Policy Brief

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An Evaluation of Legislative Proposals for Higher Cable Fees to Finance Public, Education and Government Access Channels

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Executive Summary

House Bill 5047 and Senate Bill 636 are proposed amendments to Michigan's Uniform Video Services Local Franchise Act of 2006, which streamlined Michigan's franchising process for local cable systems.[1] The bills, if passed into law, would remove several legal limitations on the size of the fee that local governments could charge cable television companies in order to finance local "public, education, and government access" channels on their cable systems. Absent these restrictions, local governments would be freer to impose on a cable company a "PEG fee" of up to 2 percent of its total revenues. These PEG fees would be in addition to the 5 percent "franchise" fee local governments may charge cable companies for the rights-of-way the companies need in order to pass their cables through public areas and connect them to consumers' homes.

This legislation does not appear to be justified or necessary. Public access channels originated in the United States in the late 1960s and largely took their present form following 1984 federal legislation that encouraged the expansion of these channels on cable systems. Local communities began to require as part of their franchise arrangements with cable companies that the companies offer opportunities for the production and carriage of community-initiated programming, both to include local programming and to provide an alternative to the more limited programming choices of the time. Cable companies often were required to provide equipment, training, studios and airtime to members of the public, educational institutions, and governments. The companies were also required to devote a percentage of revenues to finance PEG channel programming.

PEG channels do offer some benefits today. Broadcasts of local government meetings increase transparency of government functions and help inform interested viewers about local issues. School concerts, sporting events and graduation ceremonies may be viewed on cable systems and recorded by participants or their family members. PEG channels also offer training opportunities for aspiring filmmakers and on-camera personnel.

However, the idea that PEG channels offer unique choices to viewers is out-of-date. Cable television viewers now have many channels available to them on their cable system. Much of the programming and local information is available on the Internet through such Web sites as YouTube and through e-mail groups, rendering PEG channels increasingly redundant. Furthermore, only a small portion of cable subscribers actually watch the programming on PEG channels.

A recent federal court decision upheld a ruling by the U.S. Federal Communications Commission that PEG fees must be used only for the capital costs of building PEG access facilities. Thus, the proposed legislation would make tens of millions of dollars of potential funding available for PEG channels, but the fees could not be used to pay for the equipment used in PEG channel studios or the costs of programming itself — only expansions or improvements to PEG studios. This could present PEG programmers with distorted incentives to build new facilities that do not necessarily make PEG programming more valuable to viewers.

Ultimately, there is no real evidence that cable subscribers want more PEG channels or that PEG channel viewing will significantly increase following the proposed increase in the availability of funding. At a time when customers are already complaining about cable prices, the likely effect of the legislation would be to raise cable

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programming costs while providing no significant benefits to cable subscribers. To the extent these cost increases drive more customers to terminate their cable service or switch to the growing satellite services, the ultimate effect may well be to reduce the viewership for PEG programming even as PEG facilities receive expensive upgrades, since satellite and other non-cable video providers do not offer local PEG channels.

Introduction: Cable Television and the Major Alternatives

Under House Bill 5047 and Senate Bill 636, the Michigan Legislature would make it easier for a local government to require companies providing local cable television services to pay fees of up to 2 percent of their gross revenues to support public, education and government access cable television channels. If the bills pass in their current form, local governments that have not been levying such "PEG fees" are more likely to do so, and local governments that already levy them are expected to raise the fees above their current levels.

Proponents of the bills generally argue that such "PEG fees" help generate valuable local programming and provide cable viewers with important alternatives to conventional national television programs. To evaluate these bills and their likely ramifications, however, it is important to understand the history and the nature of the cable television market.

A cable television system is a wired network connecting viewers with a central source of programming distribution (the "headend"). It is simpler in structure than a telephone network or the Internet because the cable network is designed primarily for one-way distribution of signals from the headend to the television set of the viewer. (Telephone networks, by contrast, allow for complicated switching of signals back and forth over the network.*) The headend collects open-air signals from local broadcast stations, signals from distant stations via satellite or microwave transmission, and often some local programming via a wire or open-air transmission. The system delivers programming over a distribution network of cables. These cables can be run to consumers' homes only after cable television companies obtain "rights-of-way" for the lines from local governments.

* Recently cable networks have begun to be used for some two-way communication between the viewer and the service provider. For example, many systems now allow viewers to order pay-per-view and other services through their television set, with the signal sent back to the cable system operator over the same wire. This limited addition of two-way communication is still much less complicated than telephone system network communications, because the viewer typically communicates back and forth with the cable provider only, and not with other cable subscribers.

The cable system operator packages the signals into bundles of services to offer, usually in packages of programming designed to target customers at different price points. The least expensive package is a "basic tier," sometimes called a "lifeline" tier. The basic tier normally includes retransmission of the channels available for antenna reception in the area, a small number of national channels (e.g., ESPN, Discovery Channel, CNN), and some or all of the PEG channels on the cable system. More expensive packages offer one or more "expanded basic" tiers, in which the cable operator includes additional national channels in the basic package. The most expensive tiers incorporate premium services like HBO and Showtime, either as part of a more expensive package or as à-la-carte add-ons to an expanded basic package. Cable systems also often offer pay-per-view channels that typically carry high-profile sports events, entertainment events and movies not yet available on premium channels.

Cable television is part of a multichannel video distribution industry, in which the competitive relationships among service providers have evolved largely as a result of regulatory classifications that have emerged over time. Within this industry, a major cable provider, such as Comcast and Charter, is known as a "multiple system operator," recognizing that it typically operates cable systems in multiple locations that may be separated geographically. MSOs' two major competitors are "new cable entrants" and "direct broadcast satellite services."

New cable entrants are similar to cable systems in that they provide their own wireline infrastructure in the areas in which they compete with cable systems.† These entrants are often local telephone companies that can deliver television programming over the same lines used for telephone service. Electric utilities have also considered using their electricity distribution lines for delivery of television programming.

