NMHC National Multi Housing Council®

TO: NMHC Members

FROM: Betsy Feigin Befus, Vice President, Employment Policy and Special Counsel

RE: FCC Order on Exclusive Contracts with Video Providers

DATE: November 26, 2007

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On October 31, 2007, the Federal Communications Commission (FCC or Commission) announced a unanimous decision that retroactively bans the enforcement of "building exclusivity" (i.e., building access clauses) between apartment properties and most video service providers.[1]

Specifically, the Order bans the enforcement of any contract provision between an apartment owner and a covered video service provider that grants the provider an exclusive right to make video services available on the property. "Exclusivity clauses" are defined by the FCC to include those contract terms that would prohibit other providers from accessing the building. The Order does not cover inside wiring, exclusive marketing agreements or bulk billing arrangements.

The Order was released November 13, 2007 but has not yet been published in the Federal Register. Note that the Order is retroactive, so it applies to both *existing* and *future* contracts. A copy of the Order is available at www.nmhc.org/goto/4461.

Overview

On March 22, 2007, the FCC issued a Notice of Proposed Rulemaking (NPRM) requesting public comment on whether it should regulate exclusive access agreements between providers of video programming services and apartment owners and managers.[2] Among other things, the NPRM sought input on whether the FCC has legal authority to regulate in this area, the prevalence of exclusive access agreements, and the benefits and harms to both consumers and video competition attributable to those contracts. The FCC's NPRM was apparently initiated in response to claims by several large telecommunications companies that have begun to offer video services to residents of "multiple dwelling units" (MDUs) that exclusive access agreements improperly interfere with market competition and consumer choice.

It is important to note that the Order *only prohibits the enforcement of exclusive access clauses*, not entire contracts covering items beyond exclusive access rights. Specifically, the Order does not prohibit contract clauses that grant exclusive marketing rights. It also does not prohibit granting an exclusive right to use inside wiring owned by the property. Finally, the Order applies only to video service providers; it does not prohibit exclusive access agreements between property owners and service

[1] *Exclusive Contracts for Provision of Video Services in Multiple Dwelling Units and Other Real Estate Developments*, Report and Order, Docket No. 99-0217 (released Nov. 13, 2007) (the Order). Commissioner McDowell issued a "concurring" statement expressing certain reservations, but he ultimately voted for the Order.

[2] *Exclusive Service Contracts for Provision of Video Services in Multiple Dwelling Units and Other Real Estate Developments*, Notice of Proposed Rulemaking, 22 FCC Rcd 5935 (2007).

providers offering voice or Internet access.

Owners should understand that the Order *does not impose mandatory access* on properties. Rather, it only prohibits apartment owners (and other MDU operators) from negotiating agreements that grant covered video service providers exclusive access to the property. Mandatory access laws, which are in effect in 18 states and Washington, D.C., require an apartment owner to grant a right of entry to a service provider that wants to offer their product to residents.

The Order will take effect 30 days following its publication in the Federal Register. However, because the ruling is retroactive, the effective date is relevant only for purposes of establishing deadlines for further action by the Commission and stakeholders who may choose to respond to the ruling.

Background of the Proceeding

Since 1996, NMHC/NAA, as part of the Real Access Alliance[3] (RAA), have been engaged in numerous FCC proceedings arising out of the Commission's desire to promote competition in the delivery of video services. This year's proceeding on exclusive access agreements is only the latest issue in which NMHC/NAA are engaged.

In broad terms, an exclusive contract is an agreement between a property owner and a cable operator or other provider of video services that gives the provider some form of exclusive right on the property. There are three basic types of exclusive contracts (although many agreements include characteristics of more than one type):

- **"Exclusive access" agreements** or "building exclusivity" clauses. This type of contract grants the video provider an exclusive right to supply video services or to install its facilities on the property and was banned by the FCC's November 13 Order.

- **"Exclusive marketing" agreements** or "marketing exclusivity" clauses. This type of contract offers a video provider an exclusive privilege to promote its services on the property. Other video suppliers may also have the ability to actually provide their services to residents, subject to an agreement with the property owner, but the exclusive marketing provider has special support from the owner that will strengthen its competitive position. These remain permissible under the FCC's November 13 Order.

