

The Bell Monopolies Want a Special Break to Enter the Video Business

But Their Myths and Half-Truths are Not Supported by the Facts

Background

Cable Has Used Private Risk Capital – Not Government Hand-Outs – To Build and Upgrade Its Networks. Decades ago, cable entrepreneurs took a risk by investing in a new service to deliver television over cable. Cable operators had no guaranteed rate of return on the investments they made. They had to create a service that consumers would be willing to pay for at a time when free over the air broadcast networks were commanding huge viewership—and they had to do so while negotiating franchise agreements with local governments.

Starting a decade ago, advances in technology and competition from two direct broadcast satellite (DBS) providers spurred the cable industry to make additional investments to upgrade their facilities. With no federal assistance and no guarantees of recapturing their \$100 billion investment, cable created a new fiber optic broadband platform which now delivers high-speed Internet access, digital video, digital telephone service and an array of new interactive services. Cable innovation and risk taking created America's leading residential high-speed Internet access service.

A Century After Being Granted a Government Monopoly, the Bells Continue to Seek Government Favors Before Investing in Their Networks. In contrast, the telephone companies built their networks as a regulated monopoly with a guaranteed rate of return for nearly a century. And in the 1996 Telecommunications Act, Congress gave telephone companies the right to provide cable television service, but only a few ventured into the multichannel video business before making a hasty retreat. Instead of providing competition in video services -- as they promised -- the Bells spent 10 years stifling voice competition by resisting their statutory obligations to open their networks to new telephone competitors and litigating to limit the scope of those obligations.

Now, faced with voice competition from cable, the Bell telephone companies want Congress to change the rules again so they can enter the video marketplace on special terms.

In order to win these special breaks, the Bells have created a web of half-truths and myths that dangle before policymakers a promise of more video competition and lower prices for all consumers. This is not the first time that the Bells have made promises in order to win regulatory favors, only to break those promises as soon as the favors were granted.

At its core, this debate is not about the flaws in the existing franchise process. Rather, the question for policymakers is whether they are going to change the rules for the Bells in a way that will choose winners and losers by government fiat. The cable industry supports

streamlining the video franchising process so a new entrant can get a franchise in 30 days, and supports a level playing field for all providers.

MYTH—

“The franchising process is a barrier to entry.”

THE FACTS—

This is false. Telephone companies – and other new video entrants – have long received local cable franchises. Verizon CEO Ivan Seidenberg told investors in a January conference call that his company was making “good progress” on video franchising and that the franchising process does not pose “any impediment to our rolling out FiOS during the year 2006.”¹ As he explained to *Business Week*, “We haven’t been turned down anywhere we’ve gone.”²

Verizon already has franchises covering approximately two million households, and there are many examples of Verizon obtaining approval in as little as 19 days to 4 months (Beaumont, California; Sachse, Texas; Herndon and Fairfax County, VA).

Smaller broadband competitors like WideOpenWest, Knology and RCN with a fraction of the Bells’ resources have managed to obtain franchises to compete with cable companies in hundreds of communities all across America.

As part of the 1996 Telecommunications Act, Congress repealed the ban on telephone companies entering the video business. Far from complaining about local franchising as a “barrier,” Ameritech obtained more than one hundred cable franchises, which it operated until SBC acquired the company and sold off its cable business.

Most interestingly of all, at&t can’t complain about the franchising process because they, wrongly, assert that their video service does not require them even to comply with federal franchising rules.

MYTH—

“Franchising takes too long, keeping new competitors out of the market.”

THE FACTS—

This is false. Where Verizon has actually applied for a franchise, it has routinely secured franchises within several months. For example:

- Verizon secured a franchise in Sachse, Texas, in 49 days.

¹ Conference Call Transcript, VZ-Q4 2005 Verizon Earnings Conference Call, Jan. 26, 2006.

² Business Week Online, Sep. 28, 2005, "Verizon: "We've Got to Fix It".

- Verizon secured a franchise in Massapequa Park, New York, including state PSC approval, in 3-1/2 months.
- Verizon secured a franchise in Fairfax City and Fairfax County, Virginia in less than three months.
- In Beaumont, California, Verizon was granted a franchise in 19 days.
- In Bellefonte, Delaware, Verizon obtained a franchise in 46 days.
- In Herndon, Virginia, Verizon obtained a franchise in just over 4 months.

Moreover, Verizon is receiving franchises faster than it is prepared to deliver video service!

- In Sachse, Texas, Verizon obtained a franchise in less than two months but took over a year to deploy video after being granted a franchise on December 6, 2004.
- In Fairfax County, Virginia, Verizon obtained a franchise in less than 3 months but, more than 5 months later, it is still not offering video service in that community.
- In Beaumont, California, where Verizon obtained a franchise in less than 3 weeks, it did not begin to offer video service until more than 15 months after it was granted a franchise.
- In Bellefonte, Delaware, where Verizon obtained a franchise in less than 50 days, it still does not offer video service more than 2 1/2 months later.

MYTH—

“Cable is arguing that the Bell monopolies must build out entirely new networks.”

