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WPRI REPORT: THE BENEFIT OF CABLE COMPETITION IN WISCONSIN

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EXECUTIVE SUMMARY

For decades, video service has been static in the way it delivered television programming to homes. Either a household watched local channels via antenna, or the cable company provided service to their home through a dedicated wire. The very nature of cable programming created a "natural monopoly," in that it was costly and duplicative for competing cable companies to run their own second cable into a home. This gave cable companies a great deal of power in setting rates and dictating programming to subscribers.

Due to the monopolistic nature of cable service, local governments sought to regulate the activities of cable providers. Thus, the "municipal cable franchise" was born. A cable franchise is an agreement between a municipality and a cable provider that grants exclusivity within a municipality to the cable company in exchange for a fee and requirements to serve certain areas. In 1984, the federal government granted the Federal Communications Commission authority over cable and authorized municipalities to administer franchises.

New technologies in video service have rendered the justification for municipal cable franchises obsolete. Telecommunications companies have developed networks that provide cable-quality video over broadband networks. These networks use phone lines existing in nearly every home to deliver video service, rather than the traditional coaxial cable. These phone companies now seek to provide meaningful competition to cable companies, which currently have government-mandated protection for their market.

Wisconsin has now become the battleground for a fight between companies seeking to provide the new broadband video service and the traditional cable companies looking to preserve their franchising agreements. Telecommunications companies argue that competition is good for consumers, leading to the potential for cable rates dropping, customer service improving, and programming choices increasing when a new video provider enters a market. Municipalities and cable companies argue that the existing cable franchising structure should be applied to these new video providers to maintain municipal revenues and provide a "level playing field" for competition.

This study concludes that competition will be beneficial for Wisconsin consumers in a number of areas. First, prices for cable service will likely drop as they are forced to compete with less expensive broadband video services, while a standardized franchise would hold the line on fees and other giveaways, the cost of which are passed on to consumers. According to a 2004 study by the U.S. General Accounting Office (GAO), cable consumers in markets with wire-based competition saw an average cable bill rate drop of 23% when competition was introduced. Furthermore, the Federal Communications Commission (FCC) found 15.7% savings for communities with wireline competition. If similar savings are realized when broadband video offers competition in Wisconsin, expanded basic cable customers could see annual savings of between $82.80 and $149.01, depending on their cable market and rate of savings.

Secondly, consumers will see increased choices in programming when more video services are allowed to compete. In 2006, millions of Green Bay Packer fans were unable to watch the team's final home game against the Minnesota Vikings, as few local cable companies carried the NFL Network. In most cases, consumers didn't have the opportunity to watch the game, since cable was the only option they have. Once more competition is allowed in the video service industry, there will be more opportunities for customers to receive the programming they want.

Finally, competition would improve customer service as their video provider would have to fight for customers against a very real competitor. Additionally, consumers will be afforded better technology in video and data service as new video providers compete to deploy service to their marketplace.

Whether real competition can occur in the video market depends on the extent to which the state can facilitate entry into markets for new video companies. While competition is universally recognized as a good thing, municipalities and cable companies have a number of tools at their disposal to deter new video providers from offering service in their markets. The only way meaningful competition for video services can take place is if new providers face as few obstacles as possible in setting up their service.

This report will discuss the history of cable franchises in Wisconsin and the current status of state law regulating franchise agreements. Additionally, this study will investigate some of the franchise reform efforts taking place in states around America, how those efforts could be beneficial in Wisconsin, and discuss some of the issues pertinent to whether increased competition can help Wisconsin consumers. Finally, this study discusses the effects that wireless technological developments could have on networks that are currently being built.

INTRODUCTION: VIDEO FRANCHISE AGREEMENTS

One doesn't need to look too far or for too long to see examples of how quickly the technology industry moves in today's society. Consumers who buy a new computer or cell phone often find their purchases obsolete within a month. Phrases like "YouTube" and "Google" become universal phrases in the American lexicon within weeks.

Despite the explosion in new and exciting technologies, many people have yet to catch on to the benefits of these new developments. All over the country, teenagers collectively roll their eyes when their hopelessly unhip parents instruct them to get off their "e-mail machines" or not to spend too much time on "the interwebs."

Unfortunately, those parents are often light years ahead of the government in their understanding of the potential of new technology. The inherent structure of the multiple levels of U.S. government is designed to foster cautious and deliberate debate, with a variety of built in checks and balances to thwart capricious actions.

In the case of quickly evolving technology, the deliberative nature of federal, state, and local governments can often hinder important investment in and development of new technologies. Often times, up-to-the-minute technologies are forced to abide by outdated laws, which thwart their utilization.

Such is the case in the field of cable television franchising. For decades, cable television franchises have been forced into franchise agreements with municipalities for the right to provide service within that municipality's borders. In many cases, these agreements were enacted to protect local broadcast stations from the competitive threat posed by "distant television signals."[1]

In exchange for the monopoly of service to that city, town, or village, the cable franchise has agreed to pay a fee based on a percentage of their income to the municipality. Thus, both parties have been able to achieve their goals – the municipality receives cash to pay for local government channels, public access programming, and for other governmental services. The cable company is provided access to the public rights-of-way and has a built-in customer base, which they can serve without fear of competition.

The very nature of cable technology made these agreements possible. Providing cable programming means running a cable into a subscriber's home, which creates a "natural monopoly." As a result, cable companies have been subject to speculation that they have taken advantage of their noncompetitive agreements and raised rates regularly on their customers. According to the Federal Communications Commission, cable rates nationwide increased by 93% in the ten-year period between 1996 and 2006.[2]

New technology, however, is making the old set of state and federal laws governing franchise agreements and fees moot. Technology exists that provides video content over broadband (BSP) networks, and mainstream telecommunications companies have spent billions of dollars to develop such systems. Cable companies and municipalities are arguing that these types of video services violate the franchising agreements they have signed, and are making efforts to prevent implementation of the new services.

In December of 2006, the City of Milwaukee filed a lawsuit intended to prevent AT&T from providing their new 200-plus channel "U-Verse" product without a franchise. The City maintained the new service violated the terms of Time Warner's franchise agreement with the City. AT&T, disputes that their service is considered "cable television," under federal law, and believes that they should be allowed to provide the service without paying the franchise fee to the City.

Supporters of franchise deregulation argue that introducing competition into municipalities currently served by monopolistic cable franchise agreements will force rates to drop, thereby benefiting consumers. They also argue that cable companies that have chosen to provide new telephone service aren't bound by the same telecommunications regulations they are (to promote competition), so the reverse should be true when phone companies enter the video delivery service business.

Opponents of changing the current agreements argue that permitting competition will weaken franchise arrangements and will deprive municipalities of much needed revenue. In addition, public access and government information channels funded by municipalities worry that the alternative video services will not carry their content, and that they will lose revenue if franchise fees were eliminated.

CABLE FRANCHISING IN WISCONSIN

Cable television service has been an issue in Wisconsin since April of 1951, when the City of Rice Lake first proposed a cable television system. In the years that followed, cable programming gained popularity in rural areas, where cable provided programming to geographic areas that were unable to receive over-the-air broadcasts.

Soon, cable systems began to spread to metropolitan areas. By 1972, there were 72 cable systems operated by 49 companies and serving 72,818 subscribers. That same year, Governor Patrick Lucey convened a 52-member task force on cable service to study the increase in cable popularity and to make recommendations to the varying levels of government that could possibly regulate cable franchises.

This commission, headed by future Governor Lee Sherman Dreyfus, issued a report in 1973 that touched on some of the important issues that would surface with regard to cable franchising in the years ahead. Most notably, the commission recommended that local governments should be allowed to charge cable franchises fees "for the cost of regulation and to pay for other services, but these other services are limited to those related to public access programming."[3]

When initially authorizing cable service, most municipalities had developed a process by which cable companies responded to an RFP (request for proposal).These

RFPs generally provided exclusivity to a cable company within the municipality's borders, in exchange for a fee set by the municipality and charged to the cable provider.

In the years following the Lucey Commission report, disagreements surfaced as to the purpose of franchise fees. Municipalities saw franchise fees as compensation for the use of their rights-of-way, and for the right to do business within their borders. Under this scenario, cities believed that the amount of franchise fees should be negotiated in the contractual process.