Direct broadcast satellite companies deliver programming directly to the customer without passing though a headend. DBS providers reach the few rural and remote areas that are not served by cable systems, but they miss a few customers who cannot position a reception dish to point to the satellite from which the signals are sent. DBS services are national services and typically carry only about a half-dozen local channels. The local channels carried by DBS systems generally include the local affiliates of the major networks, as well as one or two additional channels.

† These new cable entrants used to be described as "overbuilders," because they built a network over the existing cable network. Of course, if existing telephone or electricity wires are used to deliver television programming, no additional network building may be needed.

The two major DBS providers are DirecTV and Dish Network, both of whom offer their service nationally. The satellite services that preceded DBS never achieved a significant market share because the reception dishes were several feet in diameter. The smaller reception dishes introduced by DBS services in the 1990s are typically about 19 inches across.

New cable entrants have proven to be effective competitors to established cable systems. According to the U.S. Government Accountability Office, rates in markets where new cable entrants compete with established cable systems are about 15 percent below rates in markets with only one cable television service provider.[2] DBS providers also appear to compete with cable systems, although it is more difficult to measure the competitive impact of satellite services on cable rates because the DBS providers offer their service nationally, preventing comparisons of cable prices between areas with and without DBS services.*

Local, State and Federal Cable Franchise Regulation

For more than 50 years, local governments have had a significant degree of regulatory control over cable systems through their franchise agreements with cable companies. In contrast, cities and other local governments have no control over DBS services delivered into their jurisdictions.

The difference in regulatory treatment is due to cable's need for rights-of-way for their network of wires. Local governments control these rights-of-way and often own the utility poles and other infrastructure used for cable television delivery. Thus, cable operators must negotiate franchise arrangements with local governments for access to rights-of-way in exchange for paying franchise fees to the local government and meeting other conditions in the franchise arrangement.

These franchise agreements are based to some extent on the "natural monopoly" regulatory model used with electrical utilities and local telephone companies, because historically the agreements have protected a local cable monopolist from competition in exchange for franchise fees and various service- quality requirements.† The franchise agreements typically also contain additional conditions requiring the cable company to provide certain services designated by the local government, including public access channels; funds to assist local citizens or organizations in producing programming for these channels; and studios and equipment for those interested in providing local programming.

Cable television does have some characteristics consistent with other industries that have been regulated as "natural monopolies." Like electrical utilities and phone companies, cable television is dependent on local governments for rights-of-way. Moreover, its network of wires is capital-intensive, a fact that made construction of a second competing network prohibitively costly in earlier times.

Other features of cable television do not lend themselves as well to natural-monopoly regulation, however. Most notable is the fact that competitors have emerged, including the telephone companies that have entered local cable markets and the national DirecTV and Dish Network satellite services. Moreover, cable television also offers highly differentiated products, such as a wide variety of channels, packages and add-on programming. Most industries regulated as natural monopolies offer predominantly undifferentiated products, such as electricity and telephone line access. Indeed, the differentiation of the cable industry's products and the potential for innovations in programming and programming packages led many commentators to criticize monopoly regulation of cable television through local franchise agreements even before DBS and new cable entrants emerged as competitive alternatives to traditional cable systems.[3]

Over time, the role of state and the federal government in regulating local franchise agreements has increased,

* Diane S. Katz, an adjunct scholar with the Mackinac Center for Public Policy, has argued that satellite services do not constrain prices of cable as effectively as new cable entrants. Diane S. Katz, "Policy Brief: Assessing the Case for Cable Franchise Reform," Mackinac Center for Public Policy, September 19, 2006.

The U.S. Public Interest Research Group, which advocates reregulation of cable television rates, has taken the argument further. PIRG points to the limitations of DBS services, including their inability to reach certain subscribers and their lack of any two-way services to compete with the emerging two-way services offered by cable companies. PIRG does note that in areas where DBS was faster to offer local channels to better compete with cable, the cable companies responded by increasing the number of channels offered on their systems, so that there was a competitive response to DBS. U.S. Public Interest Research Group, "A Blueprint for Creating a Competitive Pro-Consumer Cable Television Marketplace," (August 2003), 32-34.

Andrew Stewart Wise and Kiran Duwadi, two economists on the staff of the FCC, found that DBS does compete with cable with measureable effects on cable prices and output. It appears likely that DBS competition provides some level of competitive constraint on cable prices, although probably less than new cable entrants provide, and it is worth noting that DBS services are increasing their number of subscribers at a much faster rate than cable systems. Andrew Stewart Wise and Kiran Duwadi, "Competition Between Cable Television and Direct Broadcast Satellite: The Importance of Switching Costs and Regional Sports Networks," Journal of Competition Law and Economics, Vol. 1(4) 2005 pp. 679-705.

† As noted below, federal law now prohibits local governments from granting a monopoly to a cable television provider.

making the agreements more uniform and reducing local government discretion in regulation of cable television. Practically speaking, the natural monopoly model lost much of its applicability in 1992 when the U.S. Congress prohibited local governments from engaging in exclusive franchise agreements.[4]

Nevertheless, local governments still have significant control over local cable providers due to government control of rights-of-way. Cable companies now pay more than $3 billion per year in franchise fees nationwide.[5]

The State of Michigan has never regulated cable television rates at the state level. Before 1984, the only regulation of cable television prices was by local governments through franchise agreements with cable systems. Any local regulation of prices was largely ended when Congress passed the Cable Communication Policy Act of 1984 to greatly limit the ability of local governments to control cable rates. The 1984 act standardized procedures for cable franchise renewal and limited cable franchise fees to 5 percent of the cable system's gross revenues.[6] The 1984 act also allowed local governments to require that cable systems "provide adequate assurance that the cable operator will provide adequate public, educational, and government access channel capacity, facilities, or financial support." These "public, educational, and government" access channels are the "PEG" stations that Michigan House Bill 5047 and Senate Bill 636 would require cable television companies to finance with extra fee payments. PEG channels are discussed in more depth in the next section.[7]

The first federal regulation of cable television rates was implemented as a result of the Cable Television Consumer Protection and Competition Act of 1992.[8] This legislation occurred during period in which a cable system was subject to non-broadcast competition only in the few municipalities that allowed a second cable system franchise to enter the local market. As noted earlier, the 1992 act prevented local governments from granting a cable company an exclusive monopoly cable franchise. The "must-carry" provisions in the 1992 act required that cable systems carry all local open-air broadcast stations in their area, and the retransmission consent requirements mandated payments to the local stations.

