PROTECTING THE PUBLIC INTEREST AGAINST MONOPOLY ABUSE BY CABLE COMPANIES:

STRATEGIES FOR LOCAL FRANCHISING AUTHORITIES IN THE AT&T COMCAST LICENSE TRANSFER PROCESS

STATEMENT TO THE CITY OF SAN FRANCISCO

Dr. Mark Cooper
Director of Research
Consumer Federation of America[1]
1424 16th Street, NW
Washington D.C. 20036

CALPIRG[2]
3486 Mission Street
San Francisco, CA 94110

May 7, 2002

I. A PERSISTENT, ANTI-CONSUMER MONOPOLY

In almost two decades since the Federal government pre-empted most rate regulation and other local oversight over the cable TV companies, the industry has proven to be one of the most persistent monopolies in the American economy.[3] By any rigorous economic definition, it remains a monopoly and continues to engage in anticompetitive and anti-consumer monopoly abuses.[4] The AT&T Comcast merger will create the largest cable company in history and strengthen its market power, at the expense of competition and consumers.

While Federal authorities have been unwilling or unable to prevent abuse of market power by the cable industry, local franchising authorities (LFAs) have been frustrated by federal preemption of oversight over the business practices and operation of cable franchises. Things are likely to get worse, not better because the Federal Communications Commission has recently declared its intention to allow cable operators to keep their advanced telecommunications networks closed.[5] In the process, it will further erode local authority over cable companies. At the same time, the FCC is considering the relaxation of rules governing the size of cable companies and their ability to own alternative forms of media distribution.

Transfer of the franchise is one area in which local authorities still have a major role to play. The transfers occasioned by the AT&T Comcast merger provide an important opportunity for local officials to take measures to protect their citizens. This paper outlines the competitive, consumer protection, and financial justifications for LFAs to refuse to transfer the licenses unless stringent conditions are met. It identifies six areas in which LFA conditions are justified –consumer protection, financial responsibility, local equipment, access to advanced telecommunications services, promotion of competition, and rates.

VIDEO

Whenever rates are unregulated, the industry pushes them up at several times the rate of inflation[6] creating large monopoly profits.[7] The passage of the Telecommunications Act of 1996, with its effort to inject competition into the industry, has done little to restrain the abuse of market power.

Unchecked by the alleged competition from satellite television, cable rates have increased by over 40 percent since the passage of the 1996 Telecommunications Act, and basic service revenues increased over 50 percent.[8] While imposing this massive increase in prices, the cable industry has maintained one of the lowest customer satisfaction and service quality ratings of any major consumer service industry.[9] Only monopolists can get away with that hat trick.

ADVANCED COMMUNICATIONS AND HIGH-SPEED INTERNET

The run-up in rates reflects, in part, the move into digital video and cable modem services. The FCC has allowed the cable industry to transplant its anticompetitive, anti-consumer business model from the video market into the advanced telecommunications and high-speed Internet access markets.[10]

For example, cable operators control about 70% of the broadband market, while keeping their networks closed to competing Internet service providers.[11] Having gained a substantial advantage by capturing the most valued early adopters, AT&T and Comcast have now agreed to select a couple of ISP to sell Internet services to the public. However, AT&T and Comcast severely limit not only the number of ISPs, but the services they can offer. AT&T-Comcast

- tell the ISPs what they can and (more importantly) cannot sell, particularly streaming video and end-user generated content and applications;
- control the customer relationship and the ability of non-affiliated ISPs to differentiate themselves; and
- place independent ISPs in a price squeeze that stifles innovation on the Internet by charging a toll for access (the charge unaffiliated ISPs must pay for carriage) that is so high that there are few resources and little market left for new applications or content.[12]

This bears no resemblance to the open communications network that was the foundation of the Internet.[13]

The denial of access and discrimination against independent ISPs has resulted in a substantial market failure – rising prices, poor quality, restriction of choice, and lack of innovation. In contrast to the narrowband Internet, where a string of innovations over a truly dynamic decade (e-mail, the Web, web browsers, search engines, chat, instant messaging, file transfer and sharing, and streaming) fueled consumer demand, the high-speed Internet has been barren of innovation. Dominated by the cable gatekeepers, whose primary goal is

to prevent competition for its video monopoly, the high-speed Internet has not seen one significant innovation that exploits its unique qualities.

