably argue that its own franchise may have requirements different than those contained in the incumbent's franchise so long as the "total" franchise commitment is not discriminatory.

An aggressive municipal interpretation could include the following specific arguments on issues where municipal and other overbuilders have tended to receive more favorable treatment:

- System build-out to geographic areas and line extensions. The municipality could argue that it is not discriminatory to authorize itself to serve less than the entire community if the incumbent built out its plant sufficiently long ago that it has recovered both its investment and a reasonable return.

- PEG access channels, capital and other support. Overbuilders often argue that it makes no sense to duplicate access facilities, and many communities have accepted offers for 1% of gross revenues in lieu of any up-front capital commitment from an overbuilder. A municipality could adopt these positions and argue that it is not discriminatory to adopt a different PEG requirement that reflects the current needs.

- Institutional network commitments. One aggressive municipal response would be that institutional networks and the associated costs should not be duplicated, and consider a fee like the PEG fee described above, or even lump it in together. Another tactic of overbuilders that could be used by a municipality would be to place an artificially high value on free Internet drops.

[4] Pure financial requirements, like franchise fees, application fees, permit fees, bonds, pole attachment fees, and taxes are literally within this provision as well, but are addressed below in the discussion of ORC § 1332.04(B)(1)(c), which specifically treats financial requirements. Likewise, a separate section below analyzes municipal pole attachment practices and pole attachment fees as a single topic, although they are treated in separate subsections of ORC §1332.04(B)(1).

Perhaps a municipality could generate similar arguments on other specific issues. The law, however, gives the incumbent cable operator powerful responses, both in the law and in practice. The legal response is that Subsection 1332.04(B)(1)(b), which requires the application of all regulations "without discrimination," cannot be read independent of the rest of the section or the statute. The preceding subsection prohibits *both* discrimination against the investor-backed operator *and separately* prohibits any municipal overbuilder from giving itself "by any means" any "prefer[ence] or advantage." ORC § 1332.04(B)(1)(a).

As noted above and detailed below, the investor-owned cable operator's practical responses include a legal right to automatic relief from the regulations or requirements that are applied without parity, or the automatic benefit of more favorable regulations applied only to the municipal system. ORC § 1332.07. In addition, the incumbent operator has the right to seek non-binding arbitration, and the right to eventually obtain a court order that could include an order that the municipality pay attorney's fees, as well as an order that the municipality must comply with the law. These remedies are detailed later in this memorandum.

B. Municipal Overbuilders May Not Give Themselves Any Preference or Advantage In Any Material Matter.

In addition to the explicit requirement for regulatory parity in Subsection 1332.04(B)(1)(b), Subsection 1332.04(B)(1)(a) provides that a municipal overbuilder may not "by any means . . . prefer or advantage" its own cable system, "or discriminate against" the franchised operator "in any material matter affecting the provision" of cable service within the city, county, or other political subdivision. All of the "parity" requirements of Subsection 1332.04(B)(1)(b) could be required just as well under this provision, but this provision is in

many ways a generic catch-all provision that steps in where regulatory parity is not as obvious or has some complications, such as in dealing with issues of services bundled with electric services, rate regulation, or other instances where the analysis of parity is difficult or incomplete. The provision is therefore somewhat less certain in its application, but potentially more powerful as a tool in assuring fair competition from municipal systems.

Rate regulations. For example, under the federal rate rules, a cable operator may be subject to basic rate regulation by the municipality until the municipal system offers some video programming service (passing) 50% of the homes in the community. 47 U.S.C. § 543(l)(1)(C). Although local rate regulation is purely voluntary, the municipality could argue that the federal rate regulation is something that the local government merely administers, and that it is not a form of local cable regulation within the scope of the parity provision. An investor-owned cable operator in Ohio need not wait for the municipal system to reach the federal threshold for deregulation, but instead may view the regulation of its rates by a municipal competitor as a regulation that gives the municipal system a preference or advantage in violation of ORC § 1332.04(B)(1)(a). As such, the cable operator is automatically relieved of the municipal rate regulations as provided by ORC § 1332.07, and as more fully analyzed later in this memorandum.

