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Press Release

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FOR IMMEDIATE RELEASE
Wednesday – April 10, 2019

NEW PHOENIX CENTER ANALYSIS DEMONSTRATES THAT FCC's *SECTION 621 NPRM* STANDS ON SOLID ECONOMIC GROUNDS

Commission's Proposed Limits on Local Franchise Authorities' Extra-Statutory Exactions Will Promote Infrastructure Investment by Both Incumbents and New Entrants

WASHINGTON, D.C. — Before a cable operator can construct and operate a cable system for multichannel video and other services, Section 621 of the Communications Act requires that operator to obtain a non-exclusive franchise from the local franchising authority (or, in a few instances, a state authority). By virtue of their monopoly power over public rights-of-way, local franchising authorities are in a position to extract concessions from cable operators, especially during re-negotiations with incumbent operators that have made large sunk investments in geographic-specific networks. In 1996, Congress amended the franchise fee cap to no more than five percent (5%) of cable service revenues only, exempting revenues derived from non-cable services provided by operation of the cable system, such as broadband. Still, absent effective oversight, many local franchising authorities skirt the cap by extracting discretionary contributions, both monetary and in-kind, over-and-above a five-percent tax on gross cable service revenues.

In an attempt to rein in the excesses of local franchise authorities, last fall the Federal Communications Commission—tasked by statute with removing barriers to infrastructure investment—issued a *Notice of Proposed Rulemaking* in which the Agency is proposing to subject all in-kind exactions from cable systems to the five-percent (5%) cap, subject to the few statutorily-created exceptions. As a new economic analysis released today entitled *Infrastructure Investment and Franchise Fee Abuse: A Theoretical Analysis* demonstrates, the Commission's *Section 621 NPRM* to ensure compliance with the Cable Act by counting both monetary and in-kind contributions against the five-percent statutory cap on cable service revenues on investment grounds has strong theoretical support.

Using simple economic and financial models and a more complex two-stage investment model that mimics the regular negotiations that occur between the cable operator and local authorities, the Phoenix Center's economists demonstrate that local franchise authorities' extra-statutory exactions from cable operators deter investment by both incumbents and new entrants. As the Center's

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economists explain, "The presence of such an effect is nearly axiomatic: these exactions reduce the expected flow of revenues and/or increase the cost of an investment project, either of which reduces the net present value of an investment project and thus, at the margin, attenuates capital investments."

"In its *Section 621 NPRM*, the Commission requested an analysis of how local franchising authorities' excessive exactions affect infrastructure investment," said Phoenix Center Chief Economist and study co-author Dr. George S. Ford. "Using a variety of models, both simple and complex, we demonstrate that the abuse of power by local governments does, in fact, reduce investment and, in turn, reduces social welfare. Accordingly, Commission's attempts to shut down the abusive practices of franchising authorities is well-supported on economic grounds."

A full copy of PHOENIX CENTER POLICY BULLETIN NO. 45, *Infrastructure Investment and Franchise Fee Abuse: A Theoretical Analysis*, may be downloaded free from the Phoenix Center's web page at: http://www.phoenix-center.org/PolicyBulletin/PCPB45Final.pdf.

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