"INTERMODAL" COMPETITION IS WEAK OR NON-EXISTENT

AT&T and Comcast will assert that competition from satellite for video services and from DSL for high speed Internet access will discipline their behavior and protect consumers, but such competition doesn't really exist.[14] Satellite attracted its customers in rural areas not served by cable and by offering high volume digital services before cable could offer them. With the introduction of digital cable and the bundling of high speed Internet, there is little competition from satellite. Cable still has more than an 85 percent market share in the multi-channel video market.

A similar story can be told about high-speed Internet services. There is little effective competition in the residential market from DSL and virtually no competing cable modem service. (Cable companies haven't competed in each other's markets). Where DSL has been strong –in the business market—cable avoids competing. While cable has a 70 percent market share of residential customers and DSL has a 90 percent market share in the business market.

The economic evidence overwhelmingly supports the conclusion that the merger wave that has affected the industry reinforces the monopoly power of the cable companies. Econometric analysis conducted by the Federal Communications Commission shows that larger MSOs and clustered systems charge higher prices.[15] Vertically integrated companies offer fewer channels, restricting competition for their affiliated programs. The FCC's data also shows that satellite does not significantly affect cable's price, quantity or quality. Clustered and larger systems yield higher monopoly rents when they are sold.

Worse still, AT&T and Comcast have been in the forefront of building the anticompetitive business model of the cable industry in recent years. For example, Comcast pioneered the loophole in the 1992 Act that allows it to deny its marquee regional sports programming to competing distribution technologies.[16] Withholding the Phillies, Flyers and Sixers in Philadelphia has cut satellite's market share from a national average of 15 percent to less than four percent in Comcast's home territory.

AT&T has led the charge in seeking to close the advanced telecommunications services and high-speed Internet access markets. Together they have dominated the standards setting process in the industry, which has helped to foreclose competition.[17] Each has given Microsoft a preferential place at the core of the emerging multi-media products space in exchange for cash to pursue their strategy for market domination through acquisition.[18]

II. LFAS HAVE THE AUTHORITY AND THE GROUNDS TO DENY THE TRANSFER OF THE FRANCHISE

While Federal law has usurped much of the local authority over cable companies, to the detriment of consumers, it has not preempted the ultimate franchise. The LFA has the authority and responsibility to promote the public interest and protect the consuming public.

The franchise is a contract negotiated by the local authority on behalf of its citizens. The AT&T/ Comcast merger is a material change in the conditions of the franchise, not only involving increased debt and risk, and changes in management, but also changes in ownership form.

When the LFA initially awarded the franchise, the company made representations about the franchisee's financial viability, customer service and the deployment of high speed Internet service. At the same time, the anticompetitive and anti-consumer practices of the cable industry in the video and advanced telecommunications service market impose direct, substantial and growing harm on the consumers. The local franchising authority is empowered, even obligated, to prevent this harm under traditional state contract law. The LFA can insist on provisions in the franchise agreement to empower the LFA to monitor and take action against such practices.[19] If the changes wrought by the merger increase the possibility that the benefits the LFA bargained for on behalf of its citizens will not be delivered, then LFA should reject the transfer, or in the alternative, condition the transfer on AT&T Comcast's agreement to pro-competitive, pro-consumer stipulations. [20]

FINANCIAL IRRESPONSIBILITY

In the case of the AT&T/Comcast merger, the threat goes well beyond the likelihood of anticompetitive and anti-consumer practices. The financial and management structure of this company will be a nightmare for LFAs, as the new structure will result in less financial transparency, looking much more like an impenetrable feudal castle than a modern stock corporation.

When AT&T acquired MediaOne, it touted the fact that its large ownership interest could not influence operational decisions, because a variety of artifices had been constructed to diminish its influence.[21] In other words, AT&T prided itself on having **ownership without responsibility,** and it still does. The AT&T Comcast merger adds another absurd layer to this already absurd ownership structure. [22] The new CEO is guaranteed control of the corporation with just 2 percent of the voting stock. This is accomplished by (1) preventing the board from meeting for three years and (2) prohibiting management from being fired for six years. Thus, the company's management will have **responsibility without ownership.**

For some the LFAs the problem goes even deeper. AT&T and Comcast are informing some that the form of ownership will be transformed into partnerships and Limited Liability Companies, instead of a normal C corporation. This LLC business form has the effect of short-circuiting information disclosure and allows major policy changes without the corporate board's approval. Further, the LFA cannot examine the books and records of the local franchise corporation (there are none). The LLC form also encourages AT&T/Comcast to transfer cash out of the local community to corporate headquarters, because there are no tax consequences of declaring dividends from subsidiaries to the parent.

