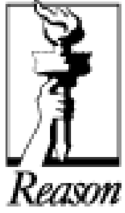
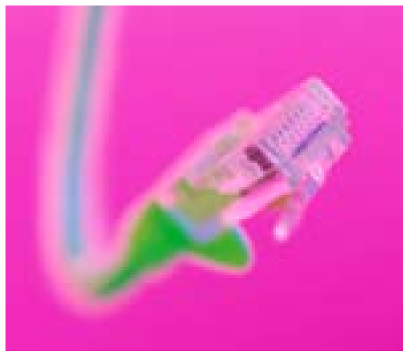


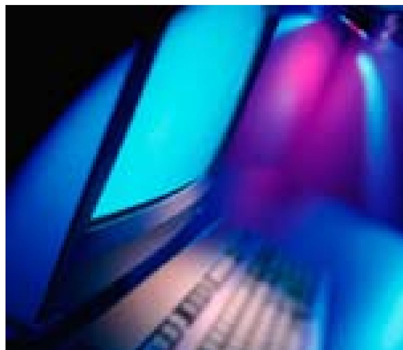
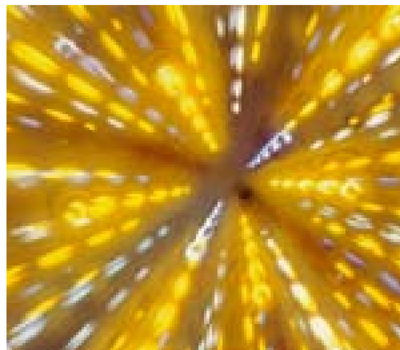
January 2007

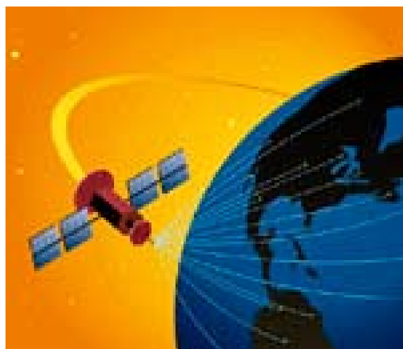
Better Prices and Better Services for More People:

Assessing the Outcomes of Video Franchise Reform

By Steven Titch





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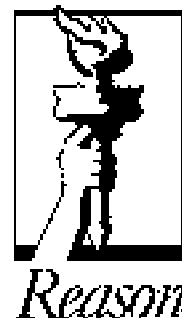

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Better Prices and Better Services for More People: Assessing the Outcomes of Video Franchise Reform

By Steven Titch
Project Director Adrian Moore

Franchise reform, the movement to replace local regulatory regimes that govern legacy cable monopolies with statewide franchise agreements that encourage competition and improved service, has taken on new urgency. Encouraged by telephone companies eager to provide an array of new broadband video services to anxious customers, ten states—Texas, Indiana, North Carolina, South Carolina, New Jersey, California and Michigan—have enacted bipartisan franchise reform since 2005.

Franchise reform lowers the legal burdens traditionally imposed by local franchise agencies. These agencies have long regulated local cable monopolies by creating a single statewide franchise application process through which companies can gain access to the entire state's market. In addition, franchise reforms restrict or eliminate the sometimes arbitrary concessions imposed by local franchise agencies. Franchise reform, however, does not eliminate the fees which are paid by cable or video broadband providers to local franchise agencies.

Where enacted thus far, franchise reforms benefits have been undeniable. Consumers have enjoyed greater choice and a range of new services, including on-demand video and "a la carte" content selection, at lower cost. Legacy cable providers have responded to new competition by lowering costs and improving service.

While critics of franchise reform predict that statewide reforms, which lack build-out provisions requiring broadband providers to serve low-income communities, will privilege wealthy households at the expense of the poor, such concerns have not been borne out by experience. New

broadband providers, including AT&T and Verizon, have deployed high-speed broadband services to wealthy and low-income neighborhoods alike.

Finally, while local governments that depend upon franchise fees for tax revenue have not been harmed by franchise reform, long-term technological trends suggest that municipalities would do well to wean themselves from franchise fee dependence sooner, rather than later.

The benefits to consumers, including greater choice, improved service, and lower cost, require remaining states to bring reforms that help end local monopolies and usher in widespread broadband adoption in the United States.

