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Municipal Cable Franchise Transfer Toolkit

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A cable operator generally cannot transfer control of its business or transfer its cable franchise without the prior approval of the franchising authority. This gives the franchising authority the opportunity to resolve outstanding problems and to seek franchise modifications as conditions of approval. But there are also risks. A franchising authority can unwittingly cut off its ability to evaluate the transferor's performance during a subsequent franchise renewal if it approves a transfer incautiously, or even face a lawsuit if it denies a transfer request. Every transfer request should be very carefully evaluated.

To help local governments understand the importance of the cable transfer process, Best Best & Krieger has prepared this "toolkit" to provide some basic information concerning applicable transfer requirements and procedures. The toolkit includes an overview of the cable transfer process, a brief explanation of why a transfer might benefit your community, responses to frequently asked questions, and three resources for useful information.

Until recently, cable franchises were granted only by local franchising authorities, such as cities and counties, and the toolkit is geared toward those jurisdictions. Some states have adopted a state video franchising regime in which the franchising authority (and local jurisdictions) may have very limited authority (or no authority) to review cable transfers. In those states with limited transfer review authority, there still may be opportunities to comment on the transfer, but those may lie in other fora such as the Federal Communications Commission or the U.S. Department of Justice.

Overview of the Transfer Process

General Considerations

A franchise is a contract with the cable operator and the franchising authority is entitled to full performance of its terms. The franchising authority can and should demand the benefit of its bargain. A franchise holder in default has little, if any, right to expect approval of a transfer.

When a franchise holder requests permission to transfer its franchise, the franchising authority normally has broad discretion to say no. The franchise holder wants something only you can give. Before consenting, the franchising authority should conclude that the transfer will benefit the local community.

The franchising authority can exert substantial leverage during the transfer process. It may be appropriate to insist on new franchise requirements to protect the community from the risks and problems associated with a new operator.

A local franchising authority often has broad discretion

to deny a transfer if the proposed transaction poses a risk that the community will not receive exactly what it anticipated when it selected the original franchise holder.

State and Local - Substantive Requirements

State and local law generally establish the substantive legal basis for granting or denying a transfer request. The franchise agreement may provide guidance. And there may be specific state statutes or court decisions that set the standards for review and approval of transfer requests. In some cases, the franchising authority may have broad discretion to grant or deny any transfer request. In other cases, there may be specific standards the franchising authority must consider and apply. Because cable operators are first amendment speakers, denials should not be based on the content of the programming carried on the cable system.

Not all transactions are equal. For instance, a franchising authority's right to approve or disapprove of a transfer may vary for an asset sale, for a stock sale, and for transactions affecting the corporate parent of the franchise holder.

Federal Law – Procedural Requirements

Federal statutes do not set substantive standards for approving or denying a transfer, and courts have reviewed local denials with deference. For example, in *Charter Communs., Inc. v. County of Santa Cruz*, 304 F.3d 927, 933 (9th Cir. 2002), the court found that a denial "should be upheld as long as there is substantial evidence for any one sufficient reason for denial." In addition to relying on state law authority, a franchising authority may deny a transfer under 47 U.S.C. subsection 533(d) if: the transferee owns or controls another cable system in the municipality, or the proposed transaction would eliminate or reduce competition in the delivery of cable service.
Federal law does establish several mandatory procedures.

A franchising authority must act within 120 days of receipt of a completed transfer application on FCC Form 394, and all information required by the franchise authority.

The parties may agree to extend the 120-day deadline. If the franchise authority does not act within 120 days, the request will be deemed approved. (See 47 C.F.R. §76.502 and 47 U.S.C. §537.)

The Form 394 often does not provide enough information to allow a community to evaluate an application. A locality should be able to request additional information, if permitted under the franchise, or state or local law. However, the FCC has asserted that a request for additional information does not toll (or delay) the 120-day deadline. (*Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992: Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-Trafficking Provisions*, FCC 93-332, 73 R.R.2d 627 (P&F) (1993) at paragraph 86.)

FCC rules also state that a "franchise authority that questions the accuracy of the information provided [on the Form 394]…must notify the cable operator within 30 days of the filing of such information, or such information shall be deemed accepted, unless the cable operator has failed to provide any additional information reasonably requested by the franchise authority within 10 days of such request." The effect of this provision is unclear. One reading is that it requires a locality to notify the operator as to whether the application is complete within 30 days (the operator has 10 days to cure the incompleteness). Some operators take the position that the reference to "accuracy" requires the locality to ask any questions it has about the application within 30 days. As a matter of caution, it is important to send a well-crafted letter to the operator within 30 days to ensure that the locality may fully investigate the transfer.

