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POSTED ON JULY 11, 2007:

Touch that dial

What happens when telecom companies write state legislation? Check your wallet.

By Fiona Morgan

Beware of legislation promising "competition." A bill passed by the General Assembly last year that was intended to jump-start competition in the cable TV industry has had the unforeseen consequence of costing the state and local governments across North Carolina millions of dollars in lost revenue. And six months after the law went into effect, that promised competition is nowhere in sight.

The Video Service Competition Act was passed with the promise that telecom companies such as AT&T and Verizon would leap to provide video services across the state. (Video is the new term for cable TV, to catch up with the technologies that deliver it. More and more, Internet, video and voice—formerly phone—are delivered through the same pipes.) The companies would offer competitive pricing and give consumers used to relying on one, or no, service provider, choices in service—if only the state would make it easy for them to get in the game. Under the old system, a cable TV provider would negotiate with the city, town or county where it wanted to provide service. But the phone companies didn't want to negotiate town by town, so they pushed for a statewide franchise system with little, if any, oversight. There's no approval process, and as long as the paperwork is filled out correctly, the state is required to accept the company's plan.

The bill's main opponent, the League of Municipalities, backed down after lawmakers reassured the group that the revenue local governments collect from cable TV taxes—money that goes into the general fund to pay for basic services, such as fire and police—would stay the same.

But according to figures from the N.C. Department of Revenue, local governments have received 27.8 percent less across the board under the new system. ([View table.](#))

Under the act, sales taxes on cable TV no longer go directly to the local government, and instead are funneled to the Department of Revenue. Local governments told the state how much money they had received during two quarters of 2006. Based on that, the state estimated what percentage of total revenue each local government should receive this year.

Yet, the pie was a lot smaller than it was supposed to be when the money was distributed to local governments on June 15. The department had no explanation for the shortfall as of press time.

Not only did the legislature fail to anticipate this shortfall, research staff working on the bill predicted the opposite outcome. A fiscal note attached to the bill says that "local governments may gain up to \$3.3 million in new money from this legislation."

How did they get it so wrong? Lee Mandell, director of information technology and research for the League of Municipalities, says that's the burning question on the minds of his constituents. "They're not happy. They're asking a lot of questions, both of me and the Department of Revenue. And so far, aside from speculation, we don't have any hard data."

He says it could be a compliance issue—companies aren't paying the taxes they owe. "To be fair, often with a

new tax there is a period of confusion and education of the vendors to make sure they know all that they're supposed to be doing. There might be some issues in terms of people just not understanding how to work the new tax."

If that's the case, Mandell says, "This is something we can hope to remedy in the second quarter."

If not, the City of Raleigh stands to lose \$1.2 million this year, and the City of Durham more than a half-million dollars.

As for competition, almost none has materialized since the act went into effect on Jan. 1. Of the 58 video franchise filings with the Secretary of State's office, only two were from companies jumping in to provide service in an area for the first time. Neither of those companies is Verizon or AT&T, the chief backers of the bill. (The two new players are both small independent companies planning to offer service in small, relatively affluent towns, neither of them in the Triangle.) Almost all of the other franchise filings are from Time Warner Cable, re-upping on existing agreements that were set to expire.

In many ways, the Video Service Competition Act is the flipside of a bill now pending in the state House. The same lobbyists are pushing for it. Where the video act removed all barriers and expectations for private companies seeking to enter the television business, HB 1587, the so-called Local Government Fair Competition Act, seeks to impose impossible restrictions on any local governments that want to provide Internet, television or other communications service, even if that service is provided through a public-private partnership.

The telecom industry argues that this bill is necessary because local governments don't have to pay taxes, and thus have a competitive advantage. However, HB 1587 requires local governments to adhere to rules the telecom and cable companies could not meet—it prohibits them from using any public money to launch the service, for instance. And cities and towns have to publicly disclose their business plans under open records laws.

The current bill is particularly galling considering that, when the video act was written, the industry refused to consider any requirements that it build out service in rural or economically depressed areas. The message is: We won't help those people, but we don't want them to help themselves, either.

Rural areas, which make up more than half of the state's population, would be most hurt by the new legislation. One after another, mayors and city managers from those parts of the state have filed into legislative hearings on the bill to say their citizens still don't have access to cable TV or broadband Internet.

Because of North Carolina's rural makeup, the state is trailing way behind the country, which is lagging behind the developed world, in access to broadband. Using statistics from a Federal Communications Commission study conducted last year, public advocacy group Free Press ranked North Carolina 41st in the nation in the number of homes subscribing to broadband, and 47th in growth of broadband subscriptions since 2002.

No private company is rushing to provide those sparsely populated communities with any kind of communications service, because the infrastructure is expensive to install. That makes it hard for rural communities to adapt to a post-tobacco, post-textile, post-furniture economy.

Local governments, however, have a more vested interest in laying down expensive fiber infrastructure in economically disadvantaged areas, because doing so helps spark economic development—just not the kind that helps the major telecom companies. The industry seems most afraid that cities and towns will launch high-speed broadband and television service that's significantly faster and often cheaper than what they're willing to provide.