Table of Contents

Video Franchise Reform—An Idea That's Caught Fire 1

Competition Happens 5

A. Texas 6

B. Indiana 7

C. Other states 8

Build-Out Happens 11

Local Tax and Regulatory Hegemony 14

About the Author 16

Endnotes 17

Part 1

Video Franchise Reform—An Idea That's Caught Fire

Now that more than a year has passed since the first franchise reform bill was passed, debate on the outcome of such legislation is no longer limited to the hypothetical and theoretical. The evidence that franchise reform results in accelerated competition, improved service and an increase in the overall value of bundled cable TV, telephone and high-speed Internet services is clear.

At the same time, new entrants are targeting all market segments, countering the assertion by franchise reform opponents that newcomers would target only the upper-income demographics and any benefits of competition would be limited only to well-to-do neighborhoods.

Franchise reform legislation seeks to accelerate cable TV competition by shifting the approval of video franchising—essentially authorization to provide cable service in a given market—from local authorities to the state level. Historically, franchising authority resided with local community and municipal agencies. Nationwide there are some 33,000 municipal franchise authorities, most estimates say, although in some cases several authorities will band together to negotiate with a cable service provider with a footprint that covers the collective territory. Statewide franchising pre-empts the need for new entrants to negotiate individual franchise agreements with local municipal authorities, and gives them immediate permission to launch services anywhere in the state.

As of December 2006, ten states had approved franchise reform legislation. Eight of these states, Texas, Indiana, Kansas, North Carolina, South Carolina, New Jersey, California and Michigan, created statewide video franchising processes. Virginia stopped short of creating a statewide process because of state constitutional restrictions. The Arizona legislature streamlined and codified the franchise application process. In both cases, each state established a basic framework for local franchise agreements that municipalities will use going forward.

In a eleventh state, Louisiana, statewide franchising passed both houses of the state legislature by near three-to-one margins, but the measure was vetoed by Gov. Kathleen Blanco out of concern that it might lead to a decrease in local franchise revenues.

In the U.S. House of Representatives, the Communications, Opportunity, Promotion, and Enhancement Act of 2006, a bill that would create a national franchising structure, passed 321-101. Franchise reform also was a provision in a telecom deregulation bill pending in the U.S. Senate, but the 2005-06 session adjourned without scheduling a vote.

In a separate but equally significant development, two states ruled that telephone companies do not need video franchises. In Connecticut, the Department of Public Utility Control ruled that existing right-of-way rules, regulations and fees that already apply to phone company networks do not change just because video programming, as opposed to merely phone calls, is now being transmitted over the network. Oklahoma's Attorney General reached the same conclusion in that state.

Compared to most other policy initiatives, especially in telecommunications, video franchise reform has evolved relatively rapidly. Sparked largely by the move of the nation's largest telephone companies—Verizon Communications and AT&T—into cable TV and cable-like multichannel video services, in less than a year franchise reform initiatives have earned bipartisan support. Republican officeholders spearheaded the first initiatives in Texas and Indiana, but, as witnessed by the overwhelming passages of bills in states like California and Louisiana, where Democrats control the legislature, franchise reform is coming to be seen less as a partisan issue and more as pro-consumer policy.

Franchise reform is coming to be seen less as a partisan issue and more as pro-consumer policy.

The franchise process dates from a time when cable TV was a government-sanctioned monopoly regulated by local government. In return for an exclusive right to offer cable TV services to all residents, cable franchisees agreed to pay a percentage of "gross video revenues" to a local franchising authority as well as set aside space on the system for public, educational and government (PEG) channels. The arrangement suited both parties. Cable service was infrastructure-intensive. It required significant investment in transmission and distribution facilities, namely the cable lines that reached every home, often over leased right of way, as well as a local "head-end," the operations facility where the cable company maintained its satellite dishes that received TV programming from network satellites and sent it down the cable to customers. Like many other infrastructure-dependent services, like water and electricity, policymakers assumed that cable was a natural monopoly—that any competitive network overlay was redundant and unnecessary.