Franchise renewal. Another situation that is somewhat complicated under the parity provision but falls well within the "no preference" part of the law is franchise renewal. If a cable operator is in or near the three year window for renewal under the federal law at the time the municipal overbuilder grants itself a franchise, the municipality could be literally in compliance with the parity provision for at least some period of time by giving itself the same franchise as the incumbent's expiring agreement. It could well be an older, long term, minimal demand

franchise. All would be fine until the municipality imposes renewal demands on the incumbent that greatly exceed those in the expiring document. The municipality could in fact create a record of community need for expensive PEG and I-Net commitments, when the old franchise had little or none. It could impose severe customer service requirements, when the old franchise had few. We believe that the incumbent could assert that the municipality can only propose requirements that the municipal system would also satisfy. Likewise, if the municipality aggressively imposed new obligation as a matter of law, as some have done, the municipality itself would have to meet all the same requirements under the parity provision of the law alone.[5] Regardless of the analysis under the "parity provision, however, the new law prohibits a municipality from giving itself a preference or advantage under ORC § 1332.04 § (B)(1)(a).

Other federally-based regulation. Other areas of local regulation based on federal law, such as customer service, emergency alert service, and technical standards enforcement, could have a similar federal overlay that could potentially confuse the application of the parity provision of the statute. If a municipal overbuilder attempts to excuse itself from any of these rules, or otherwise crafts a special advantage for itself in the application of any regulation, then Subsection 1332.04(B)(1)(a) gives the incumbent operator a way to obtain automatic relief from the contested provision.

Electric utility advantages: No cross subsidies. More generally, the mere ownership of the rights of way, utility poles, and an electric utility gives rise to the potential for any number of "preferences or advantages" or other discrimination in material matters affecting the incumbent cable operator. This catch-all provision should be considered as a legal prohibition on a

[5] The introductory language to ORC 1332.04 § (B)(1) states that no municipality that is an overbuilder shall, "by any means" violate either the parity requirement, the prohibition on preferences or advantages, or the equirement for equal application of all fees. Franchise renewal of the incumbent would fall within this broad, plain language.

municipal cable system using its rights of way, its poles, or any other special power it may have as a government or a utility, to create a preference or advantage for its cable system.

The law could be argued to prohibit any municipal electric utility from using revenue obtained from electric service ratepayers to finance or subsidize its cable business on a number of grounds that add up to an unfair advantage or preference on material matters affecting cable service. First, the existence of a ratepayer base arises from their need for an essential facility, not their willingness to finance a competitive business. Second, the municipal electric system presumably need not provide a return to investors, and can therefore charge a lower rate. Third, the municipality likely has a lower cost of capital or any debt financing it may need, again providing potentially unfair advantages. Fourth, the detailed requirements for an up-front financial plan, and annual reporting on the basis of fully-loaded costs of the cable service, described below, indicates a strong preference by the legislature that the finances of a municipal cable system be entirely independent of any electric utility. In addition, pricing strategies that do not cover some measure of long run costs have been held to be anticompetitive in other industries, and it could certainly be argued that the failure of a municipal cable system to price its cable services so as to cover its costs is an advantage in a "material matter" affecting the provision of cable service, in violation of the new law.

This is just a preliminary outline of ways in which this broad provision of the law could support arguments that a municipal cable system must operate financially independent of any municipal electric utility, and must price its cable service so as to at least cover its costs. Experience in the future with municipal efforts to avoid the strong pro-competitive impact of the legislation will very likely provide additional fact patterns for violations of this broadly worded provision.

An important final point on this "wild card" provision is that it appears to provide the least direct remedy. For example, if the incumbent operator believes that the municipal system is operating with an unfair preference through the use of its electric revenues, or its electric plant employees are not properly accounted and paid for, then the automatic relief provided by the statute is difficult to apply. The incumbent cannot avail itself of ratepayer funds, the right of way, poles, and the like, but instead must head to court or arbitration, as described below in the remedies section of the memorandum.

