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Why Cable Costs Too Much

How Local Politicians and Cable Companies Conspire to Make Cable TV Overpriced

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In 1982, Sacramento, California became one of the last major metropolitan areas to decide to wire its residents for cable television. Assuming that cable was a "natural monopoly," similar to a public utility, Sacramento saw little reason not to copy the 5,000 other cities and counties across America and announce that it was accepting bids for a cable television "franchise." The lucky winner would have the right to provide cable service within the city and county of Sacramento in exchange for paying a "franchise fee" (which, as in most places, ran about 5 percent of revenues). Such franchise rights, in turn, would leave the company in control of a market that would generate revenues of about \$ 60 million a year. That, at least, was the plan until a revolutionary new idea in cable economics--competition--rudely forced its way onto the Sacramento stage. This intrusion has left the nation's cable monopolists ill at ease and lent a bit of hope to the nation's cable consumers, who have been courted, then fleeced, from coast to coast. That's right, consumers--remember them?

Until the early 1960s, cable was little more than what it had been at its inception in the late 1940s: a way of bringing clear signals to poor reception areas, such as those in Pennsylvania's coal country. As cable operators began to add signals from distant viewing areas, however, broadcasters started to worry that their "exclusive" television licenses were being infringed upon. The Federal Communications Commission (FCC), which up to this point had pretty much ignored cable television, suddenly spewed forth regulations. Cable companies could carry only two stations in addition to local broadcasting stations. If a network affiliate in a top 50 market bought the rights to, say, "Hogan's Heroes," the cable company could not import a signal from another station that also showed "Hogan's Heroes." Cable stations could not show movies that were less than three years old or more than 10. They could not produce their own programming. And on and on.

The federal barriers to cable operation began to erode with a series of court and FCC decisions in the

1970s, and by the early eighties most of these regulatory inabilities had been removed. Once the feds were out of the way, however, and cable was ready to show what it could do, another gatekeeper appeared: local government.

When the average American politician spies the chance to regulate a public franchise, his soul begins to sing, because life's experience has shown that such power easily leads to enrichment, either through new campaign contributions from those anxious for his favor or from the more direct solicitations known as graft. This has been the case with everything from liquor licenses to race tracks, and so it was with cable. The local politicians quickly set out to rationalize their role.

The normal law of economics, that competition between suppliers keeps prices low and the level of service high, simply did not apply to cable television, they argued. Powerful economies of scale made cable a "natural monopoly." Cable companies had to dig up city streets and make their way into people's homes; flat-out competition for something this large and intrusive was simply uneconomical. Moreover, the politicians argued, left to their own devices the cable operators would bypass poorer neighborhoods. It was therefore incumbent upon local politicians to choose one supplier that would offer the best deal for consumers.

While cities could offer licenses to operate, there's one thing they couldn't do: regulate prices. A 1984 federal deregulation act stripped them of that right. This left consumers with the worst of both worlds. Having set up effective monopolies in what is now a \$ 14.5 billion industry, city governments were powerless to control the resulting prices. For the cable companies it became a situation of gouge-as-gouge-can. Nationally, the price for cable service rose about 32 percent from 1984 to 1988. In Washington, D.C., families with young children now have to pay \$ 33 a month for full service--or risk leaving their kids with a complex from being the only ones on the block without the Disney channel. As prices skyrocketed, city councils were forced to resort to impotent resolutions of protest. But they could harrumph all they liked as far as the cable operators were concerned; if a cable monopoly wasn't exactly a license to print money, it was the next best thing.

Congress is scheduled to hold hearings this summer to investigate the charge of price-gouging, and legislators have begun to wonder whether the 1984 deregulation should be reversed. That means that government may again muck things up. The problem

isn't that there's been too much deregulation but that there hasn't been enough. And the answer isn't government price-setting, it's competition.