On the other hand, cable companies thought franchise fees should merely be a reimbursement to municipalities for the regulatory costs that they actually incurred. Cable companies thought the revenue collected by local governments should be spent on cable-related municipal expenditures. Cable companies believed that the "compensation theory" supported by the municipalities was merely a way for cities to buy more fire trucks and police cars using revenue paid for by cable television customers.

Prior to 1972, there were no nationwide limits set on the fees a municipality could charge – one court case reported a franchise fee as high as 25%.[4] In 1972, the Federal Communications Commission (FCC) imposed a three percent limit on the amount of franchise fees that could be charged by a municipality. The fee could be raised five percent if a local government demonstrated a regulatory need to do so, and if the FCC granted a waiver. Naturally, local governments opposed this action as an infringement on their ability to negotiate local franchise fees. Cable companies also complained that too many waivers were being granted, and that the higher franchise fees granted through the waivers were being used as general purpose revenue.

In October of 1979, the Wisconsin association representing local cable operators decided that they wanted to test the legality of franchise fees. A cable company in Ripon, Wisconsin, filed a lawsuit in 1982 (*Ripon Cable Co. v. City of Ripon)* in an attempt to have the three percent franchise fee declared invalid.

The Ripon Cable Company claimed that the fee imposed by the City of Ripon constituted a municipal income tax, which was expressly forbidden by state law. Furthermore, the cable company argued that the fee was in excess of the city's cost for "reasonable police power regulation."[5]

In 1984, the Fond du Lac Circuit Court sided with the cable companies on both counts and declared franchise fees invalid. This decision sent shock waves throughout the state, as cable companies began withholding their franchise fees, or paying them in protest. Municipalities immediately began looking for a new venue to challenge the court ruling, hoping to find a more favorable outcome.

Also that year, Congress passed the Cable Communications Policy Act of 1984, which significantly altered regulation of cable companies by local governments. The Act pre-empted all local rate regulation, required that a business be franchised as a cable company before they could provide cable service, and prohibited phone companies from entering the cable television business.[6] The Act increased the cap on franchise fees to 5% of an operator's gross revenues, gave local governments more leeway in the use of the fees that they collected, and allowed cable companies to pass the fee on to their customers.

Additionally, the 1984 Federal Act appeared not only to explicitly declare franchise fees legal (in contrast with the *Ripon* decision), it also removed restrictions on how those fees could be used. Buttressed by the new law and a lawsuit filed against a cable company by the City of Sheboygan, Wisconsin municipalities sought to have this new interpretation codified in state law.

The state law change the municipalities sought came in the 1985 Wisconsin biennial budget. The original budget as proposed by Democratic Governor Tony Earl didn't contain the franchising provision, and passed the Democrat-controlled Assembly without the new change. However the Senate, also controlled by Democrats, made some substantial changes to the Assembly version of the budget. Senate Amendment 137 was a lengthy amendment that touched on a number of state issues, from hospital rates to mining regulation.

The budget bill provision wholly adopted the municipalities' position regarding franchise fees, including municipalities' right to charge them and to use the proceeds as general purpose revenue. The provision also grants municipalities the right to own and operate cable stations. (See Appendix A for the full text of the amendment).

Then-Assembly Minority Leader Tommy Thompson attempted to amend the Senate provision to prohibit franchise fees from being used as general revenue to local governments, instead requiring the fees to be used on cable-related regulatory spending. Thompson's amendment failed.

The budget bill was signed into law by Governor Earl on July 17th, 1985. By October 1st of that year, a group of legislators had already introduced a new bill seeking to undo the brand new franchising provision of state law. 1985 Assembly Bill 506, a bipartisan bill whose authors included Democrat Richard Shoemaker and Republican Thompson, would have repealed the ability of local governments to require cable companies to pay franchise fees for general revenue purposes. The bill made it to the Assembly floor, but was never brought up for a final vote, and died at the end of the 1985-87 session.

While Wisconsin law to this day remains tied to the Telecommunications Act of 1984, the federal government has since begun to retract anti-competitive portions of the 1984 Act. In the years following the 1984 Act, Congress recognized that while the number of subscribers to cable television continued to increase, competition among cable providers remained virtually non-existent. With a lack of meaningful competition, cable companies were able to increase rates with impunity. As a result, increases in cable rates far outpaced inflation in the late 1980s and early 1990s.

With this fact in mind, Congress passed the Cable Television Consumer Protection and Competition Act of 1992. In the 1992 Act, Congress stated that it wanted to promote the availability of diverse views and information, to rely on the marketplace to the maximum extent possible to achieve that availability, to ensure cable operators continue to expand their capacity and program offerings, to ensure cable operators do not have undue market power, and to ensure consumer interests are protected in the receipt of cable service. Pursuant to the Act, the FCC was ordered to adopt regulations to further these goals in order to foster more competition and lower rates for consumers.

In 1996, Congress again revisited the issue of monopolistic practices within the telecommunications industry. The Telecommunications Act of 1996 primarily revised aspects of telecommunications regulation, allowing smaller phone companies to enter the long distance telephone market, while also permitting long distance companies to enter local markets once a series of requirements were met. Additionally, the 1996 Act allowed phone companies to provide video service, and conversely allowed video companies to provide phone service, while also phasing out price controls on cable service. However, the 1996 Act did not address the use of municipal cable franchise agreements, which remain the most significant blockade to true deregulation of the cable industry.

WISCONSIN TODAY

In contrast to the flurry of activity in the 1980s and mid 1990s, telecommunications laws have remained relatively unchanged for the last decade. It has been commonly accepted that cable companies must obtain franchises with municipalities in order to offer cable service. This framework has worked well for both cable companies (who receive exclusive rights to a market) and municipalities (who receive a healthy financial free from the cable company, via their customers).

That arrangement, however, is changing rapidly. In Wisconsin, new broadband video providers have begun setting up services to provide video, internet, and other interactive features through phone lines, rather than the traditional fixed cable route. It is the technological advances that have permitted the alternative delivery of traditional programming. This competition is straining Wisconsin's regulatory structure, including Wisconsin statutes.

AT&T VERSUS MILWAUKEE

AT&T's emergence as a video provider in Wisconsin is forcing cable companies and municipalities to adjust their cable franchising strategies. On December 20th of 2006, the City of Milwaukee sued AT&T, maintaining that the company had to obtain a cable franchise with the City in order to provide their video service. The complaint states that AT&T initially intended to start offering their video service on December 16th of 2006. The City believes they had been misled as to whether video services would be offered when asked to approve zoning variances allowing AT&T to build their network.

Time Warner Cable holds the current franchise with the City of Milwaukee, an arrangement that dates back to 1982. It took Milwaukee a relatively long time to reach a franchise agreement, as offers were made to the City as early as 1970. In 1971, Milwaukee Mayor Henry Maier claimed the issue needed more study when he vetoed a proposed franchise agreement with Time-Life Broadcast, Inc. Wauwatosa was the first Milwaukee area community to receive cable service, in 1980 – six years after they signed their franchise agreement.[7]

Pursuant to the 1982 agreement, the first cable programming in the City of Milwaukee went live in December of 1984. The franchise with Time Warner was renewed in 1999, and is scheduled to run for 15 years – despite the development of new technologies that the City could have known would render the franchising agreement obsolete within years. Time Warner paid the City of Milwaukee $3.7 million in franchise fees in 2006, with that number expected to increase to $3.8 million in 2007.[8]

In response to the lawsuit, AT&T claims it is not a cable company as defined by federal law, and therefore is not required to reach a franchise agreement with the city, thus allowing them to provide their service to whomever they want, while avoiding the 5% franchise fee (although they reportedly have offered to pay a fee outside of the franchising arrangement). AT&T states that the U-Verse service will provide competition for Time Warner Cable and keep rates down for subscribers of both services.

In their lawsuit against AT&T, the City of Milwaukee argues that AT&T does, in fact, classify as a cable company. They cite language from the Federal Telecommunications Act of 1984 (47 §U.S.C. 522(6)), which defines "cable service" as:

(A)The one-way transmission to subscribers of:
  (i) Video programming, or
  (ii) Other programming service, and

(B) Subscriber interaction, if any, which is required for the selection or use of such video programming or other programming service.

The City of Milwaukee believes that AT&T's video service falls under this definition, which would force them to obtain a franchise agreement with the City.