C. Municipal Overbuilders Must Satisfy All Financial Obligations Imposed By the Municipality On Investor-Owned Cable Operators.

The third element of the level playing field law prohibits a municipal cable system from "fail[ing] to pay all applicable fees, including but not limited to, franchise fees, permit fees, pole attachment fees, or the equivalent of any such fees." OCR § 1332.04(B)(1)(c). Municipal payment of all such fees would likely fall within the broader two provisions of this subsection, analyzed above, which require the municipal system to satisfy all local requirements applied to the incumbent, and which prohibit the municipality from preferring or advantaging its own system. The inclusion of a provision specifically enumerating equal payment of fees should be viewed, therefore, by the investor-backed cable industry as a broad and strong requirement for equal application of all financial requirements.

Permit Fees. Permit fees, such as plat approval fees, street opening fees, or fees for blocking traffic to perform work are the most obvious kinds of municipal fees that the municipal system must pay to the same extent as the investor-owned cable system.

Franchise Fees. "Franchise fees" is not defined within the statute, but should be given the federal definition under general principles of statutory construction. The term is one with a highly specialized, uniform federal definition in the cable industry. The federal law defines "franchise fees" broadly so as to include:

> [A]ny tax, fee or assessment *of any kind* imposed by a franchising authority or other governmental entity on a cable operator or subscriber, or both, solely because of their status as such.

47 U.S.C. § 522(g). Of course, taxes of general applicability, certain PEG fees, and certain fees "incidental to the award of the franchise" are not franchise fees under the federal law, and would not be required to be paid by the municipal cable system under *this* provision. The parity and no preference provisions of the Ohio law, however, would require equal payment of most, if not all, of those same fees. Any other interpretation would defeat the stated policy of the statute to "ensure fair competition in the provision in this state of cable service . . . ," and to "ensure that all cable service . . . is provided in this state within a comprehensive and nondiscriminatory federal, state, and local scheme," ORC § 1332.02.

Taxes. Taxes present some compelling arguments for equal payment, although the statute does not mention equal payment of taxes by name. If the cable operator pays any local taxes, the cable operator would need to rely on two provisions to argue that the municipal system must also make the payment. First, the "equal fees" provision does not purport to list all possible "fees," but rather lists only examples. Second, the same provision of the statute requires that the municipality pay "the equivalent of any such fees." Outside of ORC § 1332.04(B)(1)(c), an incumbent should argue that equivalent payment of cable taxes is required under both the parity provision and the "no preference" provision of 1332.04.

The logic of requiring the municipal system to pay all local taxes paid by cable is compelling. Like rate regulation itself, the governmental power to tax a service is "the power to destroy" a business. Whether or not an incumbent itemizes and passes through to customers a cable tax, the cost is reflected in its bottom line, and creates a significant competitive advantage for the municipal system in at least the amount of the tax. If the statute is to be successful in "ensuring fair competition" and "nondiscriminatory" regulation, as the legislature directs, then it must be applied to require the local government to pay the same taxes that it imposes on the cable operator.

Municipal property, however, is generally exempt from taxation, and the taxation provisions of state law are generally sufficiently complex to permit creative lawyering by a municipality. Incumbent cable operators should therefore expect that municipalities will assume that the municipal system is exempt from any local tax, under one theory or another. Ohio cases, however, would not likely support such an exemption. Where municipalities have owned property used for non-public purposes, or commercial purposes, the courts have held that that business or property loses the municipal exemption from taxation. Incumbent cable operators should be prepared to make this point if a municipal overbuilder fails to tax itself the same as it taxes the investor-owned cable system.

