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April 16, 2007

Opinion No. 07-51

Cable Bill under the Contract Clause

QUESTIONS

House Bill 1421/Senate Bill 1933 (the "Cable Bill") would allow a cable service provider to obtain a non-exclusive state-issued certificate of franchise authority. The certificate would allow the provider to offer cable service within specified areas. Currently, many local governments have agreements with cable service providers that grant those providers a franchise to provide service within the municipality.

1. Does a Tennessee local government have standing to challenge the Cable Bill on the ground that it impairs contractual rights in violation of the Contract Clause of the United States Constitution or the Tennessee Constitution?

2. Under Section 5 of the Cable Bill, a cable service provider operating under a franchise agreement with a local government may not obtain a state-issued certificate of franchise authority until the agreement expires or is terminated. Does the Cable Bill, in light of this provision, violate the contract rights of cable service providers operating under exclusive agreements with local governments in violation of the Contract Clause of the United States Constitution or the Tennessee Constitution?

OPINIONS

1. No.

2. No. Cable providers have no legitimate expectation that the legislature will never amend state law governing franchising authority. Even if a provider could show impairment, the Cable Bill represents a valid exercise of the State's police power to provide for the health and well-being of its citizens.

ANALYSIS

1. Right of Local Government to Challenge the Cable Bill

This opinion concerns the constitutionality of the Competitive Cable and Video Services Bill, House Bill 1421/Senate Bill 1933, the "Cable Bill." Under the Cable Bill, assuming it becomes

effective, any person seeking to provide cable or video service in this State after the effective date of the bill must file an application for a state-issued certificate of franchise authority with the Secretary of State. Cable Bill, § 5(a). The certificate contains a non-exclusive grant of authority to provide cable or video service in the areas set forth in the application, and a non-exclusive grant of authority to build and operate a system on public rights of way across the State. Cable Bill, § 5(d). The Cable Bill does not alter the existing local franchise process for providers who choose to negotiate a franchise with a municipality or unincorporated county government. Cable Bill, § 3.

If enacted, the Cable Bill will open the entire State to any cable service provider able to obtain a state-issued certificate of franchise authority. Currently, many local governments have negotiated franchise agreements with cable service providers under the authority of Tenn. Code Ann. §§ 7-59-101, *et seq.* If the Cable Bill is enacted, the local government will no longer exercise the sole authority to issue cable service franchises to provide cable service within its territory. The Cable Bill also sets a maximum franchise fee that a local government may charge to the holder of a state-issued certificate of franchise authority operating within its territory. Cable Bill, § 7. Under Section 7(h) of the Cable Bill, a local government may not charge cable service providers fees other than a franchise fee charged to holders of a state-issued certificate of authority or a municipal or county franchise fee imposed on a cable service provider before January 1, 2007. Under Section 5, a service provider cannot obtain a state-issued certificate of franchise authority with respect to territory where it operates under a local franchise agreement. This section states:

> (a) Any entity or person seeking to provide cable or video service over a cable system or video service network facility in this state after the effective date of this part shall file an application for a state-issued certificate of franchise authority with the secretary of state as required by this section. An entity or person providing cable service on the effective date of this part under a franchise previously granted by a municipality or unincorporated county is not subject to, nor may it avail itself of, the franchise provisions of this part with respect to such municipality or county until such franchise expires, except as provided by subsection (b).
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> (b) An incumbent cable service provider may elect to terminate its municipal franchise and seek a state-issued certificate of franchise authority by providing written notice to the secretary of state and the affected municipality or unincorporated county that either:
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> > (1) A state-issued certificate of franchise authority indicates that one (1) or more households in the franchise area of the existing municipal franchise can obtain service from both the incumbent cable service provider under the existing agreement and the holder of a state-issued certificate of franchise authority; or
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> > (2) One (1) or more households in the franchise area of the existing municipal franchise can obtain service from at least two (2) wire-line

> providers of cable or video service acting pursuant to locally-granted franchise authority. The municipal franchise is terminated on the date the secretary of state issues the state-issued certificate of franchise authority.

Cable Bill, § 5(a) & (b). Under the Cable Bill, therefore, a cable service provider may terminate its franchise agreement with a local government if cable or video service is available from other providers within the territory.

The first question is whether a local government could challenge the Cable Bill's validity on the ground that the legislation unconstitutionally interferes with its contract rights. Article I, Section 20, of the Tennessee Constitution states "[t]hat no retrospective law, or law impairing the obligations of contracts, shall be made." Similarly, Article I, Section 10, of the United States Constitution provides that "[n]o state shall . . . pass any . . law impairing the obligation of contracts." The Tennessee Supreme Court has stated that the meaning of the federal and state constitutional provisions is identical. *First Utility District of Carter County v. Clark,* 834 S.W.2d 283, 287 (Tenn. 1992); *Paine v. Fox,* 172 Tenn. 290, 112 S.W.2d 1 (Tenn. 1938).