While the case is being litigated, AT&T and the City of Milwaukee have negotiated a temporary agreement, which allows AT&T to continue developing their infrastructure in the city in return for paying a fee to the City. According to Milwaukee City Attorney Grant Langley, the temporary agreement "looks a lot like a franchise."[9]

MUNICIPALITIES

Other municipalities, not wanting to invalidate their current franchise agreements, are initially opposed to new entry into their video markets. The City of Madison has posted pre-written anti-franchise reform letters on their official city website, urging citizens to print them off and send them to their state and federal legislators.[10] The Wisconsin Regional Telecommunications Commission, representing more than 30 other southeastern Wisconsin communities, is seeking to join the City of Milwaukee in their lawsuit against AT&T.[11]

In October of 2006, Attorney Anita Gallucci produced a memo for the League of Wisconsin Municipalities entitled "*When AT&T Comes A-Knocking: Competition at What Price?*" The piece essentially serves as a how-to manual for municipalities looking to deny AT&T the ability to provide video service.[12]

In the memo, Gallucci argues that municipalities that allow AT&T to provide service outside of a franchise agreement might be jeopardizing their current agreements with cable companies. She notes that outside a formal franchise agreement, any fees paid to a municipality could be seen as an income tax (as they were in the *Ripon* case), and could be deemed invalid.

Gallucci doesn't definitively state that broadband companies are "cable" companies, as the City of Milwaukee maintains in their lawsuit. Instead, she says:

> "There is no definitive answer today regarding how AT&T's Project Lightspeed video service is to be classified under federal law. The FCC has not yet addressed the issue through rulemaking or order, and no federal or state court has ruled on the issue. However, experts in this area representing municipal interests have evaluated AT&T's video service in light of current law and have concluded that AT&T is providing "cable service" as a "cable operator" and, therefore, is indeed subject to the federal law requirement of obtaining a local cable television franchise."[13]

In the League of Wisconsin Municipalities' "Legislative Agenda for the 2007-08 Legislative Session," they vow to oppose any statewide video franchising legislation, unless it:

- Maintains the franchising authority of local governments over cable and video services.
- Requires the payment of franchise fees to municipalities by all video and cable providers operating within the municipality based on a broad definition of gross revenues.
- Requires that Public, Education and Government (PEG) channels be offered and supported by all providers.
- Requires certain reasonable levels of "build out" by new and existing providers within the municipality to guarantee investment, jobs, competition and choice for all neighborhoods.

- Allows an incumbent cable franchisee to opt into a newly created streamlined franchising process only in those franchise areas in which it faces competition from another provider operating under a streamlined franchise.
- Retains the authority of local governments to manage rights-of-way and protect local property taxpayers.[14]

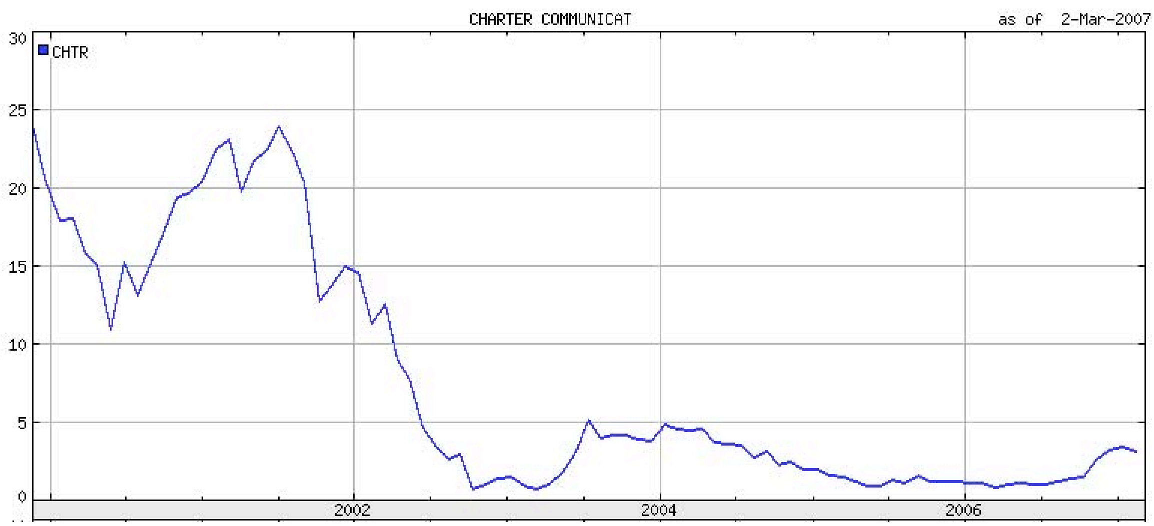
CABLE COMPANIES

Wisconsin cable companies are also fighting phone company entry into the marketplace without franchise agreements. Cable companies believe that the cost of their services are in line with what cable programming costs them, with the capital expenditures they've had to make to upgrade their systems, and the increasing demand for cable service.

Naturally, cable companies want to protect their profits by deterring competition. A look at the financial history of both Charter Cable and Time Warner Cable, the two largest cable providers in Wisconsin, show disparate financial situations.

Chart 1 shows the price of Charter Cable's stock over the past seven years. Charter's stock topped out at $26.31 per share in December of 1999, but plummeted to $.78 per share by March of 2003. For the past five years, the stock has remained mired in the sub-$5.00 range. Charter reported a $4.3 billion net loss in 2004, a $970 million net loss in 2005, and a $1.3 billion net loss in 2006. [15]

Chart 1



Time Warner Cable, on the other hand, is in transition. In July of 2006, Time Warner purchased Adelphia Communications Corporation, as part of Adelphia's Chapter 11 bankruptcy proceeding. As a result, Time Warner Cable picked up 3.3 million of Adelphia's former customers. This allowed Time Warner to spin its cable operation off as a separately traded entity. As a result, Time Warner Cable began trading as a public company on March 1st of 2007. While the stock was initially sluggish, some analysts predict annual revenue growth of up to 42% for 2007, due in large part to their new subscribers.[16]

Cable representatives dispute new entrants' use of the FCC report that shows cable rates going up 93% in the 10-year period between 1995 and 2005. They argue that the FCC report only compares basic cable rates over that 10-year period. During that period, basic cable packages have grown in the number of channels offered, thus consumers are receiving more for their money. According to the cable industry, viewers are watching more cable, so there is higher demand – as a result, the price per minute of viewing actually has actually gone down over the past decade. Furthermore, the cable industry argues that comparative prices improve when the cost of bundled services like internet and phone service are included in the analysis.

Cable representatives also point out that the FCC report notes that cable rates haven't dropped as a result of competition from satellite, which they view as their true competitor. Satellite companies such as DirecTV and the Dish Network are eligible to provide video services without franchise agreements. Cable companies say that the similar rates between satellite and cable are in large part due to the programming fees demanded by the networks, which drive consumer rates. They argue that DirecTV has to pay the same for ESPN as Charter Cable, so those built-in costs will remain the same regardless of who the carrier is. The FCC study reports that satellite programming currently holds 27.7% of the market, which cable representatives argue is a significant share. Cable companies say that if cable prices truly were artificially high, satellite would be much less expensive.

Cable companies also point to their capital costs as a reason their rates have escalated. In order to meet consumer demand, some cable companies have taken on massive debt to upgrade their systems to provide service, which they argue accounts for rate increases. For instance they point out that Charter Cable has a large amount of debt, as they borrowed millions of dollars to upgrade service to their customers. When the large cable companies bought up all the small companies in Wisconsin decades ago, they generally paid a flat "cost per customer" fee, which included payment for the existing network. Since then, any upgrades to those systems were usually paid for through borrowing, which requires higher rates to retire the debt.

Cable operators are also concerned about the effect new entrants' service will have on the "build out" provisions of their current franchise agreements. They believe that certain telecommunication companies want to be more selective in offering service – in other words, they want to "cherry pick" the right kind of customers. Franchise agreements generally require service to be delivered to a certain percentage of households, which could pose a challenge for broadband video providers. Some cable company representatives believe this is the biggest issue that must be addressed if wire-based competition is allowed into cable markets.

Finally, cable companies point out that both state and federal laws state specifically that franchises don't have to be exclusive. Thus, they argue, competition can exist as long as new entrants are granted franchises by their municipalities. According to the Wisconsin Cable Communications Association, there are 25 communities right now that have competing cable systems (although if a company wants to compete, they have to run all new cables into each home). Often times, smaller entities like co-operatives and electrical companies provide cable services, usually in rural areas. Such is the case in Reedsburg, for example, where the electric company competes with Charter for cable customers.