Cracks in that assumption appeared with the introduction of direct broadcast satellite (DBS) services such as DirecTV and Dish Network. These services bypassed cable infrastructure by offering consumers a small satellite dish they could mount on their roof or the side of their home. Since there was no local transmission or distribution component, the Federal Communications

Commission (FCC) ruled that DBS services were not subject to local franchising rules. Offering consumers a choice in multichannel video service providers, DBS had acquired 27.7 percent of the cable market as of 2005, according to the FCC.[1]

DBS was the first example of technology undermining the traditional cable TV monopoly. The erosion of cable TV's monopoly has quickened pace and is making ever clearer that the only remaining argument for video franchises is local government's unwillingness to give up a revenue source.

While competitive in terms of TV services, DBS, however, falls short when it comes to the so-called bundling of telephone and broadband, or high-speed Internet connections. The cable companies made inroads in both, launching cable modem service in the mid-1990s, and gradually moving into telephone competition, first through resale of phone company lines and, more recently, through Voice over Internet Protocol (VoIP) technologies that route phone calls over their own cable networks and through the Internet.

This evolution toward bundled phone, broadband Internet and cable services, referred to in the industry as "triple play," will drive the future business development of both the cable and telephone companies that now compete with each other for the consumer home entertainment dollar. For several years, telephone companies have been steadily losing revenues from their core phone line business as consumers adopt wireless and VoIP alternatives. Their future growth depends on how well they compete in triple play. And the most important component of this package is video.

Hence, the telephone companies are aggressively pushing for franchise reform in all states. While many legislators have become jaded because phone companies have been promising video deployment for years, developments show that, at long last, the industry is following through.

Within the past year, Verizon has launched its fiber-to-the-home service (FiOS) to 500,000 homes, accounting for half of the 1 million homes now served by fiber.[2] FiOS will pass the 6 million home mark by the end of this year, the company told investors in September.[3] Verizon has committed $18 billion to the project, a figure that even the company's own shareowners consider very bold.[4]

AT&T has rolled out its television service offerings in the form of U-Verse IP video over digital subscriber line (DSL), supported by its $4 billion Project Lightspeed fiber-to-the-node initiative in San Antonio. While rollout has been slower than expected, AT&T maintains it is on track to introduce U-Verse in Houston in November and a total of 15 markets by the end of 2006.[5]

U-Verse will offer triple-play services to customers and access to an array of new Internet and TV options.

The reality of cable competition is getting legislative attention, as is the willingness of the telephone companies to move forward in states, such as Florida and New York, where franchise reform is either stalled or not yet on the docket. As these projects move forward, the consumer benefits of competition become undeniable. Franchise reform can only deliver them faster.

Local regulatory hegemony over cable is a poor justification for barriers to competitive entry in cable, telephone and broadband services.

The competition story is so compelling that critics of franchise reform do their best to avoid it. Instead, opponents concentrate on the issue of "local control," ostensibly whether local authorities have the right to maintain their tax and regulatory hegemony over cable services. Local franchise control has perpetuated higher prices and monopolistic practices, yet is tolerated by local officials because it ensures a steady supplemental revenue stream. Government officials leery of franchise reform make no secret of this. When she vetoed the Louisiana franchise reform bill, Gov. Blanco wrote to the legislature:

> *Despite substantial efforts to determine with some certainty the actual impact of the bill on local government funding from existing cable franchise fee contracts, there remains significant doubt. Both the proponents and opponents of the bill express confidence in their conflicting points of view. If the bill became effective and the result was significant revenue loss to local government, as many have reported, traditional vital services for our citizens would have to be cut or those citizens may be asked to pay increased taxes.*[6]

The following sections of this report show that local regulatory hegemony over cable is a poor justification for barriers to competitive entry in cable, telephone and broadband services. In spite of all the efforts of franchise reform opponents, cable competition is here to stay and the consumer benefits are tangible. And, contrary to critics' claims, there has been no pattern of selective consumer targeting, discrimination and "redlining." The sky has not fallen.

Part 2

Competition Happens

As locally sanctioned and regulated monopolies, cable TV companies increased rates at an average annual rate of 7.5 percent from 1998 to 2004, according to the FCC, more than three times the rate of inflation during that period.[7] The cable industry routinely cites rising programming costs as a major factor behind these increases. While there is truth to this claim, cable companies, with their monopoly status, have little incentive to push for better deals with the broadcasters and studios, especially when the cable companies can pass along broadcasters' prices to a largely captive customer base.

