# MEMORANDUM OF LAW

DATE: October 23, 1989

TO: Rules Committee
FROM: City Attorney
SUBJECT: Cox Cable TV Franchise

Councilmember Bruce Henderson asked questions in July about the Cox Cable TV franchise renegotiations. This memorandum will first answer the questions he asked. A discussion of the duty of Cox and the City to reach agreement during a renegotiation is included.

## QUESTION

Mr. Henderson asked whether the procedures set forth in City Charter, Section 103, were followed in connection with the renegotiation and proposed amendment of the Cox Cable TV franchise. He specifically asked, "What opportunity has been provided for free and open competition in connection with the approval of this amendment?"

## ANSWER

Charter Section 103 states, in part:

> The Council shall have the power to grant to any person, firm or corporation, franchises, and all renewals, extensions and amendments thereof, for the use of any public property under the jurisdiction of the City. Such grants shall be made by ordinance adopted by vote of two-thirds (2/3) of the members of the Council and only after recommendations thereon have been made by the Manager and an opportunity for free and open competition and
>
> for public hearings have been given. No ordinance granting a franchise or a renewal, extension or amendment of an existing franchise shall be effective until thirty days after its passage during which time it shall be subject to the referendum provisions of this Charter. . . (Emphasis supplied.)

This section, among others, is referred to as authority for the grant of the Cox Cable TV franchise in Section 28 of the franchise ordinance and appears to be the basis for the assumption in Mr. Henderson's question that the "free and open competition" requirement applies to the approval of amendments. However, the long-standing interpretation of my office and the

practice of the City is that the procedure set forth in the second sentence of Section 103 applies only to the initial grant of a franchise. To interpret the section otherwise would create an absurd situation wherein a franchise would be "up for grabs" at every point of renewal, extension or amendment.

Instead, we believe the appropriate interpretation of Section 103 requires advertisement, bidding and public hearings only before awarding the initial grant of a franchise. In respect to the Cox franchise, the City followed the procedure set forth in the Charter in granting the franchise in 1979. At that time, bids were sought and public hearings completed prior to award of the franchise to Cox.

In sum, in our view there is no requirement for "free and open competition" in connection with the approval of the amendment. There was, therefore, none provided.1/

QUESTION

Mr. Henderson further asked if the clause found at Section 15(c)(1) of the franchise relating to reasonable rates is

1/ The "free and open competition and . . . public hearings" requirement provided for in the Charter is somewhat anomalous, even at the time of term expiration and potential renewal, since the system, property of the franchisee, is in place and a new franchise awardee would have to deal with the problem of buying the system from its predecessor or undertaking the uneconomic alternative of building a replacement system. In either event, the possibility of the system being "down" for an appreciable period of time makes the prospects unattractive, particularly to the franchisor, the City.

enforceable by individual subscribers or a class thereof? And, would such an enforcement action be subject to federal rate setting restrictions?

ANSWER

Although it is outside our purview to respond to a question relating to liability of a cable company to its subscribers, our initial research, outlined below, indicates that the rate regulation provisions currently included in the franchise are preempted and thus unenforceable by the City and the ratepayers.

Effective December 30, 1986, the Cable Communications Policy Act of 1984, 47 U.S.C., Sec. 521 et seq., prohibited rate regulation by cities and other political subdivisions except under certain conditions. During the two-year period 1984-1986, municipal rate regulation was preempted by state regulation in California. A case arising out of the Cox Cable franchise at issue here, Cox Cable San Diego, Inc. v. City of San Diego, 188 Cal.App.3d 952, 233 Cal. Rptr. 735 (1987), held that in spite of

the preemption of rate regulation included in the 1979 Cox Cable franchise, the franchise was otherwise valid and unimpaired, and the "provisions concerning rates under the franchise/ordinance are fully severable from the remaining contractual rights and obligations of City and Cox." Id. at page 968.

The conclusion reached by the Cox court regarding the preemption issue was also reached by the Supreme Court of Vermont in respect to the federal legislation, that is, a rate regulation clause in a local franchise was held to be illegal, preempted and unenforceable, although the remaining portions of the franchise were held valid and enforceable. City of Burlington v. Mountain Cable Co., 559 A.2d 153 (Vermont 1989), cert. denied, 109 S.Ct. 3245 (1989).