FINANCIAL PRESSURES ON THE FRANCHISE

The financial terms of the Comcast-AT&T transaction puts immense pressure on the merged company to increase profitability at the expense of local franchises. The company has declared its intentions to raise prices and slash both operating costs and capital expenditures. Capital spending will be under immense pressure – the company's SEC filing

admits as much. The ability of the company to deliver on its promised system upgrades and customer service improvements are subject to doubt.

This merger raises the centralization of the industry to a new level and threatens the ability of the company to deliver quality service. The first thing to go will be customer service. It will go farther and farther from the local franchise into regional and national call centers, call centers that will service not only a wide variety of geographic areas but also many different services.

LFAs should insist that the franchise agreement include specific language and conditions to protect the public in six areas – service quality, financial responsibility, local facilities, prevention of anti-competitive conduct, rates and non-discriminatory access to advanced telecommunications services.

III. SPECIFIC MEASURES TO PROTECT THE PUBLIC

TRADITIONAL FRANCHISE ISSUES

Routine areas of franchise renewal and transfer are clearly implicated by the proposed merger. The LFAs must pay close attention to detail to ensure that a huge corporation which sees itself as a major national player across a number of product markets, will not ignore the interest of local areas and consumers. .

Consumer Protection: Consumer protection becomes more and more important as local franchises are merged in huge national systems. Quality of service commitments must be more precise and enforceable. Given the fact that call centers will be centralized hundreds, if not thousands of miles from the local area, customer service standards should be outlined with much greater detail and monitored much more closely than in the past. Local staffing levels should be preserved to ensure quality service.

Local Facilities: For the past decade, LFAs have been negotiating significant improvements in local communications networks as part of the franchise transfer and renewal process. It is now time to take that policy to another level. LFAs should begin to look upon the cable system as a major cornerstone for a universally available advanced telecommunications infrastructure. The transfer threatens capital availability for system expansion and upgrades. Negotiate guarantees that there will be adequate capital provided the franchisee to eliminate the digital divide in your community.[23] This should include more capacity pushed farther out into the community.

As the information superhighway becomes more and more the main thoroughfare of our digital economy, local governments may come to realize that they cannot allow private parties to own and operate the avenues through which the activity of daily life flows. For two centuries, a fundamental principle of our open economy and democratic society has been that the means of communications and commerce – roads, canals, railroads, telegraph, telephone – have been open to all on a nondiscriminatory basis. Cable companies reject this principle and the FCC has now abandoned that principle.

More and more cities are realizing they cannot allow this. They would never allow private parties own and control the streets and find it unacceptable that as digital

convergence creates the information superhighway, cable companies are allowed to run these vital networks as private toll roads, dictating who gets to use them, what they can sell, and which innovations are allowed. Many have developed approaches to partner, or build open communications networks to serve their citizens.

Financial Responsibility: The recent round of disclosures on financially irresponsible management, which has reached the cable industry, demonstrates that this is not just a stockholder problem. Manipulation of accounting and management that treats the companies like personal property have impacts on employees and the quality of service to the public.

Given the new, suspect ownership and management structure of AT&T Comcast, the LFA must exercise much greater oversight over the flow of funds out of the local area. The transfer provides an opportunity to negotiate new reporting and financial disclosure requirements to assure that consumers do not become cash cows supporting other communities. Negotiate tough disclosure requirements, and guarantees that reinvestment in the community will always equal or exceed specific percentages of system revenues. With strong incentives in the merged cable company to bleed the local areas dry, and then cry poverty when promises are not fulfilled, the LFAs must establish specific schedules and targets for plant upgrades, staffing and service quality, with financial penalties for failure to meet these goals.

NEW AREAS OF CONCERN

Given the severe threat to the consuming public that is unfolding at the FCC, local authorities must take aggressive steps to protect their citizens. The franchise is a potent local right. The request to transfer control of this franchise should be used creatively at this critical juncture.