However, cable companies confronted by new players quickly change their strategy. Almost immediately service providers become actively engaged in providing a better customer experience and they lower prices and offer new choices and packages, as the many examples below attest.

Franchise reform can accelerate this competitive process, lowering costs to consumers, creating choice among providers, and providing higher levels of service. This competitive process is too important to be dismissed over concerns as to its effect on the control local franchise authorities will have in the future.

To begin with, telephone companies are not simply duplicating cable networks. Verizon and AT&T, the two leaders in telephone company video service, are introducing new technology platforms that raise the bar on service and put new pressure on the incumbent cable companies to respond.

AT&T's U-Verse Service is a cable TV-like service that, in fact, turns the cable-Internet model on its head. While cable companies deliver the Internet over their video systems, U-Verse delivers video over the Internet, using the Internet Protocol (IP). While the cable company stuffs all 200-plus channels down the cable to your home, the AT&T service works more like an Internet browser. Consumers use a set-top box to connect to high-end servers that deliver video content on request. BellSouth, which has agreed to be acquired by AT&T, is pursuing a similar platform.

In spite of some drawbacks—AT&T's IP video users experience a momentary delay when they switch channels—the system puts the company in a better position to offer "a la carte" options. Its customers can subscribe to a favored group of channels to the exclusion of all others, offering

choices long demanded by consumers. Cable companies have resisted such demands because their business model depends on aggregating all channels in the cable pipeline and selling service in tiers. The new options that derive from the carriers' choice of their video delivery platforms represent just one way competition from telephone companies will change the service landscape.

Verizon's FiOS is the industry's foremost effort to deliver a fiber-optic link to every home. FiOS' low-end bandwidth option, 5 megabits per second (Mb/s), is almost as much as the 6 Mb/s available on most cable networks. Current FiOS speeds range up to 30 Mb/s (50 Mb/s in some markets) and the company ultimately plans to upgrade service to 100 Mb/s.[8]

Ironically, many of the same policymakers and analysts who worry that the United States is falling behind countries such as Japan, South Korea, and Singapore in the race to build fiber-to-the-home networks, oppose the local franchise reform that would do more than any government program to help America catch up. For example, The Free Press, a media activist organization, the Consumer Federation of America, and Consumers Union issued a report in September criticizing U.S. broadband policy for allowing the country to "lag behind the rest of the world in accessible and affordable broadband service."[9]

Yet all three organizations oppose franchise reform. The Free Press criticized last year's Texas bill as only benefiting the phone companies.[10] It condemned the Indiana franchise reform bill as an "uglier version" of an earlier draft.[11] Its Web site criticizes other franchise reform bills in the same vein, arguing that franchise reform benefits phone companies to the detriment of consumers.

But if we go by the record of what has occurred in Texas, Indiana and other states where franchise reform has been introduced, we can see that it benefits consumers with lower prices and better service.

A. Texas

Texas was the first state to create statewide video franchising. Its legislature passed it in a special session in August 2005, and it was signed into law September 7. Almost immediately, Verizon began extending its FiOS network in Keller, Texas, which had until that point been operating as a pilot project, and into surrounding communities in North Texas. By the end of the year, Charter Communications, the incumbent cable company in Keller, had cut some cable rates by 27.5 percent, in large part owing to competition from Verizon.[12]

As AT&T ramped up its 2006 U-Verse launch in San Antonio, Time Warner Cable expanded its efforts. In a move to "stave off growing competition from phone companies including AT&T," Time Warner boosted the speed of its Road Runner Internet service in San Antonio.[13] Once AT&T went on-line, Time Warner Cable began "discounting [its] TV and phone plans, throwing in premium movie channels and faster Internet connections."[14]

AT&T has not disclosed the number of customers it has captured in San Antonio, but Time Warner continues to respond aggressively. In October, the company introduced an innovative new service feature called "Start Over" that allows viewers tuning in late to watch their shows from the beginning.[15] This feature required considerable negotiation with broadcasters, who for the first time, are allowing cable companies to store scheduled programming for transmission outside the broadcast time slot (without a pay-per-view fee). It serves as an example of the bargaining power cable companies, who in the past have claimed to have little leverage with programmers, wield when it comes to making deals in order to remain competitive.

