Deregulating Cable TV: The Time is Now!

*By William Cox and David Graulich**

Since 1996, the communications industry has undergone a deregulatory phase that has transformed how American homes receive telecommunications, television, and Internet services. Deregulation will likely continue over the next two years at a more rapid pace as telephone companies finally deliver on their fiber deployment plans and compete with cable TV providers for voice, video, and data services (the long-promised "triple play").

Deregulation ought to be good news for consumers, investors, and businesses. The troubling question, however, is what *kind* of deregulation will unfold over the next two years.

The emergence of home satellite providers DirecTV and the DISH Network as legitimate competitors to cable TV is evidence that a deregulatory environment is breeding competition. If further cable deregulation is guided by the right policies, cable TV can be transformed from its current status—a monopoly provider—to one in which a consumer can choose freely among several independent choices.

Regulatory parity would treat competitors neutrally and equally, and consumers would benefit from lower prices and higher value. Innovation and creativity would thrive. On the other hand, the existing cable regime could be subjected to *pseudo-deregulation*—a mere re-shuffling, in which one muddle of rules favoring a particular group is replaced by another muddle that favors a newly-anointed incumbent (probably a fiber-bearing phone company).

The worst-case scenario is that a poorly conceived, clumsily executed deregulatory plan by regulators will favor incumbents while leaving consumers with limited or no choice. That is the model to be avoided.

Three Different Industries

Cable deregulation does not simply involve cable TV and the multi-channel video provider market. Rather, this deregulatory bouillabaisse involves the convergence and blending of three different communications industries (telecommunications, cable television, and information services) each with its own regulatory history and profile.

Telecommunications is the most heavily regulated of the three, with rules dating back to the 19th Century. The primary regulatory instrument for telecom is Title II of the Telecommunications Act of 1996 (TA96), an ambitious but heavily criticized piece of reform legislation that has dissatisfied just about everybody.

Cable television is less heavily regulated than telecom, but still is encumbered with a bifurcated regulatory scheme that includes the Federal Communications Commission for some issues and state authorities for others. On the federal level, cable is regulated chiefly by TA96's Title VI. At the local and state level, cable is regulated pursuant to franchise agreements that grant monopolies to individual providers for fixed time periods.

Now there is the new terrain of information services, driven by the Internet and the explosive growth of Internet Protocol (IP) as an alternative pipeline for voice, video, data, and whatever else entrepreneurs can dream up. Most of this industry remains unregulated, although the FCC has some discretion to set rules for information services under Title I of TA96.

Franchises: A Game of Monopoly

The regulatory system for cable television is based on the concept of a franchise. While there have been various legal challenges to the franchise system over the years (*e.g.*, City of Los Angeles v. Preferred Communications, 476 U.S. 488 (1986)), the basic franchise model has endured. Localities got involved with cable regulation as an extension of public rights-of-way management. Typically, a municipality or other local franchising authority grants a right to provide service to a specific geographic area (franchise territory) to a cable television company for a set number of years. In most cases, the cable firm must offer cable service to all residents, regardless of income level or location within the municipality. Technically, the franchise is non-exclusive, but due to the economic realities of universal service and the capital intensive nature of building a cable system, the initial franchisee cable company has a monopoly.

The company receiving the franchise typically must also provide certain "free" services, such as subsidizing the broadcast of city council meetings and reserving a channel for the local school board. Of course, these services aren't "free," any more than the car wash at your local gas station is "free" after you buy a thankful of gasoline. Ultimately, the services, known in the industry as PEG (Public, Educational and Governmental) are reflected in the rates that the winning franchise charges each household.

Pseudo-Deregulation in California

A classic example of pseudo-deregulation was the proposed legislation in California referred to as the Strickland Amendment, introduced in the California legislature during 2003 as Assembly Bill 2242. One critic called it "The Cable Incumbents' Preservation Act." Strickland was supported by Verizon, the telecommunications company, and sought to apply one set of rules to cable companies and another set of rules to telecommunications, even though they would be providing the same video and broadband services.

This dual set of rules was proposed in the name of increasing competitive choice by reducing the barriers to entry into the cable market for telecom providers. In reality, however, Stickland would have imposed different sets of rules on competitors providing equivalent services. If home builders such as Lennar can build and operate their own cable systems, why can't a mega Regional Bell Operating Company (RBOC) like Verizon play by the same rules as Lennar and the existing cable providers? Moreover, maintaining existing franchise requirements, such as the PEG requirements, for traditional cable providers only seems unfair and unnecessary in a world where consumers would have three or more competitive choices. Fortunately, the Strickland amendment expired in committee and never came to a full legislative vote, but another bill with a similar intent is likely to re-emerge in California.

Deregulation: Do it Right

Some common sense guidelines can help shape a cable system that works to benefit consumers instead of working against consumer interests. Here are four fundamentals:

1. A competitive market, such as the flowering VOIP market, is achieved through a market-driven, regulation-minimalist approach. Computers, Internet services, and now VOIP have flourished because they compete in a world of little government regulation. The rough-and-tumble marketplace has driven this growth, that's the right model for cable television's future—minimalist regulation.

The heavily-regulated telecommunications model is obsolete, but special interests want to keep it alive. The job for consumers and voters is to keep the pressure on elected officials so that they maintain a light bureaucratic hand on this emerging landscape.

Localities *do* need to keep a role as managers—and, occasionally, police—of the public rights-of-way in this multi-wire competitive world. But we have to be vigilant to see through the cleverly written new regulations that purport to be pro-competitive, while their effect is to protect one entrenched competitor over another.

2. An IP world dictates a deregulated approach where cable franchises are largely eliminated, and local governments manage the public rights-of-way on a non-discriminatory basis for cable firms and Telco's alike. The old model of community control of cable has outlived its usefulness. Let's get towns and cities out of the TV business. Their proper role is a specific, limited one—managing the physical assets of their communities.

3. The only snags are legal in nature—namely, existing state and federal statutes that require and perpetuate cable franchises. State statutes that require cable providers to serve the entire geographic area of a franchise territory may have outlived their usefulness. Initially designed to ensure that low income areas were not left out, these state laws now serve to protect incumbent cable providers and keep out new competitors that cannot afford such an extensive build-out. In addition, federal statutes with similar requirements are in need of change to allow competition to flourish.

At the federal level, there is also confusion as to whether video services offered over Internet protocol (IP) are properly regulated as cable services, telecom services, or information services. The ruling in summer 2005 by the U.S. Supreme Court decision in the *Brand X* case has significant bearing on this issue. In *Brand X*, the FCC determined that high-speed Internet cable modem services provided by cable operators should be classified as information services. This decision was challenged and overturned by the Ninth Circuit Court of Appeals. The Supreme Court upheld the FCC's decision, with Justice Thomas, writing for the majority, citing judicial deference to the FCC's expertise.

4. The best policy is to overhaul cable franchise statutes to provide regulatory parity for cable companies and Telco's and enable the market—not government bureaucrats—to drive the development of video and broadband offerings to consumers. A level playing field is the best playing field. Some knowledgeable observers advocate that Telco's get the benefit of a grace period, during which they will be sheltered by favorable rules, so that they can make the enormous investment required to ramp up in the cable business. We can see some merit in that idea, but only if the provisions have a strict time cap—say three years—and are non-renewable.

Conclusion

Cable television used to be about getting good reception in your living room when you watched local broadcast stations and HBO. Today, cable TV is at the epicenter of America's information industries, with vast ramifications for the national economy, global competitiveness, and even homeland security. The deregulatory policies being enacted currently will determine whether this industry flourishes or falters. It's essential that, this time, we do deregulation right.

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