Anti-competitive practices: Business practices that deny residents of the franchise territory the benefits of competition harm the public and are contrary to the public interest. The franchise agreement should prohibit such practices.[24] Examples include denial of access to programming and predatory pricing. Montgomery County Maryland enforced a ban against Comcast on withholding of sports programs.

Overbuilders have alleged predatory pricing, in which the incumbent drops its monthly fees for a short period of time to customers in areas in which new entrants are trying to compete. Predatory pricing adversely affects consumer in the long term, as competitors are driven from the market. Cable companies have also refused to carry the advertising of competitors and AT&T is being sued for foreclosing the advertising market.[25] LFAs can ban these predatory and anticompetitive practices and establish procedures for hearing complaints on an expedited basis.

Most Favored Clause for Open Access: Cities and counties should insist on a clause that ensures that their citizens are the beneficiaries of open access policies no less favorable than any granted by AT&T/Comcast anywhere in the country. This will ensure that when the FCC rulings on open access are overturned by the court, the LFA can quickly get open access. The City of Pittsburgh adopted such a requirement. Without such a clause,

AT&T/Comcast will insist that they do not have to provide it under the franchise agreement.

Rates: LFAs have been able to negotiate rate concessions for specific classes of customers (e.g. seniors). With the pressure on the bottom line created by the costs of these mergers, LFAs must be vigilant in preserving senior discounts and other pricing benefits granted by the cable operator. The City of Cambridge, Massachusetts is in court over a senior discount that was slashed from $5 to $.69 by AT&T's questionable interpretation of the franchise agreement it signed when it bought MediaOne a couple of years ago.[26]

After two decades of relentless rate increases, it may be time to use the franchise transfer process to bargain for all citizens in the franchise area. Cities can demand non-discriminatory rates. This combats the anticompetitive and predatory practices of the industry.

IV. CONCLUSION

Time is short to get the cable industry back within the corral of responsible corporate behavior. Denying the transfer of the franchise may be the **only** opportunity the LFA or anyone else has to protect the public from monopoly abuse. This sounds like an extreme measure, but the cable industry, through its behavior, has pushed localities and their consumers to the wall. Federal authorities have failed to behave responsibly. Now is the time for LFAs to take a stand.

The Communications Act imposes a tight time frame on local consideration of these major transactions, a time frame that federal authorities never adhere to themselves. LFAs must use this time well, seeking all information before declaring the record complete. Model language for each of the provisions I have discussed is available from national sources representing LFAs. Each LFA will have to tailor its demands to its particular circumstances, but there is no doubt that a concerted effort by local officials would give the industry a good dose of something it has been lacking for far too long, responsible oversight that protects the public from the anticompetitive and anti-consumer business practices.

ENDNOTES

---

[1] The Consumer Federation of America is the nation's largest consumer advocacy group, composed of over 280 state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power an cooperative organizations, with more than 50 million individual members.

[2] The California Public Interest Research Group (CALPIRG) is California's largest Public Interest Research Group. CALPIRG works to protect consumers and the environment and promote good government. For the past 30 years CALPIRG's Consumer Program has worked to protect consumers from unsafe and unfair services and products.

[3] "Justice Department Sues to Block Primestar's Acquisition of News Corps/MCI's Direct Broadcast Satellite Assets," May 12, 1998, Department of Justice press release, refers to the "cable monopoly." In remarks made at the press conference, Assistant Attorney General Joel Klein added the adjective persistent.

[4] "Statement of The Consumer Federation of America, Consumer Union, Center for Digital Democracy, and the Media Access Project on the AT&T-Comcast Merger," *Subcommittee on Antitrust, Business Rights, and Competition, Senate Judiciary Committee,* April 23, 2002 (hereafter Joint Statement); with attachments Mark Cooper, *The Failure of 'Intermodal' Competition in Cable Markets* (Consumer Federation of America and Consumers Union, April 2002) (Intermodalism Study); *New Media New Controls: AT&T Comcast's Hold on the Broadband Future*, April 2002 (hereafter, New Controls).

[5] *In the Matter of Inquiry Concerning High Speed Access to the Internet over Cable and Other Facilities, Internet Over Cable Declaratory Ruling, Appropriate Treatment for Broadband Access to the Internet Over Cable Facilities,* Federal Communications Commission, GN Docket No. 00-185, CS Docket No. 02-52, March 15, 2002 (hereafter Cable Modem Ruling).