Although these must-carry requirements changed the bargaining leverage in favor of broadcasters, the most noticeable impact for viewers was probably the rapid increase in the number of shopping channels carried on their cable system. Shopping channel programmers took advantage of the must-carry rules and began broadcasting shopping programming on new or existing local stations that had to be carried by the local cable system.

The rate regulation following the 1992 act did not last long. Several significant changes occurred between 1992 and 1996. One was the rise of satellite television as a competitive alternative. The forerunners of the present DirecTV first offered programming via high-power DBS in 1994, and EchoStar's Dish Network became available in 1996. Other DBS services such as Primestar were also launched, but either failed or were absorbed by the surviving DBS services. DBS grew rapidly, aided by the passage of the Satellite Home Viewer Improvement Act of 1999. When the Satellite Home Viewer Improvement Act was passed in 1999, DBS subscribers accounted for less than 8 percent of customers paying for video services. By mid-2005, 27.7 percent were DBS subscribers.[9]

The Telecommunications Act of 1996,[10] which also contained broad restructuring provisions for the telephone industry, mandated that federal regulation of cable rates end by 1999 except for those in the basic tier. The act also allowed telephone companies to provide cable television services in local markets, potentially by delivering television programming over existing telephone lines.[*] Perhaps the most aggressive early attempt by a telephone company to enter the cable television market was launched in 1997 by Ameritech, the Bell operating company in Michigan and the surrounding states.[†] Within two years of entering the television market, Ameritech had more than 300,000 subscribers, but very few in Illinois, where Ameritech faced a "level playing field law" subjecting new entrants to burdensome and long hearings and local mandates before they could offer service.[11] Ameritech was acquired by SBC, another regional operating company, in 1999, after which SBC sold off Ameritech's two-year-old cable business.[12]

Today, cable and telephone companies are increasingly competing with each other in multiple markets. Cable companies have generally had more success entering telephone markets, while telephone companies continue to face barriers to entry in much of the country due to the cable television franchising requirements.[13] As a result, telephone company entry has continued to occur, but at a slower rate than might otherwise have been expected.[‡]

* The act was ending a restriction put in place by the 1984 federal court consent decree that divested AT&T of the seven regional Bell operating companies. As a term of this decree, the Bell companies could not provide information services.

† Following the Bell breakup in 1984, Ameritech was the primary local telephone service company in Michigan, Illinois, Indiana, Ohio, and Wisconsin. In 1999, Ameritech was acquired by another regional telephone company, SBC (formerly Southwestern Bell Company). SBC later was renamed "AT&T" after SBC's acquisition of AT&T in 2005.

‡ Some critics of cable television franchise reform have claimed that new cable service entry is occurring in Michigan at a very slow rate. See, e.g., Jon D. Kreucher, "Still Broken: Michigan's Video Franchising Law 18 Months Later," Michigan Township News, July 2008, 18-24. Entry is occurring, however. See Christina Rogers, "Cable Giant's Competition Benefits Users," Detroit News, July 7, 2008.

Recently both cable systems and telephone companies began offering "triple play" packages of telephone, television, and high-speed Internet to customers. Cable offers high-speed Internet service through cable modems and their existing wires, while telephone companies offer their high-speed Internet via digital subscriber lines (DSL). As competition to be the provider of multiple services develops, it is increasingly important for telephone companies to clear the hurdles to offering television service. Their two alternatives are to package their telephone and DSL lines either with a cable network of their own or with an existing DBS service. As telecommunications economist Thomas Hazlett has noted, "Telephone carriers can no longer afford not to be in the video delivery business."[14]

Michigan's Uniform Video Services Local Franchise Act of 2006 took effect on Jan. 1, 2007. It significantly changed the nature of future franchise agreement negotiations between local governments and cable television service providers. Before this legislation, franchise contracts could be highly complex. The negotiation of the contract itself was a significant barrier to entry for any telephone company or new cable company considering competing with an established cable company. In addition, contracts contained negotiated terms for (1) access to public easements, rights to lay lines, and other rights needed from local governments in order to build the delivery system; (2) mandatory services the franchise must offer, in the form of programming packages, equipment, or studios for public access channels, or subsidies for local programmers; (3) system design, capacity, and technology mandates; (4) requirements to offer service to all or nearly all customers even when uneconomical to do so; (5) liability protections for the community in the form of insurance or bonding; and (6) taxes, in the form of fees. [15]

The Uniform Video Services Local Franchise Act has greatly simplified the franchise agreement process. Since the act is so new, it is difficult to assess how effective it will be. At least one attorney representing municipal governments has already proclaimed franchise reform a failure, based primarily on the slow rate of entry by new cable providers and lack of evidence of price competition.* Early evidence, however, is that AT&T's "U-verse" service, now available in 160 communities in Michigan, has been expanding rapidly recently, and in response Comcast has lowered its Triple Play package from $134 per month in late 2006 (when franchise reform legislation was passed) to $125 today, with a one-year introductory rate of $99 per month.[16]

* Jon D. Kreucher, "Still Broken: Michigan's Video Franchising Law 18 Months Later," Michigan Township News, July 2008, 18-24. Note that Mr. Kreucher is the attorney representing the City of Saline in a lawsuit to require Comcast to pay the full 2 percent PEG fee under the current franchise agreement.