Federal law may also prevent you from recovering your

additional consultant fees and attorney's fees directly from the cable operators absent a law that would allow your community to recover similar fees in reviewing transfer applications from other entities with whom the community may have a franchise (electric or gas companies, for example). The FCC has determined that such fees, imposed upon a cable operator solely because of its status as such, are not "incidental to" the enforcement of the franchise, and therefore generally must be treated as franchise fees (which are capped at 5%). (*In re Implementation of Section 621(a)(1)*, 22 FCC Rcd. 19633 paragraph 11 (2007).)

Why a Transfer May Benefit Your Community

In the realm of cable television regulation, ***cable transfers are unique because franchising authorities have greater bargaining power than cable operators.*** The balance of power shifts because a cable operator generally requires the prior consent of the franchising authority to the transfer. In contrast to franchise renewals and non-compliance enforcement, the operator in a transfer is seeking to alter the status quo. Unless the franchising authority approves the transaction, the closing of the overall transaction may be delayed or it may prevent the seller from claiming the purchase price for the system. The seller therefore has a major incentive to enter into good faith negotiations with the franchising authority.

Frequently Asked Questions

1. **Is the sale of stock in a franchise holder the same as a transfer of a franchise?**

   No, but both can be "transfers" requiring franchising authority approval. Since the concept of a "transfer" is not defined in the Federal Cable Act, the answer to this question depends on how a franchise agreement, or state or local law, treats a particular transaction. Many franchise agreements and cable ordinances define "transfers" to include "changes of control" of a franchise holder. Moreover, there is wide variation in the definition of what constitutes a change in control. In some instances, a "change of control" may be deemed to have occurred if a certain percentage of a company's stock transfers; in others, the test may be whether the transaction changes the working control or management control of an organization; and in some franchises both sorts of tests are used. A transfer provision that only covers actual franchise transfers would not necessarily reach transactions where one company takes over another through an acquisition of stock (a common occurrence), because the same corporate entity would technically still hold the franchise. Hence, determining your right to review a transaction will begin with a review of the franchise agreement, and any applicable state law, in light of the nature of the transaction proposed.

2. **How long does a franchising authority have to act on a transfer request?**

   Under federal law, a franchising authority has at least 120 days to act on a transfer application. This review period can be extended by agreement of the parties. If a franchising authority does not act within 120 days, the cable operator's transfer request may be deemed approved.

3. **When does the 120-day review period begin?**

   The 120-day review period begins to run from the date a local franchising authority receives a completed transfer application on FCC Form 394 including all of the information "required . . . by the franchising authority." (47 U.S.C. §537). Incomplete applications will not trigger the 120-day deadline. When the application is "complete" can be a source of dispute between the franchising authority and the applicant. Franchising authorities can request information that is not required by Form 394 or any information

required by a franchise agreement. However, the FCC apparently believes that such a request does not toll the 120-day deadline.(*Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992: Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-Trafficking Provisions, Report and Order and Notice of Proposed Rulemaking, MM Docket No. 92-264*, 73 R.R.2d 627 (P&F), 4 (Rel. July 23, 1993).)

4. Can the franchising authority get more information than the cable operator provides in FCC Form 394?

As stated above, a cable operator must provide transfer information that is required by the franchise authority. Franchising authorities can request additional information beyond what is included in FCC Form 394 or required by a franchise agreement. Cable operators are generally obligated to respond promptly to such requests by completely and accurately submitting all information reasonably requested.

5. The cable operator says this transaction is a simple pro forma restructuring. Should the franchising authority waive the transfer approval requirements?

No. Every proposed transfer that is subject to review should be carefully reviewed to assure, at a minimum, that the transaction will not affect the community's rights under the franchise, or result in a waiver of claims and past non-compliance problems. The franchising authority should review even a pro forma transfer to ensure that it will not have a negative impact on the quality of service or the franchise holder's ability to fulfill its franchise obligations. Moreover, a waiver of authority to deny a transfer could create a precedent for a later transfer. And it will deprive a community of a substantial opportunity to understand the true nature and financial capability of the operator.

6. The franchise gives the franchising authority the right of first refusal to buy the cable system in the event of a proposed sale. Should the franchising authority exercise that right?