Pole Attachments. The new law addressed pole attachment practices in two specific ways. First, as explained in the discussion of preferences and advantages, the statute specifically prohibits a municipal overbuilder from discriminating with respect to "permits for pole attachments." O.R.C. § 1332.04(B)(1)(a). This provision requires no discrimination in the process, forms, inspections, and all other aspects of permitting. Subsection (B)(1)(c) adds the

specific admonition that the municipal cable operator must pay the same rate as the investor-owned cable system, taking away a potentially powerful deterrent to fair competition.

Although pole attachment practices in general are likely subsumed under the broader prohibitions against municipal self-favoritism, these are key clarifications. The overwhelming majority of municipal overbuilds that have proceeded or been advocated to date, both in Ohio and elsewhere, have been in communities with municipal electric utilities. And experience over the years has shown that municipal overbuilders may obtain substantial competitive advantages by leveraging pole policies.

Most important, before this legislation, the pole attachment practices of Ohio municipal electric utilities have been free from any comprehensive oversight. These utilities are exempt from the Ohio PUC's regulation of utility pole attachment law, and it is unclear whether the PUC will adopt the federal law that gives a cable or telecommunications provider a right to obtain access to utility poles, conduit and rights of way. The two new provisions, however, specify both the right of an investor-owned cable operator to the same permitting process (access, time for issuing, standards, paper work), and the right to the same fee that the municipality pays. The most common areas of utility pole abuse are thus specifically prohibited by the law.

A separate subsection below provides a case study applying various aspects of the new law to a municipal overbuild through its electric utility.

D. The Law Provides A Narrow Exception For Municipal Overbuilds to Be Treated Differently if Application of a Requirement or Rule Imposed On the Incumbent Operator Would Have No Legal Or Practical Consequence.

The final subsection of ORC § 1332.04(B) provides an exception which states that nothing in the "no preference", discrimination, parity, and equal fees provisions of (B)(1) requires the application of a local cable requirement to a municipal system:

> if that application would be without legal or practical consequence, such as the application of a . . .regulation requiring the provision of an insurance bond, which application to a public cable service provider would require it to insure its performance to itself.

ORC § 1332.04(B)(2). The key to this provision is what constitutes a requirement which would have no "legal or practical consequence."

Insurance is the only example in the statute, and an easy one to understand. The municipality already has insurance for most conceivable hazards. There would likely be little or no cost savings to the municipal system, because the coverage is either already paid for in existing insurance, or because the cost of new cable insurance for a single community would not be significant relative to the cost of the system and running the business. More important, the new coverage would give no added protection to public or customers, and would thus have no "legal or practical consequence." The failure to purchase insurance provides no real preference or advantage to municipality, and the law is correct not to insist on the purchase of additional coverage.

It is hard to imagine examples other than insurance, because every kind of significant financial obligation has a competitive impact, and therefore a "practical consequence" within the letter and spirit of the law. Perhaps a nominal bond for repair of the streets would fall into the exception, but it could be argued that any bond that has a significant cost – such as some in the industry required to be in an amount that equals or exceeds the cost of construction – would

indeed have significant practical consequences, and would violate the explicit prohibitions on preferences and discrimination.

Investor-owned cable operators, however, should expect that municipal overbuilders will try to use this exception to neutralize the entire law. It is conceivable a municipality could argue, for example, that the application of customer service rules, technical standards, reporting, and virtually all remedies would be exempt from the parity and nondiscrimination provisions. They might argue they are exempt because the municipality would be the one doing all the testing, and would be the one responding to customer service issues, reviewing reports, and enforcing the franchise. Investor-owned cable operators should expect arguments from municipalities such as "how can we be required to test ourselves, keep reports, and meet enforcement provisions when the city is both the provider and the regulator."

Similarly, municipalities might argue that they cannot be expected to collect franchise fees, permit fees, and taxes, since those activities all involve paying itself for services. To do so, they might argue, would be to take money from one pocket and put it in the other, which has no legal or practical consequence.

Each of these requirements, however, has a demonstrable impact on the provision of cable service, either through costs, manpower, or otherwise. Customer service rules, technical standards, reports, remedies, and all financial payments have a significant impact on the provision of cable service, and should be applied with equal force.