As the discussion above shows, the general trend in state and federal regulation has been toward allowing would-be television service providers greater ease of entry into local television and video service markets. The resulting reduction of barriers to market entry has increased competition between television service providers and substantially altered the cable television marketplace that existed when local government franchise agreements first mandated that cable television companies pay fees to provide public, educational and government access channels. Consumers' choices of providers and programming are much greater than they once were, even as local government regulation of cable television service has been restrained.

History and Expansion of PEG Channels

PEG channels include "public access," "educational" and "government" channels. Public access television channels provide opportunities for members of the public and various groups the airtime to present their programming content. Educational access channels allow public schools, colleges, and other educational departments to air programming and recordings of school events on the local cable system. Government access channel allow local governments to show local government meetings, election programming, local emergency announcements and other events and programs related to local government functions.

PEG programming in the United States began with public access channels, which have a colorful history dating back to the late 1960s.[17] Local communities began to require as part of the franchise arrangement that cable companies offer opportunities for the production and carriage of community-initiated programming, both as an alternative to the more limited programming choices of the time and also to address local issues on the cable system.

The first public access channel is believed to have been launched in 1968 on the cable system in Dale City, Va., near Washington, D.C. Also in 1968, an advisory committee to Mayor John Lindsey of New York City produced a report recommending city cable companies make two channels available for public access, which set forth a model used in many cities.[18]

The establishment of PEG channels was actively promoted by the FCC in the 1970s. In 1969, the FCC required all cable systems with 3,500 or more subscribers to offer at least one channel for programming from local origins.[19] The FCC expanded the requirement in 1972 to require cable systems in the 100 largest markets to provide at least three PEG channels.[20]

Various small counter-culture groups of the era took advantage of the availability of access to local cable channels to express their views. An early leading proponent for the new medium was Michael Shamberg, a former writer for Time-Life, who coined the term "guerrilla television" to describe his plan to use the channels as a nonviolent protest alternative to the few established television outlets of the time. Sounding much like today's proponents of the Internet and other alternative media, Shamberg proclaimed that the "inherent potential of information technology can restore democracy in America if people will become skilled with information tools."[21]

The growth of PEG channels was aided by the Cable Franchise Policy and Communications Act of 1984. The act allowed local governments to require PEG channels, prevented cable operators from exerting editorial control over the content of programs carried on PEG channels, and exempted cable systems from liability for PEG channel content. Cable systems were permitted to fund PEG channels with revenues from the general 5 percent franchise fee, and this is what many cable systems chose to do. Alternatively, however, the act also allowed franchise agreements to carry additional fees of up to 3 percent of cable television revenues for PEG channels. Such dedicated fees further fueled the expansion of PEG channels.[22]

This rapid growth of PEG channels was reflected in popular culture by a recurring sketch on NBC's "Saturday Night Live" based on a fictional public access channel show called "Wayne's World." In the sketches, Mike Myers was a high school student named Wayne who hosted a low-budget weekly public access channel show from his parents' basement in Aurora, Ill.. The success of this parody led to two highly successful movies. By the time of the Wayne's World movies in the early 1990s, PEG channels had largely taken the form that we see today. Throughout their history, however, the expansion of PEG channels has been driven primarily by regulatory mandates, not by growth in viewership.

Early PEG facilities included expensive racks of analog tape decks and automated video switching systems, which were often funded by the cable system as required by the franchise agreement negotiation with the local government. Today, however, digital production and distribution equipment is much less expensive. Costs of cameras, playback servers, and nearly all of the equipment used for video content production and distribution have made production facilities much more affordable even without the subsidies that franchise agreements require cable systems to pay.

The Proposed Michigan PEG Legislation

House Bill 5047 and Senate Bill 636 are identical, and the text is provided in the appendix at the end of this document. Both were introduced on July 24, 2007, and would amend Section 6 of Michigan's Uniform Video Services Local Franchise Act of 2006.

As currently written, Section 6(3) of the act effectively permits local governments to collect only two types of fees and charges from cable companies under franchise agreements.[23] The first fee, described in Section 6(1)(a)-(c), is an "annual video service provider fee" of up to 5 percent of the gross revenues of the cable system.[24] The local government can spend this money — the franchise fee — as it chooses.

The second fee, described in Section 6(8)(a)-(c), is an annual payment for PEG channels.[25] The current language provides that any fees for PEG channels described in an existing franchise agreement will continue until the agreement expires and then be capped at the lower of the current charges or 2 percent of gross revenues.[26] Since most franchise agreements today have PEG fees set at levels much lower than 2 percent, the current franchise agreement would set the ceiling for most future PEG fees much lower than 2 percent as well.

Section 6(8)(a)-(c) contains two other important provisions. First, in situations where more than one cable company is in the territory of the local government, all cable companies will pay the PEG fees set forth in the agreement for the cable company covering the largest number of subscribers.[27] Second, the law says that when no franchise agreement is in place, the maximum fee for PEG channels in a negotiated agreement will be 2 percent of gross revenues and "determined by a community need assessment."[28]

The proposed PEG bills would significantly change the PEG fees limitation in Sections 6(8)(a)-(c). When a new franchise agreement was negotiated, whether for a new cable provider or due to the expiration of an existing franchise agreements, a local government would be allowed to set the PEG fee at any level it chose up to 2 percent of gross revenues, and no community need assessment would be required.[29] The bills would also eliminate the language in Section 6(8)(a) providing that in situations where more than one cable company is in the territory of the local government (i.e., when a new cable systems by a telephone company or other provider is established or is entering the territory), all cable companies would pay the PEG fees set forth in the agreement covering the largest number of subscribers.[30] Instead, local governments would be authorized to charge a PEG fee of up to 2 percent of gross revenues immediately to telephone companies or other firms entering the market, rather than wait for the expiration of any existing franchise agreements with established cable providers that set lower PEG fees.