- **"Wiring exclusivity" agreements.** This type of contract applies when the property operator owns the wiring used to deliver video services on the property. Under this circumstance, the FCC's November 13 Order allows the owner to grant a video provider the exclusive right to use those facilities. If a competitor wants to service the property, it would be required to install a new network, thus increasing its capital investment in the property.

The Order also does not prohibit "bulk billing" agreements, in which the provider agrees to charge a discounted rate for service in return for a guaranteed payment by the apartment operator for each unit in the building. Apartment owners can still use these agreements to negotiate lower rates and upgraded services or facilities for the benefit of their residents. Apartment owners can also still obtain cash compensation in exchange for bulk billing or market exclusivity agreements. Such compensation may defray some of the property's investment in infrastructure, or compensate the owner for marketing assistance and other services it makes available to the video service provider.

[3] The Real Access Alliance is a coalition of eleven trade associations representing approximately one million members engaged in all aspects of the real estate industry. The Alliance was formed to encourage free market competition among telecommunications companies for services to tenants in commercial and residential buildings, and to safeguard the constitutional property rights of America's real estate owners.

Historical Background

In 2003, the FCC issued an Order changing its inside wiring rules. During that proceeding, the Commission considered regulating exclusive contracts.[4] That Order did not examine the exclusivity issue in detail, but it did clearly recognize the usefulness of such agreements in promoting competition owing to the particular economics of the multifamily video market. Video service providers are typically unwilling to enter a property if another provider is already serving residents. This market reality reflects the considerable capital cost of installing a network in the building; the presence of multiple providers decreases any one provider's ability to earn an adequate return on its capital investment and can put that investment at risk.

NMHC/NAA argued in 2003 that small video competitors in particular were at a disadvantage, and that banning exclusive access agreements in the multifamily industry would tend to favor companies that can spread their capital costs over a larger market and absorb greater risks over smaller providers. Preserving smaller video competitors promotes competition and helps property owners as well as residents get better service by giving the property owner an alternative to the local franchised cable operator when selecting a provider. The FCC apparently understood this reality; its inside wiring Order banned exclusive contracts in commercial properties but specifically exempted residential properties from this ban.

The FCC's current policy, however, seems to aggressively support telephone companies in their bids to compete with the cable industry for voice, video and Internet (data) services. The Commission has repeatedly raised concerns about the mass deployment of broadband technology and the so-called "triple play" that combines video, data (Internet), and voice (telephone) service. The FCC's March NPRM opened a new proceeding (Docket No. 07-51) to address whether it should assist the telecommunications industry in its collective effort to enter the multifamily video market by regulating exclusive contracts.

In July 2007, the RAA submitted comments urging the Commission not to regulate exclusive contracts because there is no market failure necessitating government intervention. We also filed reply comments responding to other comments one month later. In sum, the RAA reminded the FCC of the Commission's previous findings on exclusive access agreements, described in detail the many benefits that property owners and residents gain from such agreements, and pointed out the weaknesses in the FCC's legal arguments in support of regulation. We argued that the FCC has no power to regulate the real estate industry, and that the law that the Commission cites as granting its legal authority in this area, Section 628 of the Communications Act (47 U.S.C. § 548), was not intended by Congress to cover agreements between property owners and video providers.

NMHC/NAA and other RAA members also met with each of the FCC Commissioners and/or their key staff. Apartment companies participated in these meetings, offering their perspectives as experts in negotiating, implementing, and enforcing exclusive agreements for video services. Finally, the RAA submitted additional written materials to bolster our key points.

Key Components and Application of the FCC's November 13, 2007 Order

The FCC has concluded that the harms to consumers attributable to building exclusivity clauses now "significantly" outweigh the benefits. The Commissioners further found that the agreements interfere with broadband and triple-play deployment, limit competition, and bar new entrants into the market. Taken together, the Commission states, these alleged effects amount to "an unfair method of competition or an unfair act or practice proscribed by Section 628(b) [of the Communications Act]." However, the Order does acknowledge that building exclusivity clauses offset the cost of wiring buildings, attract

[4] *2003 Inside Wiring Order*, 18 FCC Rcd 1342 (2003), *rev'd in part on other grounds*, NCTA v. FCC, 89 Fed. Appx. 743 (D.C. Cir. 2004).

video service providers to "marginally attractive" buildings (properties with a limited opportunity to recoup costs, for example), serve as an incentive to serve new developments, and force providers to maintain higher service standards.