While the big companies come to mind when cable competition is discussed, video franchise reform has helped smaller phone companies bring service to rural areas of the state. Because of franchise reform, Southwest Texas Telephone Company of Rocksprings was able to connect 68 new consumers and deploy 125 miles of cable in six counties.[16]

B. Indiana

Statewide video franchising took effect this past summer in the Hoosier state. Verizon stepped up FiOS deployment. Comcast responded by increasing the speed of broadband service in Verizon territories such as Howard County to keep up.[17]

Comcast automatically upgraded customers of its premier broadband service to 16 Mb/s for downloads and 1 Mb/s for uploads at a cost of $52.95 per month. Previously, Comcast had offered customers in these cities speeds of 8 Mb/s downstream and 768 kb/s (kilobits per second) upstream for the same price.

Verizon's lowest tier of FiOS service offers download speeds of up to 5 Mb/s, with upload speeds of 2 Mb/s for $39.95. For $49.95, consumers can get download speeds up to 15 Mb/s with uploads of 2 Mb/s, and for $199.95, customers can download at 30 Mb/s and upload at 5 Mb/s.

Comcast's upgrades weren't isolated. The company made similar service improvements in Virginia, Maryland and Florida, all in markets where it faced competition from Verizon.

C. Other states

In the other states that have passed franchise reform, new rules have only recently come into effect. Nonetheless, telephone companies are forging ahead, even if the existing franchise rules slow progress. Where the barriers have been overcome, the competitive situation dramatically improves. All these examples emphasize the greater potential of franchise reform if legislators allow to it flourish.

Virginia enacted franchise reform this summer, creating a uniform framework for franchise agreements that local authorities were required to follow. After Verizon used the new franchise policy to step up FiOS deployment in Herndon, Cox Communications dropped its price to about $9 less per month than Verizon for its triple-play package. In other areas of the state where Verizon wasn't competing, Cox was charging $37 more.[18] As noted above, Comcast increased the speed of its broadband service in Reston.

In another example of a smaller phone company taking advantage of franchise reform and launching service in a small market, entering cable company Cavalier Telephone & TV (formerly Cavalier Telephone Co.), will offer digital TV services in Williamsburg—population 12,000—in competition with cable TV.[19]

In Florida, where a statewide franchise reform bill failed to make it to the floor before the state legislature adjourned this past spring, Verizon was able to launch FiOS in Tampa. Shortly after entering the market, Verizon projected it would enroll 5,000 new customers in June—a rate that could yield 100,000 customers in two years—prompting Bright House Networks, its cable competitor, to offer discounts and package deals.[20]

Elsewhere, Verizon's entrance into Manatee and Sarasota counties kept Comcast from raising its rates for the first time in a decade.[21] Comcast also increased the speed of its broadband services in Sarasota to keep up with Verizon's FiOS.[22]

By the fall, residents and businesses had taken notice of the competition. Home builders, always looking to increase the value of their properties, especially new developments, benefited from having two choices for bundled Internet, phone and cable. As reported in the *Chicago Tribune*:

> *"It makes everyone bring their 'A' game and their best possible service," said Judy Rembiesa, vice president of sales and marketing for Southern Crafted Homes, a builder with several projects in the region. "I've been in new home construction for 20 years, and once upon a time, this was unheard of, to have two companies competing." Ultimately, the deals amplify the competitive pressure on both companies, developers say, helping push Verizon and Bright House to offer better customer service, better channel lineups and lower prices. And that benefits her customers, Rembiesa said, because home buyers now expect far better technological links to make the most of their extensive multimedia theater rooms with large televisions, surround sound and Internet links to multiple computers in the house.*[23]

In Michigan, the threat of competition from AT&T and other competing video providers led Comcast to lower rates and hire extra workers in Detroit.[24]

In an example of a spillover effect, following the North Chicago, Illinois, city council's approval for AT&T's U-Verse service, Comcast, Verizon and RCN lowered prices for bundled services in the Chicago metropolitan area in order to lure new customers and persuade existing customers to stay.[25]