In the Burlington case, the City and Mountain Cable entered a contract in 1985 which settled numerous disputes and included a clause providing for rate regulation by the City. In an action brought for other reasons, the court, on its own, brought up the issue of preemption of rate regulation by federal authority. On appeal, the City argued that the Cable Communication Act "does not preclude enforcement of the contract because it only prohibits rate regulation by franchising authorities, and the State, rather than the City, is the franchising authority." Id. at page 154. The court, however, held that:

> The Cable Act does not suggest that the prohibition against basic rate regulation is directed against franchising authorities only. The legislative history and the language of the Act evidence the declared policy of Congress to prohibit local governments from regulating basic cable rates after two years from the effective date of the Act. Refusal to enforce an agreement permitting rate regulation is consistent with and essential to effectuate this policy. Enforcement would offend one of the essential purposes of the Act. A term of an agreement is unenforceable if the interest in its enforcement is clearly outweighed by a public policy against the enforcement. Here, the stated policy is clear and unequivocal, and the enforcement of the contract provision would undermine and detract from that policy. (Citations omitted.)
> Id. at page 155.

In the instant case, we believe a court would reach a similar result, i.e., that any attempt at enforcement of the preempted

provisions would contravene and "offend one of the essential purposes of the Act."

QUESTION

Can the current agreement on rates be enforced at present by the City?

ANSWER

Here, the response is "no," based upon the analysis set forth above.

QUESTION

Why has the provision on rates been omitted from the proposed amendment? Since it sets a standard of reasonableness to the subscriber, not the City, doesn't this standard significantly qualify the language giving potential rate setting power to the City?

ANSWER

Because the provisions regarding rate regulation are unenforceable, there appears to be no reason to keep them in the franchise. They were removed in the proposed amendment in the spirit of removing inapplicable provisions (except the proposed section which sets forth a scheme for renewed rate regulation by the City if the federal law is changed during the lifetime of the franchise).

QUESTION

During the Council hearing regarding the amended ordinance/franchise on July 24, 1989, Mr. Henderson asked if City and Cox had the duty to continue negotiations until an agreement to amend was reached.

ANSWER

Subsections (1) and (2) of Section 7(b) of the 1979 franchise ordinance state as follows:

> (1) The provisions of this ordinance shall be subject to renegotiation every five (5) years during the term of the Franchise, including any extensions thereof. These renegotiation opportunities shall be referred to as "renegotiation intervals." Renegotiation shall be initiated upon written notice given by the City or Grantee to the other not less than one (1) year prior to the particular renegotiation interval. If both parties agree to renegotiation, renegotiation shall be directed towards effecting alterations in the terms and conditions of this Franchise to reflect any significant changes which occurred during the interim

period.

(2) If any renegotiation prior to the end of the term, including extensions of this Franchise, results in agreement between the City and Grantee, or if, alternatively, both parties agree, at any renegotiation interval as defined above, that no renegotiation is needed or required, then the term of this Franchise shall be extended for an additional five (5) years by an appropriate action of the City Council.

A franchise from a government body constitutes a contract between the government unit and the grantee. Tulare County v. City of Dinuba, 188 Cal. 664, 669 (1922). And, although there are some special rules that apply to such franchises (e.g., construction against the grantee and being in the nature of real property), the general rules of contracts apply.

In interpreting a contract, one looks first to the wording of the contract itself and, if ambiguity or confusion remains, one looks to the law and usage of the place where the contract is to be performed or, if that is not indicated, the law and usage of the place where the contract was made (one and the same for the franchise/contract at issue here). 14 Cal.Jur.3d, Contracts Sec. 150 (1974).

An analysis of the language of the renegotiation sections cited above would clearly indicate that, although the provisions of the franchise are subject to renegotiation at five-year intervals, no agreement or amendment is required. Wording such as ". . . renegotiation shall be directed toward effecting alterations in the terms and conditions" clearly contemplates the possibility that agreement may not be reached. Similarly, the phrase "If any renegotiation . . . results in agreement between the City and Grantee, or if, alternatively, both parties agree, at any renegotiation interval . . . that no renegotiation is needed or required . . ." indicates that the parties could reasonably foresee fruitless as well as fruitful negotiations.