Finally, incumbent cable operators should be prepared for arguments that the state cannot abridge municipal taxing power through any means other than an explicit bill that mentions the taxing power by name and spells out the new limit.

IV. MUNICIPAL OVERBUILDS MUST SATISFY EXACTING FINANCIAL ACCOUNTING AND REPORTING REQUIREMENTS.

As Woodward and Bernstein knew in "All the President's Men," the key to unraveling any injustice is to "follow the money." Ohio's new law requires any municipal cable system to make it as simple as possible for any interested party to follow the money used in the overbuild. As explained above in the discussion of the generic prohibition on a municipality giving itself any preference or advantage "by any means," a credible argument exists that the new law prohibits any cross subsidy from an electric utility, and requires the municipal cable business to cover its own costs through some combination of revenue, equity, and debt. The financial reporting requirements support this argument, and appear designed to make it easier for voter, courts, elected officials, and incumbent operators to ascertain whether the municipal system has violated the "no preference" requirement, or other limits on municipal expenditures.

First, any bill that authorizes the expenditure of any public money for a cable system must include a "comprehensible" plan of financing for the acquisition or other investment. ORC § 1332.05(B)(2). From the outset, therefore, the plan of financing must be public and understandable.

Second, in addition to the initial financial plan, the law requires that the municipal system create and maintain a special fund for the cable system (as opposed to the general fund or an electric utility fund), and provide detailed annual reporting of the system finances. This special fund must comply with a host of Ohio laws governing such municipal funds, all of which boil down to strictly limit the purposes of the moneys in the fund, the uses of any excess funds, strict requirements for withdrawal of funds, the use of excess funds, and the disposition of all funds.

Third, the statute requires every municipal overbuilder to provide a detailed annual report, which must be "substantially in accordance with full cost accounting," and which must include "the amount, source and cost of working capital utilized for its cable system and the provision of cable service." ORC § 1332.06(B). ""Full cost accounting" includes both all "direct costs" and all "indirect costs." ORC1332.01 §§ (E)-(G). The statute further directs that, as to all "indirect costs," the municipality must allocate "costs that support multiple services or functions . . . among those services and functions in proportion to the relative burden each service or function places on the cost category . . ." ORC §§ 1332.01(E) – (G). The law thus requires a municipal system to keep its books for the cable system separate from any other books, to keep all capital and revenue of the system in a special fund, and to account for all direct and indirect costs.

The statute declares that nothing in the law requires elected officials to maintain a log or record of the time they spend on the municipal cable's business. ORC § 1332.06(B). By implication, non-elected municipal officials and employees *must* maintain a log of the time they spend on the cable business. This would appear to be necessary even without the clarification, because "full cost accounting" includes accounting for all "indirect costs," which specifically requires the municipality to allocate "costs that support multiple services or functions . . . among those services and functions in proportion to the relative burden each servce or function places on the cost category . . ." ORC §§ 1332.01(E) – (G).

The annual report must include "estimates of the amount of any franchise fee, regulatory fee, occupation tax, pole attachment fee, property tax, or other fee or tax that would be applicable" to the municipal system but for any exemption it might have by virtue of its status as a political subdivision. OCR § 1332.06(B). This provision should be read to require the

reporting of fees the municipality does not pay, but the investor backed operator pays, because of an exemption "authorized by law." In other words, the exemption does not suggest that the municipality might not pay otherwise applicable local fees or taxes, but rather recognizes that the municipality may have some exemption under state or federal law from the payment of a particular state or federal fee or tax. There can be no exemption for the municipality from any fees or taxes imposed by the municipality on the incumbent operator, as detailed elsewhere in this memorandum. Only this kind of reading harmonizes the reporting requirement with the many other provisions of the law that would require full payment of all fees imposed by the municipality on the incumbent operator.

In the event a municipality gives itself a preference or advantage through its electric system, these accounting and reporting requirements will make the investigation of the violation more efficient.