Following the Connecticut DPUC's decision to allow AT&T to compete as a video provider, Cablevision, the incumbent cable TV provider in southern Connecticut and the New York City metropolitan area, announced a "value-added speed upgrade" for high-speed Internet customers. At no additional charge to consumers, Cablevision increased Internet download speeds by 50 percent, to 15 Mb/s from 10 Mb/s. The company also doubled upload speeds from 1 Mb/s to 2 Mb/s. In addition, Cablevision introduced a 30 Mb/s premium tier for residential and business customers for $14.95 per month ($9.95 to customers who bundle telephone service).[26]

Taken together, these competitive developments reinforce existing research. In a report released earlier this year, the Government Accountability Office found that, where cable markets are competitive, prices are on average about 15 percent lower.[27]

Recent market developments also validate predictions by free market analysts that new entrants would drive down rates and yield greater value. "Were head-to-head wireline video rivalry, now offered to just under five percent of U.S. households, to extend nationwide, annual benefits to consumers are estimated to approximate $9 billion, with overall economic welfare increasing about $3 billion per year," Thomas W. Hazlett wrote this spring.[28]

Cable competition franchise reform would save California consumers between $690 million to $1 billion.

Yale M. Braunstein, a professor at the School of Information at the University of California at Berkeley, predicted cable competition franchise reform would save California consumers between $690 million to $1 billion. Braunstein calls on the same FCC data that Hazlett uses, but takes a closer look at several markets in California.[29]

Finally, Robert W. Crandall and Robert Litan, economists with the Brookings Institution, accurately predicted the immediate improvements in quality and service that come with competition.

> *Consumer value would increase as a result of a new wireline competitor in the MVPD [multichannel video program distribution] market. As explained above, a new entrant will immediately cause the price of MVPD service to decrease and will eventually increase demand of MVPD services through quality improvements to those services. An increase in the demand*

for a product indicates a higher willingness to pay, which, all else constant, increases consumer surplus. Furthermore, a price decrease will also increase consumer surplus. The combined effect of these two separate factors is to increase the consumption of MVPD services, and to increase the value above market price that consumers are willing to pay for those services. Consequently, consumer value will increase from the addition of another wireline provider of video program distribution services.[30]

Part 3

Build-Out Happens

Few franchise reform opponents challenge the overwhelming evidence that competition produces lower prices and better service. Instead they claim that only the wealthy benefit from competition; low income households are left behind. Critics point out that few statewide franchising agreements carry "build-out" provisions requiring franchisees to service all neighborhoods in a given community regardless of income level.

Build-out requirements made sense when cable was a legislated monopoly. As an exclusive service provider, cable companies' investments and revenue stream were guaranteed. In exchange for such guarantees, cable companies were required, among other things, to complete build-out within five to 10 years.

In arguing against a statewide video franchising bill in Pennsylvania, Joel Kelsey, grassroots coordinator for Consumers Union, and Beth McConnell, director of the Pennsylvania Public Interest Research Group, noted that "all [current] franchise agreements require the cable provider to offer service to all residents in the service area, rather than cherry-pick the most profitable neighborhoods while denying service to everyone else. These 'build-out' requirements ensure that all consumers in a cable company's footprint have access to service."[31]

The entry of a new competitor, however, changes the market dynamic. Competition pushes suppliers to seek new customers and new revenue streams. Since the new operations are funded by private investors who are shouldering risk, companies need a degree of freedom in choosing a deployment strategy.

Unfortunately, opponents of franchise reform assume that giving companies the freedom to formulate sound deployment timetables means that low-income populations will be ignored, even though there is no evidence in any other competitive market to suggest this. In fact, judging from Texas and Indiana, the two states with the longest history of franchise reform, the outcome has been quite the opposite.