[6] Joint Statement, p. 4.

[7] Federal Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, Fifth Annual Report, December 23, 1998, Appendix B, and Federal Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, Eight Annual Report, January 14, 2002, Appendix B. for system prices, Joint Statement at 4. For an explanation and interpretation of monopoly rents embedded in these prices see "Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, The Office of Communications of the United Church of Christ, Inc., National Association of Telecommunications Officers and Advisors, Association for Independent Video Filmmakers, National Alliance for Media Arts and Culture, and the Alliance for Community Media," in *Federal Communications Commission, In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy*, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002 (hereafter Horizontal Comments); and Reply Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, and Media Access Project, in Federal Communications Commission, *In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy,* CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, February 19, 2002 (hereafter, Horizontal Reply Comments).

[8] Contrast Federal Communications Commission, *In the Matter of Annual Assessment of Competition In Markets for the Delivery of Video Programming*, Fifth Annual Report, December 23, 1998, Appendix B, and Federal Communications Commission, *In the Matter of Annual Assessment of Competition in Markets for the Delivery of Video Programming*, Eight Annual Report, January 14, 2002, Appendix B.

[9] University of Michigan, ACSI survey.

[10] Cable Modem Ruling.

[11] Intermodalism Study.

[12] Intermodalism, Ruling.

[13] Mark Cooper, "Open Access to the Broadband Internet: Technical and Economic Discrimination in Closed Proprietary Networks," *University of Colorado Law Review,* Fall 2000); Consumer Federation of America and Consumer @ction, *Transforming the Information Superhighway into a Private Toll Road: The Case Against Closed Access Broadband Internet System,* September 1999.

[14] Intermodalism Study.

[15] Federal Communications Commission, *In the Matter of Annual Assessment of Competition in Markets for the Delivery of Video Programming*, Eight Annual Report, January 14, 2002, Appendix B.

[16] Horizontal Limits Comments.

[17] New Controls.

[18] New Controls.

[19] Under the rules adopted to implement section 617 of the Communications Act, the LFA has the right to request information that is reasonably necessary to determine the qualifications of the proposed transferee not only with respect to financial legal and technical questions but other conditions that affect its ability to meet its obligations under the franchise agreement or impact competition in the franchise territory. Notwithstanding *Charter v. City of Santa Cruz,* LFA have the authority to impose reasonable conditions that respond to circumstances, such as increased financial risk, likelihood of anticompetitive behavior, that are associated with the transfer.

[20] Under the rules adopted to implement section 617 of the Communications Act, the LFA has the right to request information that is reasonably necessary to determine the qualifications of the proposed transferee not only with respect to financial legal and technical questions but other conditions that affect its ability to meet its obligations under the franchise agreement or impact competition in the franchise territory. Notwithstanding *Charter v. City of Santa Cruz*, LFA have the authority to impose reasonable conditions that respond to circumstances, such as increased financial risk, likelihood of anticompetitive behavior, that are associated with the transfer.

[21] Consumer Federation of America, et al, *Breaking the Rules: AT&T's Attempt to Buy a National Monopoly in Cable TV and Broadband Internet Services*, August 17, 1999 attached to "Petition to Dismiss or Deny of Consumers Union Consumer Federation of America and Media Access Project," *In the Matter of Applications for Consent to the Transfer of Licenses , MediaOne Group, Inc. Tranferor to AT&T Corp. Transferee,* Federal Communications Commission, Docket No. CS 99-251, August 23, 1999.

[22] Scott C. Cleland, *Cable Valuations & Comcast – AT&T Deal on Wrong Side of Change,* Precursor Group, April 18, 2002.

[23] *Broadband, Bringing Home the Bits* (National Academy of Science, 2002), pp.

[24] *Storer v. Montgomery County*

[25] *Prime Communications, Inc. v. AT&T Corporation*, United States District Court for the District of Massachusetts, Civil Action No. 01-10805MLW. This incident of levering control over the cable system against advertising is not isolated, Jim Boldebook, "Want More Advertising Value? Just Aks1," *Dealer*, April 2002.

[26] *Hearing on Franchise Transfer,* April 30, 2002.