The answer to this question will vary with each transaction. Whether a right to purchase a system has value or should be pursued depends, in part, on the mechanism in the franchise for purchasing the system, and on the context of the sale. Rights of first refusal in franchise agreements have been upheld in some but not all circumstances in bankruptcy sales. (*In re Adelphia Communications Corp.*, 359 B.R. 65 (Bankr. S.D.N.Y. 2007).) San Antonio negotiated a $25 million sale of its right to purchase the system at the time of a transfer. If the sale price is reasonable, the municipality may be presented with an opportunity to benefit the entire community by exercising its right to purchase. Many communities have chosen to operate their own cable system to control rate increases to subscribers and to correct operational and service quality deficiencies in a particular system. On the other hand, a municipality must carefully consider whether it is prepared to assume the financial and operational responsibilities of operating a cable system (*e.g.*, dedicating qualified technical personnel, making the necessary capital investments in new technologies, negotiating programming contracts, responding to consumer inquiries). In any event, a municipality should perform a due diligence review prior to purchasing a cable system to ensure that it would be a prudent investment.

7. Does a transfer have any effect on franchise renewal?

Transfers can have a significant and adverse impact on franchise renewal. A transfer can cut off a local franchising authority's ability to consider the transferor's performance once the transaction is consummated. In this regard, the legislative history to the Cable Communications Policy Act of 1984 states that a local franchising authority should "consider the operator's performance over the life of the franchise, unless the franchise has been transferred with the franchising authority's consent. In that case, the applicable period of consideration would be the period in which the franchise was held by the operator

seeking renewal." (H.R. Rep. No. 934, 98th Cong., 2d Sess. at 74 (1984), reprinted in 1984 U.S.C.C.A.N. 4655, 4711.) If a local franchising authority is limited in evaluating the purchaser's past performance, it is much more difficult to deny renewal. Consequently, before approving any transfer, a municipality should require the purchaser to commit, in writing, to assume all of the seller's obligations and liabilities, known and unknown.

8. **What can a local franchising authority do if it learns of an illegal transfer or if a cable operator threatens to consummate a transfer without prior consent?**

   If a cable operator consummates a transfer without prior consent (assuming such consent is required), a franchising authority can avail itself of any remedies available under a franchise agreement or applicable law. For instance, a franchising authority could impose any applicable penalties, require the payment of liquidated damages, or revoke the franchise. A franchising authority could also sue an operator for breach of contract, and seek monetary damages or equitable relief (*e.g.*, requiring the operator to follow the transfer or right-of-first-refusal procedures in the franchise agreement). If a cable operator threatens to ignore a prior consent requirement, a franchising authority should prepare to initiate the enforcement process (*e.g.*, by scheduling any necessary hearings), and inform the operator, in writing, that noncompliance will not be tolerated.

9. **What can a cable operator do if a franchising authority denies a transfer?**

   A franchising authority's disapproval of a transfer is often challenged under a "tortious interference with contractual relations" theory. The issues under this theory are whether: (i) the franchising authority acted within its powers in the actions it took to protect its rights under the franchise; and (ii) the franchising authority followed a process reasonably related to the protection of its interests. A cable operator could also sue a franchising authority and seek injunctive relief (preventing the franchising authority from stopping the transfer) or equitable relief (requiring the franchising authority to approve the transfer). Finally, a cable operator could seek monetary damages from the franchising authority. It should be noted, however, that federal law immunizes local franchising authorities from damage suits prompted by the disapproval of a transfer request. This immunity does not apply to injunctive or declaratory relief.

Three Resources

1. **Federal Law:**
   Here are key code provisions:
   - 47 U.S.C. § 547 (sales of cable systems)
   - 47 U.S.C. § 533 (ownership restrictions)
   - 47 U.S.C. § 555a (local franchising authority immunity from damage suits)

   The FCC's main regulation is here:
   - 47 C.F.R. § 76.502

   The FCC's Form 394 "Application for Franchise Authority – Consent to Assignment or Transfer of Control of Cable Television Franchise" is available here:
   - www.fcc.gov/Forms/Form394/394.xls

2. **Securities and Exchange Commission (SEC):** Quite often, your cable operator (or its parent) is a public company required to file annual and quarterly investor reports (Form 10-K, Form 10-Q), and reports on major events (Form 8-K) with the federal SEC. The SEC web site (http://www.sec.gov) can provide useful information about a particular operator and proposed transfers. Form 10-K, 10-Q and 8-K filings can be accessed directly at http://www.sec.gov/edgar.shtml.

3. **Cable Operator Transfer Documents**: The transfer documents you receive from your cable operator are excellent sources of information. You should carefully examine the description and terms of the proposed transaction to determine how the transfer will affect both you and consumers.