As a practical matter, the proposed bill would allow local government to raise the PEG fee to 2 percent for each cable system in their jurisdiction as soon as that system's current franchise agreement expired. It would also authorize local governments to charge a full 2 percent PEG fee immediately for any new cable entrants, even if the franchise agreement for the established cable company set a lower PEG fee.

Impact of the Proposed PEG Bills

Today there are numerous advocacy groups, including the Alliance for Community Media, Save Access, and the Free Press Action Fund, that passionately defend public-access channels. Despite the rapid expansion of other sources for programming and information, PEG channels do offer benefits today. Broadcasts of local government meetings increase transparency of local government functions and help inform interested viewers about local issues. Local school concerts, sporting events, and graduation ceremonies may be viewed on cable systems and recorded by participants or their family members. PEG channels also offer training opportunities for aspiring filmmakers and on-camera personnel.

It should be noted that the proposed bills do not affect the current litigation over whether Comcast and other cable systems can move PEG channels to higher channel numbers available only to digital subscribers.[31] That dispute relates to federal requirements and the interpretation of franchise agreements. Moreover, this dispute over channel locations for PEG channels is likely to go away after the mandatory digital conversion of all signals beginning in February 2009. As one journalist summarized it following an interview with a Michigan PEG channel manager: "PEG people aren't against being on the digital tier. In fact, they're eager to see how going digital will potentially improve the experience they're able to deliver to their viewers. It may even introduce the possibility of HD. The problem isn't going digital, it's the timing of it all."[32]

Tax Burden on Subscribers

As noted above, PEG channels have traditionally been financed by franchise fees or dedicated PEG fees, which are assessed as a percentage of the cable system's gross revenue and justified based on the local government providing rights of way in a community. The basic concept appears to be that in exchange for access to a public asset (the rights-of-way), cable systems should fund PEG channels as a public good.

A current lawsuit in Michigan illustrates how a local community looks at PEG channels as public goods and the PEG fee as a tax. The city of Saline recently sued Comcast over whether Comcast should pay a 2 percent PEG fee under the current franchise agreement. According to WWJ Newsradio 950 of Southfield, Mich., Saline officials stated that they would use the revenues from the PEG fee to pay down debt the Saline Area School District incurred when building a video studio as part of a new high school.[33] In other words, the PEG fee revenue sought by the city from Comcast would be used to pay for school building expenses that otherwise would be funded by a local millage.

Both the 5 percent franchise fee, which is used for local government's general expenditures, and the 2 percent authorized PEG fee are effectively taxes on cable systems. This point was made at a recent local government meeting in Holland Township, where the sponsor of a proposal to provide additional funding for a public access channel noted that the general 5 percent franchise fees were originally designed to be used for cable-related expenses, such as public, educational, and government channels, but most municipalities put their fees back into their general funds.[34]

Separate PEG taxes like the one sought by the city of Saline are still relatively rare in Michigan, and the Holland Township model of relying only on the 5 percent franchise fee is more typical. According to the Michigan Cable Telecommunications Association, only about 20 local governments in Michigan charge a 2 percent PEG fee, and more than 90 percent do not charge any fee, relying instead on the 5 percent general fee and other revenue sources to fund PEG operations.[35] The MCTA calculates that a shift by municipalities to a 2 percent PEG fee could cost cable subscribers $34 million per year in addition to an estimated $80 million currently paid in cable taxes to local governments.[36]

This computation of $34 million in costs to cable subscribers appears to assume that all of the possible PEG fee increases would be passed onto the consumer.[*] Depending on marketplace conditions, however, some of the fee increase might be paid out of the cable companies' profits instead.

* The estimate may also assume that no cable customers would drop their cable service in response to the price hike. Some might, however, a possibility discussed below.

To the extent a substantial portion of PEG fees would be borne by consumers, cable television subscribers would be paying many millions of dollars annually in addition to the tens of millions they already pay in cable taxes. While local governments would have to use the revenues as "support for the cost of public, education, and government access facilities and services,"[37] this still is a collection of money by local governments, and the PEG fees are just another form of taxation. This new tax on cable services would be coming at a time when many cable subscribers already feel that costs are high, and at a time when Michigan is being hard-hit by the economic slowdown.

Competitive Disadvantages and Potential Effects on PEG Channel Viewership

If cable systems were forced to pass on any substantial portion of the costs of PEG channels to subscribers, more of the most price-sensitive customers would shift to satellite services and other video entertainment sources, resulting in lower revenues for local governments from franchise fees and lower viewership of government public access channels.* Moreover, such unintended consequences could remain even if much of a PEG fee increase were paid out of cable company profits, rather than passed on to consumers.

Currently, cable companies face pressure from major competitors who have access to the same upstream content providers cable companies do. Even during the period in which most local cable systems had monopoly power, they also had to acquire programming from strong content providers upstream, who captured a large share of the cable monopoly surplus. Reductions in the companies' net revenues because of higher PEG fees could compromise the companies' market position by reducing their ability to pay for popular programming or new technology. This competitive disadvantage would risk a loss of quality-sensitive customers, once again leading to lower revenues for local governments from franchise fees and lower viewership of government public access channels.

It may be possible for cable systems to make more of an effort to use their local channels to differentiate themselves from DBS services. DBS services broadcast their signals in wide beams covering a large area, so that they cannot provide one set of local channels in one area and a different set in communities 20 or 50 miles away. The problem with this approach, however, is that the cable system needs to have an audience to watch PEG channels. Unless PEG channels offer substantially more than government meetings, school broadcasts, and public access programming with limited appeal, the niche for public access programs will remain small. If there were any untapped demand for PEG content, we would expect to see the availability of PEG channels inducing viewers away from DBS to cable systems.