V. REMEDIES: WHAT HAPPENS IF A MUNICIPALITY VIOLATES THE OVERBUILD LAW?

The remedies for violation of the key prohibitions on municipal preferences, discrimination, and the requirements that municipal cable systems satisfy all of the incumbent operator's obligations, and pay all the same fees, are strong, quick, and could lead to an award of attorneys' fees.

First, if a municipal overbuilder violates the provisions that require no preferences, no discrimination, and equal application of fees, the statute gives a cable operator automatic relief from any local rule, requirement, or provision that is the subject of the municipality's violation. The statute declares that:

> A violation of any provision of Division (B) of [ORC 1332.04] by a political subdivision . . relieves any other cable service provider in the jurisdiction . . . from any obligation to comply with or perform any regulation . . . that is the subject of the violation, and entitles any such other cable service provider to equivalent treatment, right, or benefit.

ORC 1332.07. This key provision eliminates the need for an injunction to prevent harm. The violation itself relieves the operator from "any obligation" that gives rise to the violation, and entitles the incumbent operator to equivalent treatment.

In practice, where a cable operator assumes the benefit of this provision by, for example, lowering its PEG payments or refusing to pay taxes that the municipal system avoids, this provision could force the municipality to go to court. It could seek an affirmative injunction (one that orders the cable operator to comply with the challenged provision), or simply ask for a declaration of rights. Regardless, the usual process of getting a court to decide the controversy first is avoided, giving the cable operator a powerful tool to keep competition fair.

A municipality might argue that this provision does not provide any automatic relief, but rather specifies the relief a court may enter if it finds a violation. They might argue that courts routinely decide whether statutory remedies are available or not, and that there can be no scheme where a private party determines its own legal remedy.

Incumbent operators will note that the sections dealing with court actions and arbitration do not mention the remedy. Moreover, the wording of the statute is unusually strong, in that it declares that the *violation*, not a court's order, relieves the operator *of any further obligation to comply with the provision.* Such an interpretation is entirely consistent with the overall intent of the law to "ensure fair competition," and to eliminate any advantages the municipality might give

to itself. In short, the law recognizes the heavy advantages enjoyed by municipal cable systems, and provides a powerful remedy to level the playing field.

Grounds for litigation or arbitration. The statute sets up litigation with or without preliminary arbitration. Municipalities subject to subsections 1332.04(A),(B) or (C) (the primary obligations for fair competition), as well as any cable operator or other person harmed or likely to be harmed by a violation of those provisions, may bring a court case and/or seek arbitration. Similarly, any municipality subject to the public notice, financial plan, and referendum provision of Subsection 1332.05(A), and any cable operator or other persons harmed or likely to be harmed by a violation of that provision, are also authorized to file a court action and/or seek arbitration. As noted earlier, cable operators should be prepared for municipal claims that any violation of other provisions – such as the financial reporting requirement – does not allow court action or arbitration.

Permissive arbitration & attorneys' fees. Arbitration of any claim is not required, but is voluntary. Arbitration is, however, a prerequisite to obtaining attorneys' fees in a later court action. To obtain attorneys' fees from a municipality, a cable operator must first go to arbitration and obtain a favorable decision, and then prevail in court. Likewise, if the municipality obtains a favorable decision in arbitration and then wins in court, it might obtain a judgement for attorneys' fees against the cable operator. If either the cable operator or municipality skips arbitration and goes directly to court, there appears to be no explicit right to obtain attorneys' fees from the other party.

Arbitration process. The statute incorporates basic rules for selection of arbitrators and the process itself. The rules of the American Arbitration Association apply. Prior to initiating a civil action, any party authorized to bring an action may give written notice of its intent to have

some or all issues decided by arbitration. The other party may consent to arbitration within 7 days. If no consent is given, there will be no arbitration.

Each party selects an arbitrator, and the two arbitrators select a third. If the two cannot agree within 7 days of the date the last was selected, they are removed, and the parties each select a substitute, who in turn repeat the process for selecting a third arbitrator. If the substitutes cannot agree on a third arbitrator within 7 days, then the issues will not be arbitrated.