TELECOMMUNICATIONS COMPANIES:

Telecommunications companies, reeling from the loss of land-based phone lines, are looking to branch out into new services to maintain their profits. AT&T has seen their number of retail wire lines decrease from 79.25 million in 2001 to 61 million in 2006 – a loss of nearly 23 percent.[17] The explosion of cell phone use, voice over internet protocol (VOIP) and the introduction of wireline competition (pursuant to the 1996 Telecommunications Act) has left companies like AT&T looking for new revenue generators.

According to AT&T's 2006 Annual Report, voice wireline operating revenues have dropped from 58% of total revenues in 2004 to 54% of revenues in 2006.[18] To combat the decline in wire-based phone customers, they have announced plans to invest $4.6 billion nationwide in their video based Project Lightspeed project, in addition to acquiring BellSouth, which gives them control of Cingular.

Locally, broadband companies argue that their video service does not fit the definition of "cable service," and therefore they should not be forced to negotiate franchise agreements.

In a position paper filed with the FCC in September of 2005, SBC (now AT&T) said:

> The cable franchise provisions apply specifically to "cable operators" that provide "cable services" over "cable systems." Those three key terms, moreover, are defined very precisely by reference to particular technologies and system architectures used to distribute video programming. Thus, cable service is limited to "one way transmission" of video programming to subscribers, "cable systems" are limited to transmission facilities designed to provide such one-way transmissions, and "cable operators" are narrowly defined as providers of such service using such systems.
>
> IP-enabled video services quite clearly fall outside the legal framework bounded by these distinctly defined terms. Legacy cable systems are inherently one-way closed transmission systems, designed to broadcast all video channels simultaneously to every household and business connected to those systems. In contrast, advanced broadband networks used to deliver IP-enabled video services, such as SBC's Project Lightspeed, are two-way networks that involve regular communication and interaction with customers in the delivery of video services, and are based on a client-server architecture similar to the architecture used by customers to access the Internet. In that architecture, and in contrast to a traditional cable system, a customer's set-top equipment must be in constant communication with the network. Moreover, these switched, point-to-point, IP networks are purposefully designed and ultimately capable of allowing customers to access a wide variety of video and other content on an on-demand basis.
>
> Accordingly, based on the specific terms of the Cable Act, it is a relatively straightforward determination that, as a legal matter, IP-enabled video networks such as Project Lightspeed are not "cable systems" designed to provide "cable services" and are thus not subject to the legacy cable regulations in Title VI that apply to "cable operators."[19]

Phone companies also point out the inequity in the way the federal law is currently written, pursuant to the Cable Act of 1996. While the act intended to foster competition by allowing phone companies to provide video service, it didn't alter the cable franchising structure. As a result, cable companies are now able to offer phone and broadband service without having to negotiate franchises with local governments, yet phone companies must endure a cumbersome process if they want to compete with cable on their turf.

Telecommunications companies also point to job creation as a significant benefit they will provide to communities. In February of 2007, AT&T announced plans to hire 200 new workers to staff call centers for their new video service. According to the AT&T Wisconsin president, the jobs would be unionized and represented by the Communication Workers of America.[20]

OTHER STATES

Several states have recently enacted franchise deregulation, and others are considering such legislation this session. In August of 2005, Texas became the first state to pass franchise reform legislation. Since then, California, Indiana, Kansas, New Jersey, North Carolina, South Carolina and Michigan have passed bills authorizing franchising frameworks at the state, rather than the local, level. Virginia and Arizona enacted a form of franchise reform without a statewide franchising requirement, and Louisiana passed a bill that was vetoed by their governor.

Following enactment of Texas' landmark bill, studies were conducted as to the effect of competition on cable rates. In March 2006, the American Consumer Institute surveyed cable subscribers in three communities where Verizon began offering their FiOS TV service. Their study found that within six months, 22% of those surveyed had switched providers and new competitors had captured nearly 20% of the market. Furthermore, the study revealed that subscribers switching services saved an average $22.30/month and even those who stayed with their original provider saved an average $26.83/month, presumably due to downward pressure on rates as a result of competition.[21]

Legislation that has passed on a state-by-state level generally shares many of the same features as the Texas legislation. To date, every new law that has passed has set up a statewide franchise fee to be paid by the new entrant, and directs those funds to the local franchising authority. New laws have also required new entrants to carry PEG channels – usually a minimum of three, some with PEG provisions based on population. Each new law has also prohibited municipalities from discriminating between providers by charging higher fees for access to rights of way, and has prohibited using the average income of certain areas as a reason for denying service to those areas.

Very few bills to date have included build-out provisions, and those that do are heavily qualified. For instance, Virginia's recently enacted law requires new entrants to provide service to 65% of a market area within seven years, but allows nine exclusions from this requirement. Exclusions in the Virginia law include provisions that exempt service from low-density areas of less than 30 homes per square mile, and areas where subscriber theft and nonpayment have traditionally been problematic.[22]

The U.S. Congress has also recently been involved in franchise reform efforts. In 2006, the "Communications Opportunity, Promotion and Enhancement (COPE) Act of 2006" passed the House by a 321-101 vote.

According to a Senate report on the bill, Title III of the bill:

> "reforms the process for obtaining a video franchise under current law and makes other changes related to the provision of video services to consumers. Specifically, the bill amends Title VI of the Communications Act to require franchising authorities to issue franchises pursuant to a standard franchise application form that would be drafted by the Federal Communications Commission (FCC) and to require franchise authorities to consider standard franchise applications within 90 days. Under the standard franchise agreement, franchise authorities would be permitted to require payment of up to 5 percent of gross revenues as a franchise fee, require payment for the support of public, educational, and governmental access facilities and institutional networks subject to limits established in this title, and provide certain channel capacity for public educational, and governmental use. In addition to provisions affecting the process of obtaining a video franchise, Title III also makes a number of changes to current law designed to create greater uniformity in the regulation of video service providers to eliminate unnecessary obligations. To address concerns about cherry picking competitive build-out, the bill enhances current red-lining requirements. Finally, the new framework for video franchising would apply not only to new entrants, but would also be available to incumbent cable operators either upon the expiration of their current franchise term or upon the arrival of a new competitive video service provider, whichever is earlier.[23]

While staunch proponents of competition in the video industry may be underwhelmed by the scope of the federal bill, some see it as the first step in nationwide reform. Other groups, such as the National Council of State Legislatures, oppose federal pre-emption of video franchising laws, arguing that states need to maintain the flexibility to implement the new laws as they see fit.[24]

The bill died in the Senate, as several democratic senators objected to the lack of inclusion of a so-called "net neutrality" provision in the bill. Such a provision would make it more difficult for internet providers to bundle information and services with their product, and does not have any significant relationship to the franchising issue. Many Democrats believe preventing providers from forming partnerships with software and online applications is necessary to facilitate open discussion on the internet, while Republicans have argued that online regulation stifles development and innovation.

ANALYSIS

Price Comparison

As noted, competition has lowered prices in areas where new entrants have been allowed. In 2004, the GAO, surveyed six markets in which broadband video provided competition to local cable providers. According to the study, communities with broadband competition saw lower basic cable rates of 23 percent, on average. In one broadband market, cable rates were 41 percent lower, and in two others, rates were at least 30 percent lower than when matched up with comparable markets.[25]

Furthermore, the FCC conducted a study in 2004 to determine savings associated with wireline broadband competition. For the twelve months ending in January 2004, the FCC found that average monthly cable bills were 15.7% lower in areas with wireline competition.[26]

There are a myriad of factors that determine whether broadband video competition provides savings for cable customers, which is why savings levels fluctuate between markets. Population density, subscriber computer use, and the extent to which new video providers are allowed entry into a market by the local government are all factors in the savings realized by competition. In 5 of the 6 markets surveyed by the GAO, basic cable rates fell between 15% and 41%[27]. If Wisconsin consumers merely realized a range of savings sampled from the GAO and FCC analyses, it could mean substantial rate reductions for cable service.

According to the Time Warner Southeast Wisconsin webpage, their most basic package, the DIGIPiC 1000 digital cable plan, sells for $53.99 per month. A 23% rate reduction would drop the cost of the plan to $41.57, for a savings of $12.42 per month, or $149.01 annually. If the FCC estimate of 15.7% savings were applied, consumers would see a $101.72 annual reduction in cable bills. Again, savings could be higher or lower based on market factors.