If there were any reason to believe that higher PEG channel funding, paid for with price increases passed on to customers, would increase the demand for cable systems relative to DBS systems that do not deliver local PEG channels, then it would be in the interest of cable systems to expand PEG services even without government mandates. Instead, the growth of PEG channels has always been driven by regulatory requirements rather than competitive incentives. Hence, there is little reason to expect that raising cable fees to expand PEG facilities would have any effect other than to drive more viewers away from cable systems and away from the very PEG channels the legislation is intended to promote.

Questions About PEG Channel Demand

Evidence of how many viewers actually watch PEG channels is scant, but the little that is available suggests that there is little demand for PEG channel expansion and perhaps little demand for even maintaining current service levels. Cable systems have conducted surveys that consistently show little demand for PEG channels, but proponents have criticized these surveys as being biased against PEG channels and their funding. A recent study by a Hope College marketing class showed that viewership of the Holland Township municipal government channel was limited, that less than half of the respondents watched the channel at all, and that those who did watch tuned in less than two hours weekly.[38] The migration of many subscribers to DBS services, which do not offer local PEG channels, provides some evidence that these channels are not sufficiently important to a substantial proportion of customers.

Much of the programming on PEG channels does not actually originate locally, and many public access channels carry either "bulletin board" announcements or programming from non-local sources for all but a few hours each week.[39] Some of the non-local programming found on public access channels is of questionable value, including a documentary shown on many cable

* Although (as noted earlier) there is some debate about how closely DBS competes with cable, there is at least some evidence that cable and DBS services compete intensely. The mere fact that DBS and cable systems direct so much of their advertising at each other is strong evidence that they see each other as competitors for the same subscribers.

systems asserting that the U.S. government destroyed the World Trade Center on Sept. 11, 2001,[40] "The LaRouche Connection,"[41] the "Scientology Program,"[42] and various UFO cover-up conspiracies and other sorts of programming that most cable subscribers will never watch. These shows may have passionate viewers, but it is likely that there are very few of them.

At the same time, the customers targeted by cable systems have more access to information and programming today than they did in the 1980s, when PEG channels grew most rapidly. Today, far more channels are offered on cable systems, and consumers can also turn to e-mail, online and cell-phone sources for local information. Viewing programming on computers and portable handheld devices has also become popular.

Cable television viewers now have many more channels available to them on their cable system, and more than a quarter of cable subscribers have switched to satellite services or other new entrants into the cable market. Much of the programming and local information is now available on the Internet, through such Web sites as YouTube and though e-mail groups, so PEG channels to a large extent no longer provide information that cannot be found elsewhere. Thus, any justification for offering PEG channels to give more choice to viewers no longer applies.

In general, PEG channel programming appears to be limited to certain narrow niches, which are primarily government meetings, high school events such as sports, concerts and graduation ceremonies, and certain very specialized programming. It is not clear how the appeal of PEG channels would increase with expanded funding. It is very possible that increased funding would do little to increase the appeal of PEG channels if the only change is better productions of the current local programming and perhaps better quality programming from outside the community (which in any event may have outlets on current non-PEG channels).

PEG channels still offer unique local programming, but only a small portion of cable subscribers actually watch the programming on PEG channels. There is no real evidence that PEG channel viewing will significantly increase following a huge increase in funding. Moreover, technological constraints preclude the satellite services from offering the highly localized programming found on PEG channels, so requiring cable systems to fund a large expansion of PEG channels and programming will place cable systems at a disadvantage as they compete with the growing satellite services.

Federal Limitation of PEG Fees to Capital Costs Only

The FCC has taken the position that PEG fees, by federal statute, may only be used for the capital costs incurred for PEG access facilities. This position was challenged in federal court and was upheld on June 27, 2008.*

Thus, any additional fees collected from the proposed PEG fee legislation must go solely for studios. In fairness to the sponsors of the legislation, this federal court ruling came well after the proposed Michigan legislation was introduced. It was still an open issue at the time the PEG legislation was introduced as to whether PEG fees could be used for programming, equipment, or general expenses related to PEG channels, but the issue has now been clarified by the federal courts. If Michigan enacts the proposed legislation, cable subscribers and cable companies will pay tens of millions of dollars each year for every imaginable improvement to PEG studios, but these additional PEG revenues will not, by federal law, be allowed to go toward programming, production, overhead or equipment costs.

Marketplace Resolutions of Programming Availability and Pricing

The long history of carriage disputes between MSOs and programmers demonstrates that such disputes can be sorted out in the marketplace. The "I Want My MTV" campaign from the 1980s was part of an attempt by MTV to get its loyal viewers to call cable systems and demand that they carry MTV at a time when MTV was raising its rates.

In recent years, several carriage disputes have resulted in channels being dropped by cable and DBS systems. Sports fans are aware of some of these disputes. In 2003, Fox Sports Net and Time Warner Cable failed to reach a carriage agreement for Fox Sports Net North (Minnesota sports) and the Sunshine Network (Florida), so that both were not carried by Time Warner cable systems for over two months until the companies agreed to a new contract.[43] More recently in Michigan, the Big Ten Network was launched before the 2007 college football season, but the Big Ten conference and Comcast failed to reach an agreement until nearly a year after the channel was launched, giving the DBS services a significant advantage over Comcast during the 2007 fall football season.[44]

* Alliance for Community Media v. FCC, 529 F.3d 763, 784-86 (6th Cir. 2008). ("During the enactment of this provision, Congress made clear that it intended section 622(g)(2)(C) to reach 'capital costs associated with the construction of [PEG] access facilities.' H.R. Rep. No. 98-934, at 26. ... Against this legislative pronouncement, the FCC's limitation of 'capital costs' to those 'incurred in or associated with the construction for PEG access facilities' represents an eminently reasonable construction of section 622(g)(2)(C).")