The United States Supreme Court has long held that the Contract Clause of the United States Constitution does not, in general, apply to relations between a municipal corporation and its creating state. *Hunter v. Pittsburgh,* 207 U.S. 161, 28 S.Ct. 40 (1907). In that case, the Court dismissed a challenge brought by citizens of a smaller municipality annexed to an adjacent and larger municipality. The Court noted that, since municipal corporations are created by statute, "[n]either their charters, nor any law conferring governmental powers, or vesting in them property to be used for governmental purposes, or authorizing them to hold or manage such property, or exempting them from taxation upon it, constitutes a contract with the state within the meaning of the Federal Constitution." 207 U.S. at 178. Nor may a city challenge a state statute on the grounds that it impairs an agreement between a city and a third party. *City of Pawhuska v. Pawhuska Oil & Gas Co.,* 250 U.S. 394, 39 S.Ct. 526, 63 L.Ed. 1054 (1919)*; Worcester v. Worcester Consolidated Street Railway Company,* 196 U.S. 539, 25 S.Ct. 327, 49 L.Ed. 591 (1905). In *Pawhuska,* a city challenged a statute transferring its authority to regulate gas rates to a different regulatory authority. The Court found the city could not challenge the statute under the Contract Clause even though it affected a franchise agreement between the city and a gas company. In *Worcester,* a city had a franchise agreement with a railroad company under which the company was required to repair city streets arounds its tracks. A later state law freed all railway companies from this obligation. The Court found that the city could not challenge the statute under the Contract Clause. The Court found that the state legislature could nullify the contractual rights of the local government under its franchise agreement with the railroad company.

These cases address the rights of a city to challenge a state statute. In each, the United States Supreme Court found that cities are creatures of state law and that the legislature may amend the laws under which they operate, even if those laws impair a contract between a city and a third party. A similar rationale would apply to the ability of a county to assert rights under the Contract Clause

against the State. Under Tennessee law, counties are also creatures of statute, and their powers and duties are strictly construed. *Howard v. Willocks*, 525 S.W.2d 132, 134-35 (Tenn. 1975); *Bayless v. Knox County*, 199 Tenn. 268, 286 S.W.2d 579 (Tenn. 1955).

Similarly, under Tennessee law, a municipal corporation is not entitled to challenge a state statute on the ground that it impairs a contractual right of the municipal corporation. *First Utility District of Carter County v. Clark, supra* (a utility district could not challenge a legislative change to its charter under the federal or state Contract Clause); *Metropolitan Development & Housing Agency v. South Central Bell Telephone Co.*, 562 S.W.2d 438 (Tenn. Ct. App. 1977) (a metropolitan housing agency could not bring a challenge under the Contract Clause to a state law requiring a public body to reimburse a utility for relocating utility services for an urban renewal project, citing *Worcester, supra*); *Cunningham v. Broadbent*, 177 Tenn. 202, 147 S.W.2d 408 (Tenn. 1941) (a county could not bring a challenge under the Contract Clause to a state law reducing the interest the State paid to counties on highway reimbursement bonds). For these reasons, Tennessee cities and counties lack standing to challenge the Cable Bill on the ground that it impairs their contract rights.

2. Rights of Cable Service Providers to Challenge the Cable Bill under the Contract Clause

The next question is whether, particularly in light of Section 5, the Cable Bill diminishes the value of an existing franchise agreement to an incumbent franchisee so as to violate the Contract Clause of either the United States Constitution or the Tennessee Constitution. In determining whether a particular state regulatory measure is constitutionally valid under the Contract Clause, courts generally apply a three-pronged test. *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 410-13, 103 S.Ct. 697, 704-05, 74 L.Ed.2d 569 (1983). The threshold inquiry is "whether the state law has, in fact, operated as a substantial impairment of a contractual relationship." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244, 98 S.Ct. 2716, 2722, 57 L.Ed.2d 727 (1978). In determining the extent of the impairment, the courts are to consider whether the industry the complaining party has entered has been regulated in the past. 438 U.S. at 242, n. 13, 98 S.Ct. at 2721, n. 13. Where, in light of all facts and circumstances, including past regulation and the terms of the agreement, changes in state law are foreseeable, the change does not impair the parties' reasonable expectations. *Energy Reserves Group*, 459 U.S. at 416, 103 S.Ct. at 707.