In Madison, Charter Cable raised rates 4.1% on their expanded basic package for 2007 to $49.99 per month. Similarly, a 23% reduction in monthly cable bills would drop consumers' bills to $38.49, for savings of $11.50 monthly and $137.97 annually. The more conservative FCC estimate of a 15.7% reduction would yield $94.18 annual savings for Madison area cable consumers.

Chart 2 shows a sampling of Wisconsin communities, the rates for expanded basic packages, and what consumers would save if the 23% average GAO estimate or the 15.7% annual FCC estimate were applied. Prospective annual savings for Wisconsin consumers range from $82.80 in La Crosse (at 15.7%) to $149.01 in Milwaukee (at 23%).

Chart 2

City	Carrier	Package Name	Basic Rate	23% savings	15.7% Savings	Yearly Savings Low Est.	Yearly Savings High Est.
Milwaukee	Time Warner	DIGIPiC 1000	$53.99	$41.57	$45.51	$101.72	$149.01
Madison	Charter	E-Basic	$49.99	$38.49	$42.14	$94.18	$137.97

Stevens Point/Wausau	Charter	E-Basic	$49.99	$38.49	$42.14	$94.18	$137.97
La Crosse	Charter	E-Basic	$43.95	$33.84	$37.05	$82.80	$121.30
Eau Claire	Charter	E-Basic	$49.99	$38.49	$42.14	$94.18	$137.97

Actual savings will depend on a variety of factors, including state legislation that would reform local franchising agreements. For instance, if legislation requires carrying public interest channels, it could restrict the savings seen by consumers, as it would cost the new entrant more money to operate in a market. If a new statewide framework imposed burdensome network building requirements on broadband providers, the capital costs of those build-out requirements could be passed on to consumers.

The FCC eschews the argument made by the cable industry that the 10-year 93% increase in cable rates is due to the addition of new channels to cable systems, since different channels are of different values. They rebut the cable industry's reliance on "rates per channel," by saying:

> The average rate per channel does not reflect the prices offered to consumers because cable operators do not permit consumers to purchase channels included in the expanded basic package on an individual basis, nor do they provide refunds to consumers who opt to have certain channels blocked. If cable operators offered consumers the option to purchase channels individually, it would be appropriate to consider the prices charged to consumers for those channels. Further, the use of the average rate per channel as a proxy implies that recently added channels are of equal value to previously existing channels. For example, the use of this data as a proxy would suggest that quality-adjusted prices would be unchanged if there were a 10 percent increase in monthly cable rates and a 10 percent increase in the number of channels; however, this does not take into account how consumers might value the additional channels. In particular, a consumer who placed no value on the additional channels would see a 10 percent increase in his or her monthly cable rates, but no increase in quality.[28]

The FCC report also takes aim at the cable industry's claim that the rate increases were necessary because of increased programming costs. The report compares programming costs for competitive and noncompetitive communities, and shows how much of the increases are attributable to the increased programming costs.

In the non-competitive markets (which would include nearly all of Wisconsin), the FCC found that the increase in programming costs made up 51% of the overall increase in cable rates. In areas where there was effective competition, that percentage was much higher. For instance, in communities where direct broadcast satellite (DBS) is competitive, increased programming costs made up 70% of rate increases, while in areas with a second cable provider, programming costs ate up 74% of rate increases.[29]

This can be explained primarily by the fact that rate increases were smaller in competitive locations. Thus, an equal increase in programming costs will show up as a larger percentage of costs in areas with smaller rate increases. Companies in competitive markets have less leeway to increase rates. Yet these companies are still able to provide service in an efficient and cost-effective manner to serve their customers. The fact that programming costs only constituted 51% of rate increases for noncompetitive areas leads one to wonder what the other 49% of the increase is for.

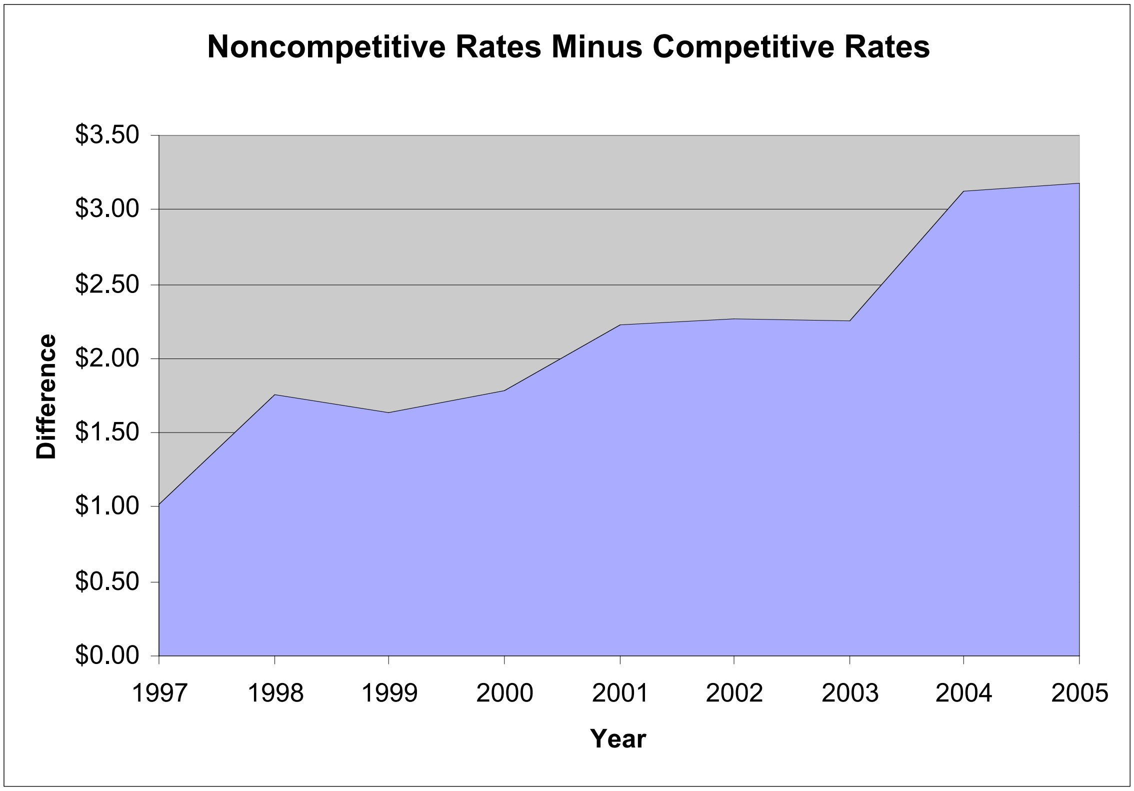
In their 2004 testimony before the U.S. Senate Committee on Commerce, Science, and Transportation, the GAO offered some explanations of why cable rates may be increasing at such a high rate. They note that programming costs are increasing at a quick rate, especially sports networks. However, they also point out that cable company advertising revenue has been increasing, which has offset some of the cost to consumers. Of the cable companies they surveyed, the GAO estimated that advertising revenue was able to offset nearly 31 percent of their total programming costs.[30] They also point out that many cable companies are seeing increased revenues from broadband and phone services, which should further offset increased programming costs.

According to the FCC report, cable rates are lower in communities where a statutory definition of "effective competition" is met.[31] These are communities where a second cable company is permitted to operate, where a sufficient number of homes have DBS service, where the incumbent cable operator has low penetration, or where a wireless operator provides service.

While rates weren't significantly lower in communities where satellite was the primary competitor, prices were dramatically lower in areas where a second cable operator was able to function. In noncompetitive communities, prices were 20.9% higher than in communities where a second cable company operated.

Chart 3 details the growing difference between the average monthly cable price in competitive markets versus noncompetitive markets. In 1997, competition saved consumers $1 per month. By 2005, that savings had tripled to over $3 per month. Clearly, cable costs in noncompetitive markets are growing at a faster rate that in markets where there is competition, as the spread between the two increases.

Chart 3



Source: FCC

The fact that DBS broadcasting has yet to provide effective competition to cable does not prove that broadband video service cannot, as the cable industry claims. DBS service is a completely different type of service, with unique challenges and barriers to attracting customers. For instance, customers must purchase a satellite dish system and have it installed on their home. For customers who don't own their own homes or live in condominiums, whether they can even set up a dish is at the discretion of their landlords or condo boards. It was only a few years ago that home satellite systems were so expensive as to be out of reach for most consumers, yet viewership is now growing with the drop in system costs.