Similarly, in 2006 EchoStar, the parent of Dish Network, refused to carry the Lifetime channel in a carriage dispute. The channel responded with a "Take Back Your Lifetime" campaign that urged viewers to drop Dish in favor of another programming provider. A year earlier, EchoStar had a similar dispute with Viacom Inc., the parent of CBS, MTV, and Nickelodeon, and dropped carriage of the Viacom cable channels and 15 local CBS stations for two days until a new carriage agreement was reached on March 12, 2005.[45]

A long dispute between the National Football League and Time Warner Cable led to the NFL running ads in other media telling football fans to call the cable system and demand it carry the NFL Network. Time Warner responded with its own ads explaining that the league's $137 million price tag would force the company to raise prices for subscribers.[46]

Recently the FCC has discussed intervening in cable carriage disputes, but the discussions were contentious, and no majority has emerged for moving forward with any plans.[47] The common theme from all of the past carriage disputes is that if viewers want the channels that are the subject of the dispute, the negotiations between delivery services and programmers are resolved, and the channels are made available to viewers. It is unlikely that state or federal government intervention will have the intended effect, and more likely will result in each side investing more in lobbying efforts, rather than in efforts to resolve disputes.

What is most striking about the contentious carriage disputes between programmers and cable or DBS systems is how rarely they occur, and how they always are resolved without government intervention. Mandating PEG channel carriage is another example of a government intervening in a market system where it is unlikely that that government can do a better job than private parties in resolving essential private disputes. Moreover, future carriage disputes are likely to be exacerbated if resources are diverted to PEG channels, rather than the sometimes costly channels that large numbers of customers demand.

Alternatives to the Proposed Bills

A taxpayer-funded statewide model for PEG fees is inconsistent with the historical mission of PEG channels to serve local interests. Other alternatives are available that would be more consistent with local funding and control of PEG channels.

First, local governments and franchises could make PEG channels available on cable systems at a higher fee for the subscribers interested in receiving them. If the state then wants to encourage subscribers to help fund the channels, it could provide a tax deduction for PEG channel contributions, consistent with the tax deduction currently available for local PBS channels.

Second, local schools and governments could make current PEG channel programming available for Internet broadcasting. Alternative means of video distribution are now available through YouTube, blogs, vlogs, iPods, and many other new channels. Diane S. Katz has noted: "In the 1970s, when PEG became a standard feature of municipal franchising, video production systems could cost $100,000 or more. …Today, a high-definition portable camcorder can be had for less than $3,500, and there exist thousands, if not tens of thousands, of Web sites where video can be uploaded and viewed at no cost. …"[48] The Detroit News recently televised the removal hearing for Detroit Mayor Kwame Kilpatrick on its Web page using the same technology that could be used to carry a city council meeting over a local Internet site. Thus, it is now an option to make PEG channel programming available for Internet broadcasting, as Meridian Township near Lansing is currently considering doing.[49]

Conclusion

If cable systems are forced to set aside 2 percent of revenues for expanded PEG facilities, they will undoubtedly pass on some portion of their costs to consumers by raising their subscriber fees. Michigan cable customers already complain about rising cable costs, so a new legislative mandate that they pay millions of dollars more for their cable services would hardly be welcome.

Of course, if cable customers saw the value in the mandated PEG fees, then they might be willing to pay. If they were willing, however, it seems likely that cable systems would have already realized this and devoted more resources to PEG channels in an attempt to attract and satisfy more customers.

The benefits cable customers would receive from additional PEG fees seems paltry when compared to the cost they would pay. All of the PEG fees would be required to go to expanded PEG facilities — not to programming, equipment, or employee salaries. Thus, cable customers would likely see the same government meetings, school concerts and sporting events televised from impressive new studios, but with no significant change in programming content.

While public access channels have passionate supporters, the channels are left over from previous decades when far fewer alternatives were available to viewers and content producers. If local programming on public access channels is truly valued, it does not depend on the increases in franchise fees that would be sparked by House Bill 5047 and Senate Bill 636. History and the video marketplace show that the market, not the state government, is the right place to decide this matter.

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HOUSE BILL No. 5047

HOUSE BILL No. 5047

July 24, 2007, Introduced by Reps. Johnson, Constan, Hammel, Clack, Cushingberry, Accavitti, Scott, Lemmons, Jackson and Hammon and referred to the Committee on Energy and Technology.

A bill to amend 2006 PA 480, entitled

"Uniform video services local franchise act,"

by amending section 6 (MCL 484.3306).

THE PEOPLE OF THE STATE OF MICHIGAN ENACT:

Sec. 6. (1) A video service provider shall calculate and pay an annual video service provider fee to the franchising entity. The fee shall be 1 of the following:

(a) If there is an existing franchise agreement, an amount equal to the percentage of gross revenues paid to the franchising entity by the incumbent video provider with the largest number of subscribers in the franchising entity.

(b) At the expiration of an existing franchise agreement or if there is no existing franchise agreement, an amount equal to the

HOUSE BILL No. 5047

percentage of gross revenues as established by the franchising entity not to exceed 5% and shall be applicable to all providers.

(2) The fee due under subsection (1) shall be due on a quarterly basis and paid within 45 days after the close of the quarter. Each payment shall include a statement explaining the basis for the calculation of the fee.

(3) The franchising entity shall not demand any additional fees or charges from a provider and shall not demand the use of any other calculation method other than allowed under this act.

(4) For purposes of this section, "gross revenues" means all consideration of any kind or nature, including, without limitation, cash, credits, property, and in-kind contributions received by the provider from subscribers for the provision of video service by the video service provider within the jurisdiction of the franchising entity. Gross revenues shall include all of the following:

(a) All charges and fees paid by subscribers for the provision of video service, including equipment rental, late fees, insufficient funds fees, fees attributable to video service when sold individually or as part of a package or bundle, or functionally integrated, with services other than video service.