THE FACTS—

This is false. No one is suggesting that the Bell monopolies should build beyond their existing network and no one is asking the Bells to build out a “new” network. **The issue before Congress is whether the Bells should make upgrades to their existing networks in a manner that is equitable and nondiscriminatory—just like cable did when it upgraded its networks to provide digital video, high-speed Internet access and telephone service.**

The Bells are making the case that their video service will bring widespread benefits to consumers while, at the same time, telling Congress that they should not be required to provide such service to an entire community. For example, SBC (now at&t) has announced to Wall Street that it would serve 90% of “high-value” customers, 70% of “medium-value” customers, and only 5% of what they deem to be “low-value” customers.³

Overall, the Bells have targeted towns with median household incomes that are, on average, twice the national median. Barely 10% of the communities where the

³ SBC Project Lightspeed Investor Relations Call, November 11, 2004

Bells have announced plans to provide video have a median household income below the national median.

The evidence is clear that the Bells intend to compete only for high-end customers and deny the benefits of additional competition to those who could benefit the most. Ironically, in the past the Bells attacked voice competitors for the same type of cherry-picking they now want to practice as they enter the video business. SBC paid for advertising in major newspapers criticizing competitors who wanted to selectively target their customers. “*We proudly make SBC service available to everyone, in every neighborhood, in every region we serve,*” the SBC ads declared. SBC should have added a disclaimer: “But when it comes to video, we’re not interested in serving ‘low-value’ customers.”

MYTH—

“Cable companies are not required to provide phone service throughout communities they serve, so it would be unfair to impose such a requirement on the phone companies when they offer video service.”

THE FACTS—

This is false. First, when cable companies offers digital telephone or high-speed Internet access, they do so to ALL their customers.

Second, to the extent the Bells are trying to compare themselves to competitive local exchange carriers (CLECs), this is a strange rewriting of history. Congress sought to promote voice competition -- any voice competition -- as part of the 1996 Act as an alternative to the Bells’ overwhelming dominance. Congress had to do so by relying on new competitors who were by definition companies with limited networks competing with a historical monopoly with all of the key components of a network in place. Conversely, cable operators face vigorous video competition from DBS companies and other broadband providers.

Finally, this argument fails also because CLECs were, in fact, required to obtain certificates of public convenience and necessity before they could offer service, and they complied with almost every other requirement imposed on the incumbent telephone companies, other than rate regulation.

MYTH—

“Cable companies that offer telephone service face lighter regulation than telephone companies so why should telephone companies be straddled with the same obligations as cable companies in the provision of video service”?

THE FACTS—

This is a false comparison. First, all Voice over Internet Protocol (VoIP) providers enjoy lighter regulatory treatment, whether offered by a cable operator, a Bell monopoly, or a competitive carrier.

Second, when cable companies provide phone service, they abide by the same set of social obligations that apply to the phone companies—payments into the Universal Service Fund, access for people with disabilities, compliance with E911 (to the extent phone companies provide access to the elements necessary to provide E911) and compliance with the Communications Assistance to Law Enforcement Act (CALEA).

Third, just as telephone providers are not subject to economic regulation and tier buy-through rules when they offer video, providers of competitive phone service are not bound by the same economic regulation as the incumbent phone companies which still control nearly 90% of the local telephone market.

Furthermore, unlike new providers of video services, cable operators and other competitors to the local phone companies must enter into interconnection agreements with their Bell company competitors. Although these negotiations are supposed to be conducted in good faith, the Bell companies make great use of this opportunity to frustrate competition by introducing constant revision and delays.

MYTH—

“GAO and FCC studies prove that wireline video competition reduces prices.”

THE FACTS—

This is false. The most comprehensive study of wireline competitors shows that prices are not likely to fall significantly over the long run when new wireline video providers enter the market because the video market is already highly competitive.

In contrast to the Bell monopolies’ continued dominance of the voice marketplace, every cable company faces at least two powerful satellite competitors and prices its services accordingly. The GAO and FCC studies provide little basis for concluding that, in this competitive environment, telco systems will result in lower prices for consumers. While those studies were based on a sampling of overbuild communities – only six small systems, in the case of GAO, and 66 systems, in the case of the FCC – an NCTA study submitted to Congress examined **all 433** markets with wireline “overbuilders” (competitors). That study showed that where overbuilders’ prices were lower, this was because:

1. Many of the systems had unusually low costs because they had purchased their systems from failed competitors at heavily discounted prices;
2. others were municipally-owned systems, subsidized by taxpayers; and,
3. many other overbuilders simply found their lower rates to be unsustainable and either quickly raised them to at least the same level as the incumbents or went out of business.

The bottom line: many overbuilders simply engaged in pricing strategies that were not sustainable in a long-term competitive market, a market that was already highly competitive among cable and two nationally distributed satellite companies.

MYTH—

“When Verizon entered the video market in Keller, Texas, Charter cut its prices by nearly 50%.”

THE FACTS—

This is false. Charter initiated the lower package rates *nearly a year before Verizon launched FIOS video service in Keller*, in direct response to the competitive threat of the two large satellite providers, who have unusually high penetration in that market (32%, vs. 21% nationwide).

Competition is not a new concept for the cable television industry. Cable operators have faced vigorous competition at least since the launch of DBS and Congress’s enactment of the ban on exclusive cable franchises in 1992.

In fact, Keller, Texas is an excellent summary of how half-truths have permeated this debate. Verizon would have you think the franchising process held them back. In fact, they received a franchise in Keller, Texas in 7 months. And, they received that franchise 7 months and 21 days *before* they were ready to actually deliver video service. Keller actually proves that the franchise process works.