The FCC report points out that in 2005, average equipment and installation charges are higher for DBS than cable.[32] Furthermore, fewer consumers subscribe to the DBS expanded basic package than cable's (88% to 84%). If DBS providers continue to make strides in reducing the overhead cost of equipment, they will be able to pass those savings on to consumers and provide more competition in the future.

Other Benefits of Competition

Competition also has benefits to consumers beyond simply price. When companies are forced to compete for customers, service also improves. As noted by Diane S. Katz of the Mackinac Center for Public Policy in Michigan, cable companies garnered lower customer satisfaction scores than the Internal Revenue Service in a recent nationwide survey. While survey respondents thought prices were too high, they also complained about service quality.[33]

According to the GAO broadband report, some local cable providers responded to competition by improving their customer service effort. One cable company initiated door-to-door visits with customers to discuss picture reception quality and answer questions about their service. [34]

Competition also gives consumers more choice in terms of programming options. When a single cable operator is allowed in a community, consumers are limited to whatever programming package their cable company offers.

This problem came to a head in Wisconsin in December of 2006, when the Green Bay Packers were scheduled to play an NFL Network-televised Thursday night game against their NFC North rivals, the Minnesota Vikings. Not only were the Packers still alive for a potential playoff spot, but it was entirely possible at the time that it could have been the last home game of the revered Brett Favre's career.[35]

Most major cable companies in Wisconsin didn't carry the NFL Network due to contractual disagreements with the network. Thus, the only way a Packer fan could see the game was to either buy a scalped ticket, go to a bar with satellite, or have DirecTV come to their house and set up a satellite so they could watch this one game.

According to AT&T, the NFL Network is available in Milwaukee on their "U-200" package, which includes 190 channels and high speed internet for a base price of $74 per month.[36] According to Time Warner Cable's website for Southeast Wisconsin, the NFL Network isn't available on any of their packages.[37] Verizon offers the NFL Network on their FiOS "Premier" base package, which costs $42.99 per month.[38]

This lack of choice, of course, made Wisconsin citizens furious. U.S. Congressman Ron Kind even sent a letter to the NFL urging them to make the game more widely available, calling the NFL's decision "ill-considered and financially-motivated." [39]

Ironically, the day after Kind wrote his letter to the NFL Network urging them to make the game more widely available, U.S. Senator Russ Feingold wrote his own letter to FCC Chairman Kevin Martin protesting an FCC decision to promote more competition for cable. In his letter, co-signed with Representative Tammy Baldwin, Feingold says FCC support for easier video provider entrance into marketplaces would "threaten the public interest by limiting support for local public, educational and governmental (PEG) channels and institutional networks (INET), and allowing companies to exclude parts of a community from receiving service."[40]

Feingold's letter supports the antiquated notion that government should be in the business of deciding what people should watch. Mandating that video providers carry PEG channels supposes that a small group of individuals knows what the public should be watching, whether viewers actually tune in or not. Video service subscribers pay for the delivery of these channels through higher monthly bills.

Since the content on some local public access channels can generously be described as questionable, local governments must mandate their inclusion on video systems to keep them alive. A Madison public access channel carries fringe programming such as "The LaRouche Connection," "Astrology, the Universe, and You," "Vegan Vixens," and "Disc Golf – LIVE!"[41] However, satellite providers aren't bound by franchising requirements, and generally don't carry PEG channels as a result – which gives them a competitive advantage.

Finally, another benefit to Wisconsin in expanding the video marketplace is the increased availability of new technologies to areas that may currently be underserved. For years, Wisconsin has been attempting to legislate incentives for broadband companies to provide service to rural areas. Sparse rural populations often make it less feasible economically to build high-speed internet service to homes in low-density areas. In 2003, Wisconsin enacted a law that provided a tax credit to businesses that provide service to previously underserved areas. Later that year, a bill was signed into law that limited the ability of municipalities to provide broadband service, in an attempt to spur on private investment in new networks.

Allowing companies that offer broadband video into previously underserved markets will encourage deployment of new technologies to that area. These services provide phone, video, and high-speed internet service that may or may not be offered by the local cable provider.

Franchise Fees

Any discussion of increasing video competition in Wisconsin must deal with the issue of franchise fees, which constitute a "hidden tax" on cable consumers. As noted, franchise fees are paid by cable operators to local governments for the right to operate within that municipality's limits. Generally, franchise fees are set at 5 percent of a cable company's gross receipts. According to the National Cable and Telecommunications Association, cable companies paid $2.8 billion to local governments in franchise fees nationwide in 2006.[42]

Cable companies pay $45 million per year in franchise fees to local Wisconsin governments.[43] In actuality, the $45 million paid to local governments is borne by Wisconsin consumers. This amounts to a tax on their cable service. And until now, consumers didn't have the opportunity to avoid paying the fee. Pursuant to Wisconsin law, municipalities are free to spend the $45 million in any way they see fit.

The justification for franchise fees has long passed. Initially, franchise fees were charged to cable companies for the use of rights-of-way, and they pay for that access. However, phone companies such as AT&T and Verizon already have access to the rights-of-ways through their phone service. Furthermore, cable companies can expand their service to include broadband and phone service without being assessed additional franchise fees, even though those services require expanded use of municipal rights-of ways. Requiring fees from phone companies looking to provide cable merely serves to protect the incumbent cable provider and thwart competition.

Franchise fees stand out as an anomaly in the telecommunications industry, as no other services have to form such an agreement on a municipal level. In a perfect world, franchise fees wouldn't be necessary. They discourage competition and create artificially high prices for video service. However, if competition caused a reduction in franchise fees, it is likely that local governments in Wisconsin would raise property taxes to make up for the lost revenue. For local governments, the most germane issue with competition is the potential loss of franchise fee revenue. According to the Wisconsin Taxpayers Alliance, total municipal property taxes in 2006 were expected to be 2.02 billion. If property taxes had to be raised to make up a $45 million loss in franchise fees, it would require a 2.2% property tax increase statewide.

That scenario would only be necessary if franchise fees were eliminated altogether, which is unlikely. Another scenario involves broadband providers providing video service without paying a fee and slowly eating away at cable companies' market share, in the manner that satellite TV currently does. If this were the case, local governments would see a slow erosion in the amount of revenue collected via the franchise fee, as BSP providers gained more and more of the market within a municipality.

A statewide scenario would occur if BSP providers agreed to pay a fee, as has been done in other states that have enacted franchise reform. This could be done in the form of an agreement between the BSP and the municipality, or it could be dealt by setting up a new framework in state law. BSP providers have not opposed paying franchise fees in other states where franchise reform has been enacted.

Wisconsin municipalities have made it clear that if such a framework is constructed, the revenue from the new fee should go back to the franchising body. Since such legislation would also likely set up a statewide franchising framework, municipalities are worried that the fees could conceivably be sent to the state, rather than the local authorizing government. As noted before, nearly every bill passed nationwide to date assesses a fee to BSP providers and returns that fee to the local franchising entity.

By protecting the current franchising system, Wisconsin municipalities might actually be limiting their revenue. Numerous studies have shown that when competition is made available in video markets, the total number of subscribers to video services increases.[44] In some cases, it is the lower prices that lure people to become subscribers where they weren't before. In other cases, the new network infrastructure reaches individuals more quickly than it had when there was only cable provider. If BSP providers agree to pay franchise fees, it is conceivable that revenues to local governments would increase.

However, even if municipalities realize new revenue through expanded viewership, it still begs the question of whether fees should be assessed. The theoretical determination that franchise fees are unnecessary clashes with the practical consequences if the fees are not charged. If these fees are not assessed, municipalities will likely fight any new entrant with endless litigation, which would delay implementation of the new service. Some municipalities have indicated that if they don't sue prospective new entrants to keep their service out, they risk being sued by the incumbent cable provider for violating the current franchising agreement.

As the previously cited studies show, consumers benefit greatly from increased competition in the video service market. In some cases, cable bills drop by at least 20 to 25 percent when competition is introduced – which would more than make up for any fee assessed to a new provider. If the offer of new revenue to a municipality is enough to encourage them to let a provider operate more quickly, then that deal is worth it to consumers. Competition delayed is competition denied – which is bad news for video subscribers. Even if a fee is assessed to BSP providers (and therefore consumers), the effect of instant competition is likely more than enough to offset the fee, leaving customers well ahead on total savings.