(b) Any franchise fee imposed on the provider that is passed on to subscribers.

(c) Compensation received by the provider for promotion or exhibition of any products or services over the video service.

(d) Revenue received by the provider as compensation for carriage of video programming on that provider's video service.

(e) All revenue derived from compensation arrangements for advertising attributable to the local franchise area.

(f) Any advertising commissions paid to an affiliated third party for video service advertising.

(5) Gross revenues do not include any of the following:

(a) Any revenue not actually received, even if billed, such as bad debt net of any recoveries of bad debt.

(b) Refunds, rebates, credits, or discounts to subscribers or a municipality to the extent not already offset by subdivision (a) and to the extent the refund, rebate, credit, or discount is attributable to the video service.

(c) Any revenues received by the provider or its affiliates from the provision of services or capabilities other than video service, including telecommunications services, information services, and services, capabilities, and applications that may be sold as part of a package or bundle, or functionally integrated, with video service.

(d) Any revenues received by the provider or its affiliates for the provision of directory or internet advertising, including yellow pages, white pages, banner advertisement, and electronic publishing.

(e) Any amounts attributable to the provision of video service to customers at no charge, including the provision of such service to public institutions without charge.

(f) Any tax, fee, or assessment of general applicability imposed on the customer or the transaction by a federal, state, or local government or any other governmental entity, collected by the provider, and required to be remitted to the taxing entity, including sales and use taxes.

(g) Any forgone revenue from the provision of video service at no charge to any person, except that any forgone revenue exchanged for trades, barters, services, or other items of value shall be included in gross revenue.

(h) Sales of capital assets or surplus equipment.

(i) Reimbursement by programmers of marketing costs actually incurred by the provider for the introduction of new programming.

(j) The sale of video service for resale to the extent the purchaser certifies in writing that it will resell the service and pay a franchise fee with respect to the service.

(6) In the case of a video service that is bundled or integrated functionally with other services, capabilities, or applications, the portion of the video provider's revenue attributable to the other services, capabilities, or applications shall be included in gross revenue unless the provider can reasonably identify the division or exclusion of the revenue from its books and records that are kept in the regular course of business.

(7) Revenue of an affiliate shall be included in the calculation of gross revenues to the extent the treatment of the revenue as revenue of the affiliate has the effect of evading the payment of franchise fees ~~which~~ **THAT** would otherwise be paid for video service.

(8) In addition to the fee required under subsection (1), a video service provider shall pay to the franchising entity as support for the cost of public, education, and government access

facilities and services an annual fee equal to 1 of the following:

(a) If ~~there is~~ **A PROVIDER IS OPERATING UNDER** an existing franchise **AGREEMENT** on ~~the effective date of this act~~ **JANUARY 1, 2007**, ~~the fee paid to the franchising entity by the incumbent video provider with the largest number of cable service subscribers in the franchising entity~~ **THE PROVIDER SHALL PAY THE FEE** as determined by the existing franchise agreement **UNTIL THE AGREEMENT EXPIRES**.

(b) At the expiration of the existing franchise agreement, ~~the amount required under subdivision (a)~~ **AN AMOUNT AS ESTABLISHED BY THE FRANCHISING ENTITY** not to exceed 2% of gross revenues.

(c) If there is no existing franchise agreement ~~, a percentage of gross revenues~~ **OR AT SUCH TIME ON OR AFTER JANUARY 1, 2007 THAT A PROVIDER ENTERS INTO OR POSSESSES A UNIFORM VIDEO SERVICE LOCAL FRANCHISE AGREEMENT, AN AMOUNT** as established by the franchising entity not to exceed 2% ~~to be determined by a community need assessment~~ **OF GROSS REVENUES**.

(d) An amount agreed to by the franchising entity and the video service provider.

(9) The fee required under subsection (8) shall be applicable to all providers.

(10) The fee due under subsection (8) shall be due on a quarterly basis and paid within 45 days after the close of the quarter. Each payment shall include a statement explaining the basis for the calculation of the fee.

(11) A video service provider is entitled to a credit applied toward the fees due under subsection (1) for all funds allocated to the franchising entity from annual maintenance fees paid by the

provider for use of public rights-of-way, minus any property tax credit allowed under section 8 of the metropolitan extension telecommunications rights-of-way oversight act, 2002 PA 48, MCL 484.3108. The credits shall be applied on a monthly pro rata basis beginning in the first month of each calendar year in which the franchising entity receives its allocation of funds. The credit allowed under this subsection shall be calculated by multiplying the number of linear feet occupied by the provider in the public rights-of-way of the franchising entity by the lesser of 5 cents or the amount assessed under the metropolitan extension telecommunications rights-of-way oversight act, 2002 PA 48, MCL 484.3101 to 484.3120. A video service provider is not eligible for a credit under this subsection unless the provider has taken all property tax credits allowed under the metropolitan extension telecommunications rights-of-way oversight act, 2002 PA 48, MCL 484.3101 to 484.3120.

(12) All determinations and computations made under this section shall be pursuant to generally accepted accounting principles.

(13) The commission within 30 days after the enactment into law of any appropriation to it shall ascertain the amount of the appropriation attributable to the actual costs to the commission in exercising its duties under this act and shall be assessed against each video service provider doing business in this state. Each provider shall pay a portion of the total assessment in the same proportion that its number of subscribers for the preceding calendar year bears to the total number of video service

subscribers in the state. The first assessment made under this act shall be based on the commission's estimated number of subscribers for each provider in the year that the appropriation is made. The total assessment under this subsection shall not exceed $1,000,000.00 annually. This subsection does not apply after December 31, 2009.

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