Consider the case of Morganton, a city of about 17,000 people 60 miles east of Asheville. In the mid-1980s, Morganton played by old cable rules, which allowed cities and counties to negotiate with would-be cable providers. At that time, the Morganton City Council became frustrated because it couldn't convince the private cable company, Madison Cablevision (owned by conglomerate TCI, which has since been absorbed by Time Warner), to provide the quality of service it wanted. So the council decided to provide its own cable service, which it has done as a public utility since 1992.

Morganton is the industry's whipping boy. At the most recent legislative committee meeting on HB 1587, industry lobbyist and attorney Wade Hargrove said, "Morganton is Exhibit A for why cities should not go into the telecommunications business." In Hargrove's version of events, the city "drove out" the private cable provider, "said 'no' to free enterprise and went on to build and operate a monopoly, government-owned cable TV business."

After 13 years, Hargrove said, Morganton's cable business is \$7 million in debt. Hargrove even suggested that electric bills were higher for Morganton residents as a result of the city's bad investment.

Morganton Assistant City Manager Ron George has a different story. "Much like the people who are talking about broadband now and companies not willing to make the investment to provide service, that was the situation Morganton felt like they were in," George says. "That was cable; now they're talking broadband, but it's the same thing."

The city borrowed money to start the system, but eventually cable subscriptions paid off that debt, George says. "The system became positive not only in terms of cash flow, but it paid back the money that was spent on it."

A couple of years ago, the city borrowed another \$7 million to upgrade the system and run fiber throughout the town, making Internet access available to all Morganton's residents, not just those in wealthy neighborhoods. The city is paying off that debt at \$1 million per year. George says it is untrue that electric rates have increased to cover that debt—they're the same as they were in 1996.

The system is a success, George says, in spite of the fact that the industry has long opposed it. After Morganton declined to renew the private company's franchise, a six-year court battle ensued before the city could launch its service. A federal judge ordered that a state court should decide whether North Carolina law entitled Morganton to run its own cable system. The state judge said yes, but TCI appealed it all the way up to the State Supreme Court, which upheld the ruling. When the federal judge said that settled the matter, TCI appealed to the Fourth Circuit, which also stood by the ruling. Then TCI tried unsuccessfully to get the U.S. Supreme Court to hear the case. The attorney representing TCI: Wade Hargrove.

Having failed in court to stop the city's cable plans, TCI managed to get a ballot measure before Morganton voters on whether their city should be able to launch cable service. Voters sided with the city more than 2.5 to 1.

If HB 1587 passes, cities such as Morganton will no longer have the prerogative to launch their own systems, and instead will be forced to accept whatever lousy service the telecom or cable companies provide them.

With all this talk of competition, why are the industry's major players still warming the bench?

In May, AT&T announced it wouldn't be rolling out its U-verse video service in North Carolina, citing technical difficulties, despite the fact that the service is available in at least 18 other U.S. markets. A company spokesperson said this week that AT&T "definitely" plans to roll out the service here, but she couldn't say when.

And Verizon has no plans to offer its FiOS service, a bundle of video and broadband, in North Carolina "for the foreseeable future," according to company spokesperson Robert Z. Elek. FiOS requires a fiber network that Verizon is installing in 16 other states, but not this one.

The company pushed for the state franchising legislation here, he says, as it continues to do in other states. "The concept is important to Verizon, whether we are ready to utilize it or not. Consumers deserve competitive options with their cable TV service sooner rather than later, and the state permitting process is much more effective toward that end."

That's exactly it. AT&T and Verizon are more interested in the legislation than in providing the service because they want to change legislation nationwide, to leave their options wide open. Eighteen states have passed cable franchise bills so far, though some are getting wise—Tennessee rejected such a bill last month. AT&T and Verizon have demonstrated by their actions that they consider North Carolina a low-priority when it comes to providing service. That's not going to change.

Just after denouncing Morganton, Hargrove briefly addressed the frustration expressed by HB 1587's opponents—which now include Google, Intel and Alcatel-Lucent—that broadband is unavailable in so much of the state. "If the General Assembly believes that we need to do more to get high-speed Internet or cable or whatever, there are ways to do it," he said. "There are tax incentives; there are all kinds of things." In other words, the state should pay for the privilege of having cash extracted from its citizens, without any expectations about the services they'll receive. Doesn't sound like much of a game plan for the new global economy.

Legislators should let HB 1587 die in committee and remind the telecom and cable companies that there's absolutely nothing standing in their way, except their own unwillingness to make investments in our infrastructure. The fact is, the telecom companies got exactly what they asked for last year and they're not doing anything with it. Their promises of competition, consumer choice and better service for all have so far proven empty. With North Carolina lagging behind the nation in access to the most crucial technology of the 21st century, how long should we be expected to wait?

Budget woes plague PEG channels

Public access, educational and government channels also fell victim to the budget shortfall. Although state lawmakers created extra PEG funding as part of the bill, legislative staff undercounted the number of channels that would need it. They estimated about 80 channels and set aside \$2 million, equaling \$25,000 per year per channel. However, more than 300 channels applied, leaving little more than \$6,000 annually for each.

For an operation like Raleigh Television Network, which offers not only four channels of programming but state-of-the-art studio and editing facilities, equipment rental and training, this budget gap could hamstring their operations. To fill the gap, a bill currently before the Senate appropriations committee would provide \$3.5 million for grants to PEG channels, plus \$3.5 million for broadband build-out. E-NC Authority, a state initiative that promotes broadband deployment, would administrate the funds. —*Fiona Morgan*

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