Build-Out Provisions

One of the most contentious issues with regard to cable franchise reform is the extent to which new entrants to a market are required to provide their service within that market. These so-called "build-out provisions" make a substantial difference in whether it is economically feasible for a new entrant to provide video service in a given market. In order to build their networks, broadband providers currently have to install large boxes in the rights of way to transfer the high speed signal via digital phone line. Often times, build-out provisions can be the tools used by municipalities to deter competition, thereby preserving existing exclusive franchise agreements.

A build-out provision in a franchise agreement generally requires a provider to build their network out to a certain percentage of the market. This is intended to prevent new video companies from "cherry picking" customers, or providing service to only a select few. Cable build-out agreements mandate that nearly all consumers in certain areas be provided the opportunity to purchase service.

In application, build-out provisions have become the means by which municipalities deter competition. In a free market system, a new competitor would be able to provide a service in whatever geographical area they want. However, the antiquated regulatory system that oversees cable television is not a free-market system.

The United States Department of Justice has recommended that no build-out provisions be a part of agreements with new entrants, due to the deterrent effect they have on competition. In an ex parte memo to the FCC, the DOJ says:

> A number of factors inform a potential entrant's decision whether to serve a particular geographic area, such as population density, local construction costs, the characteristics of the technology to be used, the ability to use existing facilities, and potential revenues. And, of course, earnings are affected by the existence of other providers and, for new entrants, the costs of competing to attract customers away from incumbent providers. Build-out requirements that impose on an entrant the obligation to serve a geographic area that the entrant had concluded would be uneconomical to reach can lead to the entrant abandoning its plans for the entire area or, if the entrant agrees to the condition, result in competition being less vibrant or efficient. When the entrant agrees to such a build-out requirement, prices may be higher than they would be otherwise, due in part to the entrant's increased construction costs or inability to make optimal technology choices, or because the area cannot economically support another competitor.[45]

Municipalities often force new entrants to sign extensive build-out clauses that require a substantial initial capital investment. Build out clauses require broadband video companies to finance for a network that they don't even know will be successful, to communities where they don't know if their product will sell. Drawing service areas through the municipal governmental process, rather than allowing a company to follow through on its business plan, deters new entrants from entering a market.

In addition to deterring entry into a new market, build-out provisions also keep prices artificially high. Requiring new entrants to overextend their network building plans forces the costs of that network on to the new subscribers. This prevents prospective competitors to cable companies from initially offering rates as low as they'd like, since they have to pay for a network that may not be used for years.

Cable companies argue that they were subject to build-out provisions when originally granted their franchises. Municipalities believe that build-out agreements are necessary to guarantee access to low-income and low-density populations. Under the 1984 Cable Act, it is permissible for municipalities, through the franchising process, to "assure that access to cable service is not denied to any group of potential residential cable subscribers because of the income of the residents of the local area in which such group resides."[46] Municipalities argue that without mandating service in lower income areas, only wealthy, high-density areas will be able to receive the video services.

Ironically, the supposed concern for whether certain groups of people will receive service actually hurts the chances of those individuals being provided service. Unrealistic build-out provisions serve as a barrier to entry for potential competitors, who may decide that it's just not worth the initial investment to provide service in a given area. Thus, low-income and rural consumers who are supposed to be guaranteed competition end up getting no competition at all. Without build-out provisions, those consumers would likely get service, but only after a new entrant can set a solid financial foundation and branch out to those areas.

Some municipalities have been able to compromise with new entrants by offering what are known as "success-based" build-out provisions. Under such an agreement, a new entrant would be required to build their network out on the condition that their product is selling. If their product isn't selling, the build-out provision would be cancelled.

Municipalities and incumbent cable providers often make the argument that franchises and build-out requirements should be necessary for phone providers to achieve "symmetry" between the two systems. Cable companies argue that they were subject to build-out provisions when they signed their franchise agreements, and to truly be competitive, phone companies getting into the video business should be subject to the same regulations. Others may argue that build-out provisions promote competition, since more consumers would have the network available to them than if the phone companies started small and expanded into a market.

Some states actually have "Level Playing Field" statutes, which mandate that local governments may not issue new franchises that are less burdensome than the franchise owned by the incumbent provider. These states include Alabama, California, Connecticut, Florida, Illinois, Kentucky, Minnesota, New Hampshire, Oklahoma, Tennessee, and Virginia. While Level Playing Field laws prohibit less burdensome franchise requirements for new entrants, they generally do not outlaw more burdensome requirements for new providers. This means municipalities are welcome to impose tougher restrictions on prospective competitors if they intend to protect the incumbent.

George Mason University economist Thomas Hazlett addresses the issue of "symmetry" with regard to build-out provisions in his paper "Cable Franchises as Barriers to Video Competition." Hazlett points out that the basic justification for franchise agreements has shifted. He says:

> It is crucial to note, at the outset, that the "symmetry" argument now serves to justify franchise obligations for entrants even as the original rationales – natural monopoly and rate regulation – have disappeared. The premise of regulation has flipped from *consumer* protection to *incumbent* protection. Incumbents would be harmed financially under rules resulting in greater competitive system build-out; that they ardently support such obligations for entrants is compelling evidence that the mandates are expected to reduce the scope of head-to-head competition altogether. [47]

With regard to the cable industry's desire for "fairness," Hazlett points out that existing cable systems took decades to construct. Often times, existing cable networks were built before any franchise was created (federal law made franchises mandatory in 1984). Even when cable companies are supposed to abide by build-out provisions, it is unclear how many actually do so. According to an analysis conducted by Hazlett, two-thirds of California cable companies had failed to live up to their build-out requirements during their five-year agreement terms.[48] Thus, if the goal is to enact "equal burdens" relating to build-out on new entrants, how will that be measured if the incumbent isn't living up to their deal? Ironically, incumbent cable companies would assuredly litigate to make sure a new entrant was meeting their build-out obligation, while the incumbent likely had a great deal of leeway in actually living up to their own build-out requirement.

Hazlett also points out that supposedly "symmetrical" franchising provisions are actually asymmetrical when applied to new entrants. Specifically, build-out requirements are financially more onerous on new entrants who are not first into a market. Building a network is much more financially feasible when there is no competition, since a monopoly is likely to have a built-in consumer base. When cable companies initially built their infrastructure, they were the only way customers could get cable-type programming. Customers were easy to come by, since they were the only game in town – so building a network was likely a profitable endeavor.

The obsolescence of Level Playing Field build-out requirements is demonstrated by the cable companies' own successes. The Telecommunications Act of 1996 paved the way for cable companies to branch out into providing both voice and broadband services. As a result, cable companies now enjoy the ability to provide phone and data service to whomever they want without having to obtain onerous franchise agreements. This means cable companies providing phone service aren't subject to any sort of "universal service" agreements, to which they insist phone companies that provide video must adhere.

When cable companies began offering telephone service, they did so only in selected markets, in order to build a profit base before expanding service. Rural areas and business customers were often avoided, as the profit margin didn't make if feasible for cable companies to provide service. As Hazlett points out, the practice of offering selective service based on economic factors is called "red-lining," which is exactly what cable companies accuse prospective video competitors of likely doing.

Some may argue that allowing companies to provide video service to certain sub-markets at their own pace will disadvantage consumers in areas they choose not to serve. Studies have shown that providing competition in one sub-market doesn't raise rates in nearby sub-markets.[49] Furthermore, if competition is forced through build-out provisions in markets where it isn't economically viable, there may be no competition, as the new provider may not be able to afford to provide any service within the market.

So while limited competition in a market may not impact consumers equally, it will provide price relief to those consumers that are able to get service initially. As a new entrant gains customers and branches out, other areas will get service and see the benefits of competition. However, inflexible build-out provisions will make sure nobody receives the benefits of competition, as they could likely deter a new company from providing service.

Build-out provisions impose an undue burden on new entrants to a video market, and serve as the means to prevent competition in markets that choose to impose them. The quickest way for a municipality to ensure new service to underserved areas is to allow companies to grow their product at their own pace. Forcing them to build an infrastructure without customers only guarantees that those individuals will never get service, as new entrants will likely decide the cost of providing new service isn't worth the potential economic benefits. The only way to provide competition is to allow competitors the easiest path of entry into a market – which build-out provisions prevent.