If the challenged regulatory measure does substantially impair a contract, then the second inquiry is whether the regulatory measure came into being pursuant to a significant and legitimate public purpose, *United States Trust Co. v. New Jersey*, 431 U.S. 1, 22, 97 S.Ct. 1505, 1517, 52 L.Ed.2d 92 (1977), such as the remedying of a broad and general social or economic problem. *Allied Structural Steel Co.*, 438 U.S. at 247, 249, 98 S.Ct. at 2723-2725. Once a legitimate public purpose has been identified, the next inquiry is whether the adjustment of "the rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purposes justifying [the legislation's] adoption." *United States Trust Co.*, 431 U.S. at 22, 97 S.Ct. at 1518. Furthermore, "as is customary in reviewing economic and social regulation, . . . courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure." *Energy Reserves Group, Inc*., 459 U.S. at 412-13, 103 S.Ct. at 704-05.

Under the first prong of this three-part test, any provider challenging the Cable Bill would be required to establish a substantial contract impairment. A provider's assertions of impairment would depend on the facts and circumstances, including the terms of the specific contract and market conditions. The cable service industry directly subject to Section 5 of the Cable Bill is already extensively regulated. Any authority of local governments to negotiate franchise agreements with "cable service providers" as that term is defined under the Cable Bill must be exercised consistently with federal law. Tenn. Code Ann. § 7-59-102(a); 47 U.S.C. § 556(c).[1] A local government exercising its authority to negotiate franchise agreements with cable service providers as defined in federal law is a "franchising authority" within the meaning of 47 U.S.C. § 522(10). Under 47 U.S.C. § 541, a franchising authority may not grant an exclusive franchise and may not unreasonably refuse to award an additional competitive franchise. 47 U.S.C. § 541(a)(1). A local government, therefore, has no right to grant, and a service provider has no right to obtain, an exclusive franchise for cable service within its territory. Further, the Cable Bill does not directly interfere with the cable provider's authority to operate under the agreement. In fact, it allows the provider to terminate the agreement provided certain conditions are met. Rather than impairing a cable provider's contractual rights, the Cable Bill provides that the state government may also grant franchises with respect to territory within the State.

Although video service providers are not subject to the same federal regulation as cable service providers, neither group has a legitimate expectation that the statutory framework governing the cable service industry will never change. *See Energy Reserves Group, supra; Knoxville Water Co. v. Mayor & Aldermen of the City of Knoxville,* 200 U.S. 22, 26 S.Ct. 224, 50 L.Ed.2d 353 (1906). In that case, a private water company received a franchise to build a water system within a city. Twenty years later, the legislature authorized the city to build and operate its own water system. The company sought to enjoin the city from exercising this authority. The United States Supreme Court found that, under its contract with a private water company, the city had not bound itself never to build its own water system. *See also State ex rel. Cream City Railway Co. v. Hilbert,* 72 Wis. 184, 39 N.W. 326, 328 (Wis. 1888) (in *dictum,* the legislature may alter or repeal a franchise granted by a local government exercising its statutorily delegated authority). For this reason, the Cable Bill does not substantially impair any franchise agreement between a cable or video service provider and a local government.

In any case, the Cable Bill can also be defended as a valid exercise of the State's police power. By providing a relatively uncomplicated way for a cable company to provide services in a territory, the Cable Bill seeks to relieve companies of the burden of entering into an agreement with each city or county. As a result, the legislation purports to promote competition among service

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[1] While the Cable Bill covers both "cable service," and "video service," Section 5 by its terms is limited to a provider of "cable service." The bill defines "cable service" to have the same meaning as set forth in federal law, 47 U.S.C. § 522(6). The term "video service provider" under the Cable Bill expressly excludes a "cable service provider." Cable Bill, § 4(11). Section 5 of the Cable Bill, therefore, applies only to contracts for cable services already subject to federal regulation under 47 U.S.C. §§ 521, *et seq.* The current state law authorizing local governments to enter into franchising agreements, however, also applies to video service. Tenn. Code Ann. § 7-59-201.

providers, with resulting benefits to Tennessee citizens. This is one of the purposes of the federal law regulating cable service. 47 U.S.C. § 521(6). The Cable Bill, therefore, is being promoted as furthering a legitimate and significant public purpose. In summary, by providing an alternate method of obtaining a franchise, the Cable Bill only indirectly affects cable providers' contract rights and appears to be an appropriate way to further its intended purposes. For these reasons, the Cable Bill does not violate rights of existing cable service providers under the Contract Clause of the United States Constitution or the Tennessee Constitution.

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