Whispers and bribes

Cynics may suspect that the politicians who concocted the current system had more than the public interest in mind. The benefits to the politicians? They could shake down potential cable operators for hefty campaign contributions. Their stretched city budgets could be replenished with "franchise fees." Community groups could demand that franchises build elaborate "public access" studios for local programming, often starring--surprise!--the groups and the politicians themselves.

It's not just politicians who benefit from the monopolies but the politicians' well-connected friends too. The properly connected found themselves being offered cable stock by bidders in exchange for the right words whispered in the right ears. In Denver in 1982, one city councilwoman said that the only person she knew who didn't own cable stock was the coach of her son's little league team. Then again, he didn't live in Denver.

Investigations by the FBI and local district attorneys have revealed widespread corruption in the cable industry, from its beginnings to the present. In the mid-1970s Irving Kahn, head of TelePrompter, a pioneer in the cable industry, went to federal prison for trying to bribe the mayor of Johnstown, Pennsylvania. Allegations of cable corruption were part of the problem for Donald Manes, the Queens borough president who killed himself while under investigation. A recent Wall Street Journal editorial, quoting court papers, drew this portrait of a 1982 meeting between Manes and a cable executive: "Fearing the room was bugged, Manes tried unsuccessfully to communicate through hand gestures and lip movements his desire for a bribe." (Areas of America still without cable might try this pantomime as a parlor game, "Name that Bribe.") In Sacramento, the man who chaired the Metropolitan Cable Commission when the monopoly contract was awarded, William M. Bryan, is himself now on trial in federal court for bribery. Prosecutors say Bryan attempted to steer a contract to a cable businessman in exchange for a \$ 150,000 line of credit. In sentencing a Washington lawyer to jail in 1985, Federal District Judge Susan Getzendanner commented, "I think it was a bribe, and apparently what goes on in the cable industry all the time."

"Influence peddling"

Back now to Sacramento, and the unraveling of this seamy system:

After much lobbying, the franchise contract first went to the United Tribune Cable Company, in 1982. Though the company had seemed eager to promise the world in exchange for the franchise, subsequently it balked at some of its extravagant pledges, such as planting 20,000 trees in the area. United Tribune dropped out. The bidding was reopened.

One of the bidders was River City Cable Company, formed by a group of 73 local investors--whom the press later dubbed the "Gang of 73"--each making \$ 2,000 investments. None of the people involved with River City had the least experience in running a cable television company, and \$ 146,000 in working capital isn't much for starting one. But they had something more important: clout. The Gang of 73 was a Who's Who of Sacramento's politically powerful and well-connected, including Michael Deaver and a sitting federal district judge. Each investor was told by the organizers of the venture that they stood to realize a profit of as much as \$ 120,000 or more by the mid-1990s, according to subsequent trial testimony. To actually run the system, the shell that called itself River City Cable teamed up with Scripps-Howard Broadcasting to form Sacramento Cable Television; the Gang of 73 owned 5 percent of this corporation. The combination of clout and capability worked. In 1983, Sacramento Cable was selected over four other bidders by the Sacramento Metropolitan Cable Commission to run the local system. All seemed smooth sailing.

One man who wasn't satisfied, however, was Rod Hansen, president of Pacific West Cable and one of the unsuccessful bidders. All he had was a cable company--no Gang of 73. He decided to apply to operate a second cable system in the city. "[The cable commission] told me that I was wasting my time," Hansen says. "When I persisted, they said I would have to put up a \$ 40,000 nonrefundable deposit and all this other stuff. And even if I did that, they still told me my chances were non-existent."

Had Hansen accepted that answer, that's where things would have ended. Instead, he got in touch with Harold Farrow, a noted First Amendment lawyer in Oakland. Hansen filed suit in 1983 charging that the city and county of Sacramento had violated his First Amendment rights of free speech by awarding what amounted to a monopoly to one company. Farrow argued that the process of granting cable franchises was akin to "the business of licensing the press that we thought we were done with a couple of hundred years ago."

