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Written Testimony of

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Mr. Chairman and Members of the Committee:

We appreciate the opportunity to enter written testimony into the record of the Committee's hearing on video franchising. We are research fellows with the Regulatory Studies Program of the Mercatus Center, a 501(c)(3) research, educational, and outreach organization affiliated with George Mason University.¹

As part of the Mercatus Center's ongoing program to assess the costs and outcomes associated with regulation, we have recently completed an analysis of the effects on consumers of video franchising. Our study is attached as an appendix to this testimony. We also submitted this analysis in the Federal Communications Commission's proceeding on video franchising. Principal findings include:

- Cable franchising costs consumers approximately \$10.1 billion annually in higher prices and forgone benefits.
- Higher cable prices account for \$8.4 billion of this cost:
 - \$5.9 billion in higher rates for basic, expanded basic, and equipment rental
 - \$113 million in higher rates for digital cable
 - \$2.4 billion in franchise fees

¹ This testimony reflects only the views of its authors and does not represent an official position of George Mason University.

- The remaining \$1.7 billion is what economists call “deadweight loss”—value that consumers forego because the higher prices induce some consumers to go without cable television.
- Excluding the effects of franchise fees, franchise regulation costs consumers approximately \$6 billion in higher prices and \$1 billion in forgone benefits (deadweight loss).
- The “natural monopoly” rationale for preventing competition is unconvincing. Contrary to natural monopoly theory, two decades of research by federal agencies and independent scholars consistently finds that cable rates are lower in markets with wireline video competition. The most recent Government Accountability Office study finds that cable rates in markets with wireline video competition are 16.9 percent lower than they would be without this competition.
- The argument that entry regulation lowers rates by reducing the cable operators’ risks and costs is also unconvincing. Even when cable was first deployed in urban and suburban areas, jurisdictions with open entry policies or competing cable companies had rates equal to or lower than rates in monopoly jurisdictions.
- Local governments’ need to manage public rights-of-way may justify some regulation of construction and a cost-based fee to prevent congestion and reimburse the public for inconvenience when video providers use the public rights-of-way. Legitimate rights-of-way management, however, does not justify monopolization, and there is no evidence that a 5 percent franchise fee reflects costs actually imposed on the public when video providers use the rights-of-way.

The Federal Communications Commission has significant authority to preempt unreasonable franchising practices by local franchise authorities. We urged the FCC to take the following steps to promote competition:

- Declare unreasonable any refusal to grant a franchise justified on the grounds of natural monopoly, reduced investment risk, or rights-of-way management unless the local franchising authority presents overwhelming empirical evidence that the alleged problem exists and cannot be solved in any way other than barring new entry.
- Require local franchise authorities to explain in writing any refusal to grant a franchise.
- Preempt aspects of state level playing field laws that force entrants to make the same capital expenditures or cover the same service area as the incumbents.
- Declare unreasonable any state or local requirement that would force a new entrant to build out its network faster than the incumbent actually and originally built out its network.

- Declare unreasonable any delay in granting a franchise that exceeds some specified deadline, such as 120 days. Establish simple default conditions under which a new entrant would automatically receive a franchise if the local franchising authority has not acted by the deadline.
- Declare unreasonable any “nonprice concessions” in franchise agreements that are not directly related to setup or operation of a cable system.

These steps could significantly reduce the anticompetitive effects of franchise regulation. However, it is not clear at this time whether the FCC will choose to take all of these steps. In addition, some anticompetitive franchising practices might be dealt with more comprehensively in federal legislation. Clearly, the stakes for consumers are significant. Congress could address anticompetitive franchising practices in the following ways:

- Remove barriers to open entry by amending Title VI of the Communications Act to no longer require a franchise before a provider may offer video service.
- Promote certainty and regulatory uniformity by adopting clear rules for anyone offering video service, including:
 - An obligation to carry no more than a fixed number of Public, Education, and Government (PEG) channels. For example, Texas’s statewide franchise statute has set this number at three channels for a municipality with a population of at least 50,000, and two channels for a municipality with a population of less than 50,000.
 - In place of franchise fees, obligate video providers to pay only a *reasonable* fee to the municipality in which it operates to cover the costs imposed on the municipality by its use of the public rights-of-way. However, this fee should be capped, just as franchise fees are now capped. If a video provider is already making payments for use of the public rights of way, these payments should be taken into account.
- Allow municipalities to manage the public rights-of-way only through nondiscriminatory rules that apply generally to all users of the rights-of-way.
- Allow providers to offer video service in only part of a municipality, and prohibit any authority from requiring a provider to build out its video service in any particular manner.
- The above framework should be made applicable not just to new entrants, but incumbents as well. Existing franchises should be preempted to the extent they are inconsistent with the new system.

The evidence is overwhelming that where video competition is permitted, it has served consumers well. We hope our findings are useful to the Committee as it weighs various options for reform of video franchising policy.