It appears to us that the meaning of the contractual language is abundantly clear and unambiguous and that we need not go further in a search for clarity. However, in order to cover every possible interpretation of the renegotiation sections, we will look briefly at the applicable law and past practice of the City and Cox pursuant to this section.

California law holds that modification of a contract requires the same elements as the original contract, that is, an offer, an acceptance (mutual assent) and consideration. 14 Cal.Jur.3d,

Contracts Sections 218-219. Here, although City and Cox entered negotiations and appeared to agree prior to the June and July council hearings, there was clearly no consent by the City Council to approve and accept the agreement. Further, Cox withdrew its offer and consent at the last moment. Without the essential element of free and mutual consent of all parties, no binding modification can be created. To force a party to continue negotiations or to require modification once negotiations have commenced is the direct antitheses of this rule.

In respect to the past practice of City and Cox, the first five-year interval renegotiations were never initiated in 1983. The City staff had indicated that if renegotiations were to commence, the question of possessory interest taxes would be raised. Cox indicated it had no interest in discussing that element so the matter was dropped until 1988 when the parties agreed to consider the possessory interest tax issue, among other things, and renegotiations culminated in the proposed amended franchise before you in July. The first five-year interval renegotiations were also never initiated by either party to the Southwest Cable franchise. Therefore, the City has no history in implementing this specific section.

We therefore conclude, based upon the clear reading of the franchise/contract as well as applicable law, that under the terms of the franchise, City and Cox were not required to continue negotiations until amendments were agreed upon. However, Mr. Henderson further asked if the general duty of good faith and fair dealing implied in all contracts impose the obligation to continue negotiations upon the parties.

An implied covenant of good faith and fair dealing exists in every contract. This means that each party has the duty not to take unfair advantage of a situation or prevent or hinder performance by the other party. Further, it means a party has the duty to do everything that the contract presupposes to accomplish its purpose. 14 Cal.Jur.3d, Contracts Sec. 181 (1974).

As applied to the renegotiation clause in Section 7(b) of the franchise, the implied covenant of good faith and fair dealing means that, once renegotiations have been initiated, the parties must discuss issues and negotiate any proposed amendments which are on the table fairly and reasonably pursuant to the request of either party. As to the case at issue, representatives from the City Attorney's office and City Manager's office met with Cox representatives over a period of 15 months, discussed many issues and entered tentative agreements regarding amendments to the 1979

franchise. As participants with a close-up view of events during those fifteen months, we believe both parties put forth their best efforts to reach agreement and neither party breached the implied covenant of good faith and fair dealing. The fact that the amended franchise was not executed is not, in itself, a violation of the implied duties.

In conclusion, with the renegotiations terminated, it appears to us that neither the City nor Cox have any obligation to renegotiate the franchise unless third-round negotiations are initiated in 1993 for possible amendment of the franchise in 1994, or the parties mutually agree to an earlier renegotiation.2/

2/ I have been involved personally with local regulation of cable television for over 20 years, including service in the early 1970s on the Steering Committee of the Special Advisory Committee to the Federal Communications Commission (FCC) on Federal/State and Local Regulation of Cable Television, by personal appointment of then-FCC Chairman Dean Burch. I have two observations based on that experience that should be made at this point: 1) Beware of rival "competitors" who offer cable services at subscriber rates less than those charged by the incumbent franchisee. Generally, they are seeking to "skim the cream" by offering significantly lower levels of service than those required of the existing franchisee under local and Federal policy standards; 2) Do not listen to claims that new franchises being granted in other urban areas are significantly better than those already in place at home. Generally, the new franchises are not operational or have not stood the test of time necessary to determine whether they are actually viable in an economic sense. Bidders for most urban franchises have tended to promise much more than they can deliver and, when they actually are awarded the "super franchises," they either fail to build the system as promised or they ignore the obviously uneconomic parts of the franchise and refuse to provide them. The renegotiation options of our franchises were designed to give both the operator and the City the opportunity to reexamine the franchise in light of rapidly changing technology. That was an innovative concept in 1979 and still is. It did not replace, however, the realistic fact that a franchise is a contract which may not be altered during its term except by agreement of both parties.

A report from the City Manager setting forth his views on the issues within his purview will be sent under separate cover.

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