The arbitrators must decide the issues, in a written opinion, within 120 days of the date three arbitrators are selected. A majority opinion of the panel is the opinion of the whole panel (like an appellate court). The panel's findings and decisions are not binding on the parties or a court that reviews the matter, but may be admitted into evidence in court.

Lawsuits for declarations and injunctions. The statute authorizes lawsuits, as explained above, by municipalities affected by the level field provisions and financial reporting requirements, and by cable operators or others harmed or likely to be harmed by violations of those provisions. If arbitration led to an adverse finding against either party, the prevailing party in the court could be awarded attorneys fees. In deciding whether or not to award attorneys' fees, the court must consider at least: the degree to which the party prevailed; the reasonableness of the party's action; the reasonableness of the arbitration decision; the effort or lace of effort of the parties to reach a settlement; and the good faith or lack thereof of the parties.

Modification Under Federal Law. It should be noted that, in addition to the automatic relief, arbitration and lawsuits authorized by Ohio's law, a cable operator subject to any overbuild retains its rights under federal law to seek a modification of its franchise. This is what happened in Naperville, Illinois, where the City gave a sweetheart deal to Ameritech New Media, and Jones Communications sought a modification of its franchise on grounds that it was a

fundamental assumption of its franchise that it would not be subject to competition on more favorable grounds. Case law under this statute holds that the mere filing for modification provides a stay of any local enforcement of the provision for which modification is sought. This provision could be used in a number of combinations with the Ohio law to provide effective tools to ensure fair competition.

VI. CASE STUDY ON APPLICATION OF LAW TO MUNICIPAL ELECTRIC UTILITY EXPANSION INTO CABLE.

All of the elements of the statute can be demonstrated in a brief hypothetical of a municipal cable overbuild by an electric utility. In the past, utilities have taken dramatic steps to block or impede fair competition. They use electric service revenue to subsidize cable. They have electric utility technicians deployed to build and maintain the cable system. They use the pole permit process to delay any cable upgrades or repairs, and impose new clearance requirements on cable, while giving electric plant cable system a special place in the electric space. Rates for cable attachments have been raised by municipal utilities that are immune from federal regulation. The Ohio law provides a strong reply to each of these tactics, as shown below.

Pre-construction. If the municipality plans to consider financing a study of a municipal overbuild, or otherwise to consider spending electric utility or other municipal funds on a cable system, the law requires that notice be given to the existing cable operator. Other general laws likely require public notice as well. The law also requires that any final bill include a detailed financial plan.

The cable operator will have time to alert local activists to oppose the law. If the law passes, then voters have 30 days to obtain 10% of the voters' signatures on a petition for a referendum. If the signatures are gathered, the law authorizing the cable system will not go into effect until at least after the next general election. The voters could defeat the proposal at the election by a simple majority.

At any time during this process, the cable operator and/or other interested parties could challenge the authority of the municipality to be in the competitive cable business. An injunction could well be obtained to prohibit any municipal activity on cable until the case is resolved. There appears to be some good law to the effect that Ohio municipalities may not be in a competitive business.

If the overbuild proceeds, or already exists. Assuming that the municipal overbuild goes forward, or already exists, the law requires fair competition in the broadest sense. A key part of the law requires strict financial accountability for all municipal cable expenses, whether through an electric utility ("bundled", in the statute) or not. Separate books must be kept, with full cost accounting, and an accounting of all indirect costs as well – meaning that all potential electric utility subsidization must be included in the costs. Annual reports must be made, and of course, such documents would likely be available at any time under the Freedom of Information Act.

The municipal system must comply with all requirements imposed on the incumbent, must not otherwise give itself an advantage, and must pay all fees and taxes paid by the incumbent as a result of local laws. The municipality might see fit to reduce the incumbent's obligations, so as to make compliance easier for both and to recognize the discipline competition will impose on the quality of service and rates.