In Ft. Wayne, Indiana, Verizon began deployment of FiOS service in the low-income Hanna-Creighton neighborhood. According to the *Ft. Wayne Journal-Gazette* "Hanna-Creighton…beset by vacant lots and decaying homes—is on track to be among the first areas in the Midwest to have

Internet service that at its slowest download is 89 times faster than a traditional dial-up modem. At its fastest, the fiber-optic network is 536 times faster."[32]

By all newspaper accounts, AT&T has rolled out U-Verse service across all parts of San Antonio, not just the tony neighborhoods. Its plans are just as inclusive as it rolls out service in other parts of Texas. In June, AT&T won a contract from General Growth Properties to extend Project Lightspeed and U-Verse service to the Bridgeland master planned community of 20,000 homes in Houston. Bridgeland, a diverse development including a range of demographic segments, has homes priced as low as $150,000.[33]

Where video franchises are still negotiated locally, the phone companies are not applying for franchises in only the richest communities. Verizon, for example, in October began offering FiOS service across Nassau and Suffolk counties, the two counties that make up suburban Long Island outside New York City. To be sure, Verizon is offering FiOS in Laurel Hollow, where per capita income is $83,366. But the company is also offering service in Massapequa, Mineola, Valley Stream and Roosevelt, where per capita incomes are $32,532, $28,840, $25,636 and $16,950 respectively.[34]

AT&T, meanwhile, perhaps with an eye toward offering future connectivity, has announced a $100 million grant program aimed at providing low-income households with personal computers and Internet access. The national program, administered by the AT&T Foundation, will offer two years of free high-speed Internet access and affordable computers to qualifying households as early as the end of this year.[35] AT&T also has announced plans to make Project Lightspeed services available to more than 5.5 million low-income households as part of its 41-market rollout over the course of the next three years.[36]

To those who follow the cable TV market, this should be no surprise. Opponents of franchise reform mistakenly assume that service providers see low-income residents as an unappealing market. Cable penetration data contradicts this. Robert J. Shapiro of the American Enterprise Institute-Brookings Joint Center points out that low-income households are, in fact, a coveted segment.

> *To begin, businesses go where their customers are, and lower-income households should be a highly attractive market for advanced video services. Low-income households subscribe to current video services at about the same rates today as high-income households, providing the same basis for deploying fiber for video in low-income and high-income areas. Moreover, African-American and Hispanic households subscribe to the premium channels of current*

> *video services at higher rates than other groups. There is also evidence that minorities are "early adopters" of new video technologies, purchasing digital televisions at higher rates than other groups, for example. In the case of advanced video services, lower-income households and minority neighborhoods appear to be very high-value customers that businesses will seek.*[37]

Telephone companies have already shown they can underprice incumbent cable companies. Low-income households, for whom cable services account for a larger portion of disposable income, should find these competitive offerings appealing. There is every reason to expect that telephone companies will continue to target this demographic.

Within a few years, many low-income households have higher levels of disposable income they can in turn spend on upgraded service.

In addition, low income households also offer the greatest promise of future revenue growth. This is another trap critics of market economics fall into—equating low income with chronic poverty. Many low-income households include immigrants and young wage earners at the start of their careers. The general upward economic mobility that prevails in the United States means that within a few years, many low-income households have higher levels of disposable income they can in turn spend on upgraded service. For a service provider, the long-run value of loyal customers makes the initial investment in customer acquisition, costing between $250 and $300 per customer, so important. It is also why incumbents work hard to keep customers they have.

The bottom line, however, is that low-income households purchase cable services. Considering the billions of dollars the phone companies are spending to enter the cable business, to ignore this segment would be a monumentally bad business decision. From the deployment pattern so far, there's every reason to believe that the telephone companies won't make this mistake.

Part 4

Local Tax and Regulatory Hegemony

Franchise reform decreases, but does not eliminate, local authority over cable systems. Under statewide regimes, franchisees still pay franchise fees to the local authority, not some new statewide agency. PEG channel requirements remain. Local agencies retain control over rights-of-way.

Local franchise authorities lose their ability to extract concessions that have little to do with the provision of cable service, but simply increase the cost of service for consumers. In franchise negotiations, cities have demanded parking lots, free televisions for every "house of worship," and discounts for select customers. One town asked for a new recreation center and pool.[38]

Statewide franchises also codify what qualifies as "gross video revenues." Statewide franchising laws do reflect the 5 percent cap contained in federal law,[39] but the definition of what counts as "video revenues" has traditionally been a negotiating point. Hence, in addition to applying the 5 percent assessment to subscriber fees for cable service, some localities have included local advertising revenues, commissions from home shopping channels, and even promotional fees paid by cable networks in the calculation of the franchise fee. While some states retain these extra revenues in their statewide laws, the standardization of the definition of gross video revenues represents a loss of power to the local governments.