It took four years for the case to come to trial in federal district court, but when the jury ruled, the whole cable television industry sat up and took notice. The judge asked the jury for certain findings of fact. The answers shocked the defendants.

Question: "Was the 'natural monopoly' argument a sham by defendants (city and county) to obtain

increased campaign contributions for local elected officials?"

Answer: "Yes."

Question: "Were defendants motivated to provide such benefits (public access channels and other community grants) by either a desire to obtain increased political influence for elected or appointed local officials or a desire to favor local officials' political supporters?"

Answer: "Yes."

Jurors later told local press that it was the "influence peddling" by the Gang of 73 that had obtained the franchise for Sacramento Cable. "We felt the way the whole thing was written up was to exclude competition and it had to do with this Gang of 73," juror Judith Mosier told the Sacramento Bee.

Wire the poor

This unexpected defeat was so total that the city and county did not even bother to appeal the jury verdict. Instead, the cable commission immediately rewrote its ordinance to allow free competition, requiring applicants only to obtain a license and bond from the government before tearing up the streets. Subsequently two other companies entered the fray--Hansen's Pacific West and Cable AmeriCal, which Sacramento Cable eventually bought out for \$ 11 million.

One of the most frequently repeated arguments in favor of franchising is that without the guaranteed profits that come with a monopoly, no cable company would provide service to the poorest neighborhoods. Fewer poor people would buy the service, and they would default more often than their more prosperous neighbors--or so the theory went. Sacramento Cable set out to make this a self-fulfilling prophecy when, upon losing its monopoly status, it announced it was dropping plans to wire the low-income neighborhood of Oak Park. But a storm of public protest caused Sacramento Cable to reverse its decision. At the same time, Pacific West applied for a license to wire Oak Park, too. So it is supremely ironic that one of the city's lowest-income sections is likely to be one of the first in the area with competing cable systems.

The poor-will-suffer theory of cable monopoly was flawed anyway--poor people tend to watch television more avidly than others, making poor neighborhoods ripe markets. And the bunching of homes close together makes them cheaper to wire. In fact it's the poor who often subsidize service to affluent suburbs, which pay the same rates even though the distance between homes makes them more expensive to reach.

Competition brought another boon to Sacramento consumers: cheaper prices. As part of the settlement of a lawsuit by the city against Sacramento Cable for various non-payments, the company won the right to charge different rates in different neighborhoods, something the

franchise agreement had prohibited. A few months after raising its rates to \$ 16.50 for basic service, Sacramento Cable turned around and waived installation fees, offered several months of free viewing, and matched Pacific West's price of \$ 13.50--but only, of course, in those areas where Pacific West had begun stringing cable. None of this solicitous behavior was on display in neighborhoods where Sacramento Cable still had its monopoly.

Windbags and trees

Citizens seem to accept the "natural monopoly" argument with surprising alacrity. If cable is such a "natural monopoly," then why would city and state governments--not to mention companies with a franchise--go to such extraordinary lengths to enforce this supposed law of economics? As Rod Hansen and Pacific West were making progress in the Sacramento lawsuit, other cable operators made a beeline for the state capitol. They got legislation passed in both chambers to give local officials the authority to bar competitors on the grounds of--what else?--"the public interest." Governor George Deukmejian vetoed the bill.

The same kind of lobbying to bolster this "natural monopoly" with unnatural help has occurred across the country. The city of New York spent years trying (unsuccessfully, as it turned out) to prevent an independent satellite cable provider from operating in Co-op City, the world's largest private apartment complex. Similarly, Dallas tried unsuccessfully to prevent a satellite provider from competing with its local franchised cable firm. Don Barden, who holds the Detroit franchise, includes a clause in his contracts that forbids his customers from contracting with any other operator, including satellite reception services (or so-called "wireless cable").