The Order

- The Order applies to both existing and future exclusive access clauses.

- Because the Order bans only the use of "exclusivity clauses," exclusive agreements as a whole are not voided under the Order. Only the contract terms that grant exclusive building access have been rendered unenforceable. As a result, the Order does not affect exclusive marketing agreements, wire exclusivity, or bulk billing arrangements. (The Order announced the FCC's intention to address whether exclusive marketing agreements or bulk billing arrangements should also be prohibited. There are no references to banning wire exclusivity.)

- The Order does not apply to private cable operators. The Order applies only to video service providers that are subject to Section 628 of the Communications Act of 1934, as amended.[5] This section of the Act makes it unlawful for covered video providers to "engage in unfair methods of competition or unfair or deceptive acts or practices, the purpose or effect of which is to hinder significantly or to prevent any multichannel video programming distributor from providing satellite broadcast programming to subscribers or consumers." The affected types of video programming service providers are: (1) franchised cable operators, (2) telecommunications common carriers that also provide video services, and (3) open video system operators. Private cable operators are generally not considered cable operators for purposes of the statute; consequently they remain free to enter into and enforce contracts with exclusive access provisions.

It is clear that Direct Broadcast Satellite (DBS) providers and private cable operators are not affected by the ban. However, the FCC's new rulemaking will examine whether DBS providers, private cable operators, and "other multichannel video programming distributors" should also be subject to the ban.

For purposes of the Order, the FCC defines MDUs to include apartments, cooperative residential buildings, and condominium buildings. Also covered are other centrally managed residential real estate, including gated communities and mobile home parks. The Commission asserts that these property types are composed of households with individuals that reside in private units for "lengthy, indefinite periods of time." The Commission expressly excluded time shares, academic campuses and dormitories, military bases, hotels, rooming houses, jails, prisons, halfway houses, hospitals, and nursing and other assisted living facilities. The FCC found that covered properties house residents with a "strong interest in making his or her own choice of a [video service] provider and thus warrant regulatory action to preserve the resident's ability to do so."

The Commission claims that a "significant number"[6] of apartments are now subject to building exclusivity clauses and that cable operators are the primary beneficiaries of such agreements. The Real Access Alliance's July 2007 comments opposing regulation argued against those assertions.

Further Actions Proposed by the FCC

As noted above, the Commission is seeking comments on whether it should bar bulk billing and exclusive marketing agreements, as well as whether private cable operators should be covered by the

[5] 47 U.S.C. § 548.

[6] *See supra* note 1, at 3. The Commission claims that a "significant number of … MDUs are subject to exclusivity clauses" but we are unaware of any market studies of exclusive access agreements for video service in the MDU market.

ban on exclusive building access agreements. (The central legal question here is whether the FCC should apply the Order to video service providers that are not covered by Section 628 of the Communications Act.) The Further Notice of Proposed Rulemaking (FNPRM) also raises the question of whether any prohibition of exclusive marketing and bulk billing agreements should be retroactive or prospective. The Commission has stated that it plans to issue a final order on these issues within six months of the publication of the proposal in the *Federal Register*.

In addition, the commissioners have stated that they will act within two months of publishing the November 13, 2007 Order on the issue of exclusive agreements for voice service. This issue has been dormant since the FCC released its 2000 order in the Competitive Networks docket, which banned exclusive contracts for voice service in commercial buildings. At that time, the RAA opposed regulation on the grounds that the FCC has no authority in this area.

Next Steps

NMHC/NAA, as well as RAA, are reviewing the details of the November 13, 2007 Order, and FNPRM, to determine our response going forward.

Our options for responding include petitioning the FCC to reconsider its decision and seeking appellate judicial review. The former may make sense if we conclude that some sort of clarification is needed or if we find that any concerns with the Order are relatively minor and there is a reasonable chance that the FCC would reconsider those concerns. If our objections are more fundamental, we will consider whether a judicial appeal of the Order would be appropriate. As it stands now, the Order presents a potentially dangerous precedent that might allow further FCC regulation of the apartment industry.