The debate is whether preservation of local hegemony—in essence the power to extract costly concessions from a particular group of local businesses—is worth sacrificing the benefits franchise reform brings. Increasingly legislatures have concluded the benefits of franchise reform to consumers outweigh the costs to local franchise agencies.

Moreover, despite concerns from state leaders like Louisiana's Gov. Blanco, local revenues from franchise fees, at least in the near term, do not appear to be endangered. A new franchisee means another provider selling services. Two service providers, actively competing, means more cable subscribers, higher revenues and therefore, a rising franchise revenue stream.

Crandall and Litan of the Brookings Institution quantified this intuitive notion: video competition could mean at least $249 million in additional franchise fee revenue—an increase of some 12.3 percent for most local communities.[40]

In the long term, however, franchise fees may suffer, simply because of shifting business models in the delivery video content, particularly those that might incorporate the Internet and Web. Franchise fees are tied to the sale of video programming over cable, not the Web.

"On demand" video over the Internet, in fact, may be the most significant development in delivery of home entertainment since the introduction of multichannel cable TV. Until recently, cable TV companies had exclusive control over the distribution of entertainment to the TV. While customers could purchase or rent videocassettes and DVDs, DVD rentals still required a visit to a video store or an on-line order through Netflix. The "impulse" decision that drives video-on-demand purchasing was the exclusive purview of the cable provider until recently.

The introduction of market economics into cable TV services, accompanied by a rollback in government intervention, has yielded proven benefit for consumers.

Franchise fees remain only as strong as the cable distribution model. Connecticut and Oklahoma have already ruled that IP video is not subject to cable franchise regulations. Some city officials, notably Curt Pringle, mayor of Anaheim, California, a city that has ended cable franchise fees, understand that municipalities should wean themselves from a tax tied to a technology platform that may prove ephemeral.

> *But, in fact, cities have created an unfair tax on cable companies and limited competition in a fast-paced, competitive marketplace. Furthermore, many cities have used these fees to fund essential municipal services unrelated to cable, although the fees simply are not a long-term stable source of revenue for cities. As an example, just look at the emergence of satellite services. This, a non-taxed cable competitor, has increasingly taken a significant share of the entertainment market. As cable companies have lost customers to other competing entities, cities have seen a corresponding drop in the revenues that come from cable franchise fees. It is a weak fiscal model that subjects core municipal services such as public safety on a dwindling source of revenue, regulated by sources out of direct control of that municipality.*[41]

Franchise reform is but one part of the deregulatory process. What's left for debate is whether these fees should exist at all. Franchise fees are, in the end, a discriminatory tax applied to a specific suite of services. While statewide franchising does much to increase competition and service availability, as well as level the playing field among competitors, it nonetheless preserves a system that adds an unnecessary cost to integrated broadband, increasingly viewed as an essential service.

However, the introduction of market economics into cable TV services, accompanied by a rollback in government intervention, has yielded proven benefit for consumers—and that's reason enough to support franchise reform.

About the Author

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Titch graduated cum laude from Syracuse University with a dual degree in journalism and English.

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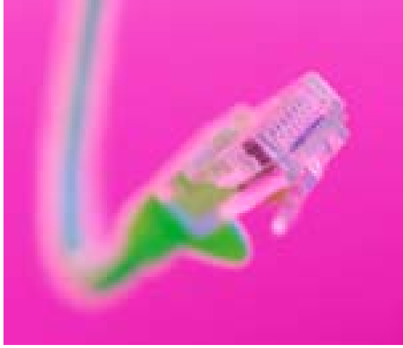

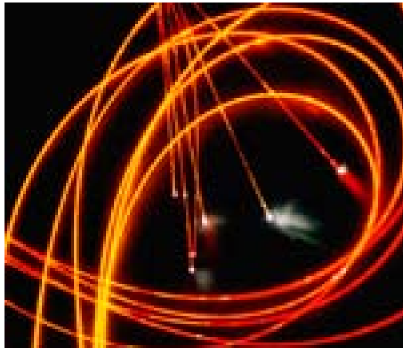

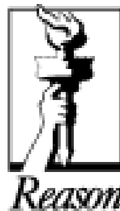

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