But doesn't a contract with a franchise provide guarantees that consumers wouldn't have if they simply took their chances on whoever came in? This is one of the first arguments employed by the monopolists. It is also one of the most bogus. Before the contracts are signed, there is precious little a cable operator won't promise. They pledge gargantuan systems of 120 channels (less than half of which are generally used). Sacramento had its infamous 20,000 trees. Miami forced its franchise holder to finance a drug rehabilitation program. One of the favorite scams are the so-called "public access" channels. These are meant to appeal to a democratic dream--local studios providing talk shows and other programming on local issues. In reality, they typically become flatulence forums for windbag politicians, attracting little viewer interest.

Where cable operators have managed to keep their monopolistic grip, consumers have paid the price. Thomas Hazlett, a professor of economics at the University of California at Davis who has testified as an

expert witness in numerous anti-franchising lawsuits, estimates that all the "bells and whistles" promised in order to win the franchise probably add 20 to 30 percent to the average customer's bill. "If a typical cable consumer pays \$ 25 a month for basic service and a premium channel," he says, "at least \$ 5 to \$ 7 of that results from politically imposed costs, most of which is pure waste....[a] dollar so the mayor and his friends can have their own talk shows that nobody watches, and on and on."

Promise-the-moon is the m.o. only until the ink dries. The next step is equally predictable: once the franchise is awarded, the lucky winner shuffles sheepishly back to the city and admits that many of the promises were, financially speaking, quite unrealistic. The "giveback" negotiations then get underway. In a study of the 30 largest markets in the country, Hazlett found that 21 of them had acceded to givebacks. In eight of those instances, the givebacks occurred before a single home was wired.

Speedy hookups, anyone? The city of Washington, D.C. began its franchising process in 1982, and the city is still less than half wired. Meanwhile, suburbs of San Diego, Phoenix, and parts of Fairfax, Virginia--some of the few areas of the country that did not bother with franchising--got their MTV faster than their neighbors, who enjoyed the "protection" of the monopoly system.

Keeping cable honest

In contrast to the sordid record left by cable monopolists are a few examples of communities willing to allow competition. Their experience shows how well it works. From 1971 to 1984, the residents of Bryan and College Station, Texas enjoyed direct competition for viewers, and customers saw their cable rates drop to the lowest in the state. In March 1986, the city of Huntsville gave a company called Cable Alabama, which had been operating in surrounding Madison County, permission to compete with Group W, the franchise holder. Residents had frequently complained about Group W's service and price--\$ 10.45 a month for 12 channels. Cable Alabama offered 50 channels for \$ 8.95 a month--more than four times as many channels for less money.

UA/Columbia and Cablevision of New Jersey have been the competitors in Hillsdale and Paramus, New Jersey for a decade now. Borough Clerk Elizabeth Roter says the situation results in high awareness among the residents of cable rates between the two companies. A recent promotion campaign had both companies reducing charges to \$ 9.95 a month, and both often offer reduced installation charges.

Probably the best known competition success story is Allentown, Pennsylvania, which has about 150,000 subscribers. Two companies, Service Electric and Twin County Cable, have provided state-of-the-art service to the residents since the early 1960s. Joe Rosenfeld,

Allentown's cable administrator, says the two companies are keen competitors. Complaints are few, he says, and if people are dissatisfied, they usually just switch companies.

Even if competition doesn't actually take place, or eventually comes to an end, the mere prospect of it can have remarkable effects. The residents of Presque Isle, Maine complained about their small (12 channel) cable service for a long time. The city government finally announced plans to bring in a competitor. The franchise holder almost immediately upgraded to a 54 channel system.

Instead of allowing cities and counties to regulate cable rates, Congress should simply forbid franchising. There is no reason a cable operator cannot be treated under the law in exactly the same way as any developer who wants to build a house or an office building. He applies for a right of way to use the necessary public property and posts a bond to cover any damages incurred while ripping up streets or stringing wire along telephone poles.

Decades of Cable Monopoly have put franchise holders on Park Place, sent local officials directly to jail, and left hapless consumers with Virginia Avenue service. Time for a new game: free enterprise.