If the municipality does not reduce the incumbent's obligations, the incumbent can insist on equivalent franchise and other local regulations, such as system design, capacity, PEG, I-Net, customer service, and so on.

Pole attachments must be processed in the same way for both systems, with the same rates for attachments, and turnaround times. Construction standards and code interpretations may not favor the municipal cable system.

Assuming the municipality gives its cable system a more favorable franchise, or fails to pay all the same fees, abuses it pole attachment power, or otherwise violates the level field requirements, the cable operator has immediate remedies. Given the overall tenor of the law, the cable operator should make its position known before it discontinues compliance with any provision of its franchise. Good faith in conduct will be valuable insurance against any possible later award of attorneys' fees. If the municipality does not agree to a reasonable compromise on the disputed issues, then the incumbent operator is excused by law from any obligation to comply with the provision at issue, and is entitled to any benefit the municipality enjoys. For example, the incumbent could refuse to pay some exorbitant pole rent, or to give over excessive information, or refuse to pay a fee or tax that the municipals system does not pay.

Either the municipality or the incumbent operator is likely to seek arbitration, in order to both expedite a decision and keep alive the threat of attorneys' fees. Settlement is always possible. The party that loses at arbitration might find settlement attractive in light of potential attorneys' fee awards.

At some point, the incumbent cable operator might also file for a franchise modification under the federal law, and declare any attempt by the municipality to enforce the provisions in question to be void. Eventually, with or without the modification, the reality of competition,

whether it fails or continues, will overtake the legal jousting and provide a check on the parties' behavior.

VII. OHIO LOCAL GOVERNMENTS MAY NOT UNREASONABLY WITHHOLD CONSENT FOR THE TRANSFER, MODIFICATION, OR RENEWAL OF A CABLE FRANCHISE.

Although almost every provision of the new cable law governs competition by municipal cable systems, buried in the statute is a provision which applies to all local governments in Ohio regardless of whether that government provides cable service. New ORC § 1332.04 (D) states:

> No political subdivision of the state that is a franchising authority shall unreasonably withhold a request by a cable service provider to transfer, modify or renew, in accordance with the terms of the franchise and in accordance with the provisions of the [Federal Communications Act 47 U.S.C. §§ 537, 545 or 546], its existing franchise to provide cable service over a cable system.

ORC § 1332.04 (D). This provision clarifies any ambiguity that may exist in the federal law regarding the obligation of a franchising authority to regulate in a reasonable fashion when considering a cable operator's request to transfer, modify or renew the franchise.

This provision does not purport to override any existing franchise provisions governing the transfer of a franchise. If, for example, a franchise requires a cable operator seeking to transfer its franchise to provide detailed information, such information would still be required. Once supplied, however, in addition to the information required by the FCC Form 394, the new Ohio law prohibits unreasonable failure to grant the requested consent.

The law could be invoked to prevent many of the most common abuses of transfer proceedings, in particular. If a municipality issues a slew of detailed requests for information, not otherwise required by the FCC Form 394 or the franchise, and claims that the 120 day clock

does not begin to run, a cable operator could claim an unreasonable withholding of consent has occurred. Municipal demands for new, amended or modified franchise provisions would likewise be subject to challenge as an unreasonable withholding of consent.

Despite the obvious intent of the legislature to prohibit unreasonable withholding of municipal consent, a local government could argue that a cable operator has no right to obtain judicial enforcement of this new limitation on municipal consent. The statute explicitly states that a cable operator has a right to file a lawsuit for a declaration of rights and an injunction if the local government violates the provisions of the new law that dictate the ground rules for municipal overbuilds. The legislature, however, did not provide a similar explicit right for a cable operator to file a lawsuit for municipal violations of the "unreasonable withholding consent" provision. It should be expected that a local government will argue that the absence of an explicit right of action in the consent provision of the law, as there is in the overbuild provisions, means that no such action exists. A cable operator would need to be prepared to demonstrate under Ohio law that it has an implied right of action or a right to mandamus for violation of the prohibition on unreasonable withholding of municipal consent.