Statewide Franchising

Existing law that requires new entrants to negotiate franchise agreements at the municipal level serves as a barrier to competition. Any new entrant into the video market would have to negotiate over 1,850 separate franchising agreements just in Wisconsin if they had to do so on a municipality-by-municipality basis.[50]

As noted before, delaying competition clearly hurts consumers. The sooner new entrants are allowed in local markets, the sooner consumers will see the benefits of lower prices, better technology, and improved customer service. Forcing BSP companies to negotiate thousands of agreements constructs a barrier to consumer relief.

Statewide franchising agreements also standardize the franchise fee framework. While federal law caps franchise fees to 5 percent of gross video revenues, municipalities have leeway in determining what constitutes "gross revenues" for a provider. Some municipalities include local advertising revenue, commissions from home shopping networks, and fees paid by cable network programmers to local providers in the definition of "revenues."[51] Creating a statewide franchising framework would set a uniform statewide definition of revenues, which will give new entrants more certainty in what their costs are likely to be.

A statewide franchising system could also serve to benefit incumbent cable providers. Some states have included provisions in their franchise reform laws that allow an incumbent cable operator to obtain a statewide franchise upon entrance of a competitor in their service area. Others merely require cable operators to obtain a statewide franchise when their current franchise agreements expire.

Such an arrangement removes the ability of municipalities to deny new cable companies the ability to provide competition within their market. However, the natural barriers to entry for a new cable company would still exist, as the incumbent cable company would continue to own the existing infrastructure. The only way true competition between traditional cable companies can exist is if there is a line-sharing agreement is mandated, similar to the wire-sharing that occurred with phone companies in the 1996 Telecommunications Act.

As previously noted, all state franchise reform legislation to this point has set up a statewide franchise fee to be paid by the new entrant, and directs those funds to the local franchising authority. Thus, while the franchise is granted statewide, local governments continue to collect the revenue that they currently realize from existing cable franchise agreements. This has likely been a key point in municipalities' acceptance of statewide franchising arrangements.

Finally, the idea that municipalities need to regulate video services on the local level has become outdated. Satellite video providers have proven that franchising is not necessary to ensure quality service, as they are not required to obtain franchises.

The Future

Just as previous video industry regulation grew outdated as technology developed, so will any law changes currently being considered. While broadband television service is a new and exciting technology now, it may only be a few years down the road that technology exists to bundle television, phone, and data service wirelessly. In fact, in March of 2007, Verizon announced plans to stream television programming from eight major networks directly to cell phones.[52]

Some would say that satellite television already represents a wireless network at work. While there is no wire running to a consumer's home, there are still barriers to obtaining satellite service. First, a consumer must have a home where they can put a large satellite dish. Secondly, they must have a south-facing view of open sky. Finally, there are costs associated with purchasing the equipment necessary to receive satellite service.

Furthermore, satellite companies currently do not offer data and phone service. Bundling of services will be important when wireless networks are developed, as consumers will likely see reductions in rates when products are bundled. Also, satellite service is fixed to a consumer's home. It's not too distant in the future when consumers will be able to receive premium television service on their laptop computers and in their cars. Communications companies are already offering phone and data service wirelessly – how far behind can television service really be?

Clearly, phone companies are betting that hard-wired networks will remain viable in the near-term future. AT&T reports capital investments of $4.6 billion to construct its new wire-based video network nationwide. Certainly, they have done cost/benefit analyses and have determined that the expensive new network is worth it for them.

But what if wireless technologies develop quickly? New broadband video services could merely be a stepping stone to a wireless system that would render the wire-based service obsolete. Current new systems could merely be a transitional phase – much like the advent of the cordless phone era was a brief period between hard-wired phones and completely wireless cell phones.

When society goes completely wireless, it will render the current franchising regime obsolete. Consequently, it will render the laws currently being considered around the country obsolete, as they generally retain franchising agreements, just in different forms. Companies will be able to compete for customers no matter where the consumers reside, much like digital phone service today. As a result of that increased competition for consumers, rates will likely drop, service will improve, and consumers will be offered more programming options.

When current lawmakers look at current deregulating legislation, they should also pay attention to issues that will arise in the future. For instance, a wireless society will eliminate all the revenue for local governments through franchise fees. It is imperative that both local and state governments have a plan in place to address this funding shortfall when it happens (it could already be happening gradually with the growth in satellite service).

Any legislation should be wary of the effect it will have on competition from multiple companies in the future. Competition among several companies is good for consumers, not just when a single company has an interest in breaking into a market. Lawmakers should keep this in mind when drafting specific legislation designed to help a single provider.

SUMMARY

In the fast-moving world of technology, governmental policies have become antiquated and cumbersome. Laws requiring monopolistic cable franchises have become relics of a bygone era, and have served to retard investment and innovation in video services.

Wisconsin can reverse this trend by encouraging statewide video franchising reform. Providing consumers with a choice in video services will improve prices, encourage better customer service, and trigger more investment in innovative new technologies. Such a change will make new technology available to customers who previously could not access cable or high-speed internet services, and could provide municipalities with extra revenue, depending on how the framework is structured.

Furthermore, the extent to which competition is effective depends largely on how much competition is allowed. Build-out provisions, forcing new entrants to carry PEG channels and other mandates obstruct many of the benefits true competition can provide. Erecting barriers to new competition does not guarantee more consumers will see the benefits, as some suggest. Instead, making competition more burdensome only makes it less likely that any consumers within a market will be able to benefit from the cost savings associated with franchise reform.

Franchise fees pose a unique challenge for proponents of more competition within the video industry. The fees represent a tax on consumers, keep rates artificially high, and thwart effective competition. Conversely, new video entrants have calculated that paying the fee is in their best interest, as it allows them the ability to provide competition more quickly within a market. When the fees are paid, municipalities are less likely to obstruct their entry into a market, which allows for speedier competition. As previously noted, the benefits of competition to consumers often far exceed the extra fee they must pay on their bill as the franchise fee is passed on to them. Therefore, consumers are better off the sooner they are allowed a choice in video service.

Future technological advances will likely render the current franchising system obsolete within years. Even bills that are passing state legislatures today are likely to be outdated when wires cease to be the data delivery method of choice. While new laws providing video competition to cable are beneficial to consumers now, they should consider what new technological advances could mean in the future, and what effect that will have on consumers.

ENDNOTES

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APPENDIX A

Wisconsin Statute 66.082

66.082 Regulation of cable television by municipalities.

(1) LEGISLATIVE FINDINGS

(a) The legislature finds that :

1 . The federal cable communications policy act of 1984 authorizes, and, for systems installed and services provided after July 1, 1984, requires, the award of a franchise to a cable operator .

2. The practice of individual municipalities in this state prior to December 29, 1984, requiring a franchise for operation of a cable television system within their respective boundaries conformed to the policy and regulations issued by the federal communications commission.

3. Prior to December 29, 1984, federal law did not prohibit requiring compensation for operation of a cable television system in a city, town or village.

4. The federal cable communications policy act of 194 authorizes a city, town or village to impose a limited franchise fee based on the gross revenues a cable operator derives from operation of a cable television system in the city, town or village.

5. Section 637 of the federal communications policy act of 1984 reaffirms the authority of cities, towns and villages to award cable television system franchises and maintains the integrity of existing franchises.

6. Regulation of cable television services by cities, towns and villages is necessary to ensure citizens adequate and efficient cable television service and to protect and promote public health, safety and welfare .

7. It is in the public interest to maintain the authority of cities, towns and villages to grant and revoke cable television franchises, require the payment of franchise fees and establish rates charged to customers by franchise holders .

(b) In this section the legislature intends to :

1 . Clarify the legislature's position on certain antitrust and franchise fee and other compensation issues which affect the cities, towns and villages of this state, which are related to the regulation of cable television services and which have arisen in recent state and federal court actions.

2. Reaffirm the policy of the legislature, which is to provide that the exercise of the police power of this state concerning cable television service remain in the cities, towns and villages of this state.

3. Authorize cities, towns and villages to impose franchise fees for the purpose of raising general revenue.

4. Maintain the spirit of the compromise between the cable industry and municipalities effected under the federal cable communications policy act of 1984, the enactment of which the municipalities agreed to support because it provides for their clear right to impose and collect a limited franchise fee based on cable operator income or gross revenues.