

Letter Report

Charges for Video Service

December 2009



Legislative Audit Bureau

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Janice Mueller
State Auditor

December 1, 2009

Senator Kathleen Vinehout and
Representative Peter Barca, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Vinehout and Representative Barca:

At your direction, we conducted a limited-scope review to assess whether the rates that video service providers charge subscribers have changed since 2007 Wisconsin Act 42 took effect in January 2008. The Act instituted a state-level franchising process under which land-based providers apply to the Department of Financial Institutions for a single video service franchise instead of negotiating separate franchises with individual municipalities.

We analyzed ten providers' monthly charges for basic and expanded basic service in 17 Wisconsin municipalities at two points in time—July 2007 and July 2009—using data reported to us by the providers. Over this two-year period, charges for basic service increased an average of 21.2 percent, and charges for expanded basic service increased an average of 11.5 percent. The reported data do not suggest that competition has had a substantial effect in reducing either basic or expanded basic video service charges or in slowing their rates of growth during the period we reviewed.

However, the data we analyzed must be interpreted with caution for several reasons, including variations in the number and types of channels that different providers offer as basic and expanded basic service, as well as variations in individual providers' charges for the same services because of promotional rates and the increasingly common practice of "bundling" video, Internet, and telephone services and charging less than their standard rate for each bundled component. In addition, a relatively short amount of time has passed since passage of the Act, making it difficult to assess whether the rate trends we identified will continue in the future.

We appreciate the courtesy and cooperation of the Department of Financial Institutions, the Wisconsin Cable Communications Association, and video service providers that assisted us in collecting this information.

Sincerely,

Janice Mueller
State Auditor

JM/PS/ss

Enclosure

CHARGES FOR VIDEO SERVICE

In January 2008, 2007 Wisconsin Act 42 instituted a state-level franchising process for certain video service providers, which are commonly referred to as cable television providers but include both cable and certain telecommunications companies. Previously, video service providers negotiated franchise agreements with individual municipalities and typically paid them franchise fees. Under the new process, the providers apply to the Department of Financial Institutions (DFI) for a single state-level franchise. A recent study by the University of Minnesota found that as of December 2008, 27 other states used similar processes to franchise video services.

State regulation of video service providers exists within a broad framework of federal regulation. For example, the Cable Communications Act of 1984 granted municipalities the authority to enter into franchise agreements with cable companies and limited franchise fees to no more than 5.0 percent of a provider's gross revenues in the municipality served. The Cable Television Consumer Protection and Competition Act of 1992 and the Telecommunications Act of 1996 promoted competition among video service providers, allowed telephone companies to begin providing video services, and required local and long distance telephone companies to share their infrastructure with other telephone companies.

At the direction of the co-chairs of the Joint Legislative Audit Committee, we conducted a limited-scope review to assess whether the rates that video service providers charge subscribers have changed since the passage of 2007 Wisconsin Act 42. In conducting our review, we:

- interviewed staff at DFI; the Wisconsin Cable Communications Association, which is the trade association of the cable television industry in Wisconsin; and ten video service providers in Wisconsin;
- analyzed data reported to us by video service providers concerning their monthly charges in 17 Wisconsin municipalities that we selected; and
- reviewed other available information related to changes in video service charges in Wisconsin and nationwide.

State Franchising of Video Service

Under 2007 Wisconsin Act 42, any entity or person seeking to provide video service through land-based technology must file an application for a certificate of franchise authority with DFI. Satellite providers, such as DirecTV and Dish Network, are not required to do so. State franchises for video services are in effect for ten years, after which the provider must reapply.

Providers with 10,000 or fewer subscribers pay DFI an application fee of \$2,000 and subsequent annual fees of \$100, while providers with more than 10,000 subscribers pay an application fee of \$5,000 and subsequent annual fees of \$2,000. For a fee of \$100, an approved franchise may be amended to address changes such as a provider's name, service area, or transfers of ownership.

Providers may terminate their franchises by filing a withdrawal form with DFI and paying another \$100 fee. DFI retains provider fees in its appropriations to help fund general operations.

Video service providers must also:

- pay a quarterly fee to any municipality in which service is provided, which may be no more than 5.0 percent of their gross revenues generated in the municipality;
- agree to continue to broadcast public, educational, and governmental channels, which are commonly called public access channels; and
- provide monetary support for public, educational, and governmental programming for a period of three years if such support was offered when the provider's state franchise was approved.

In addition, 2007 Wisconsin Act 42 requires any large providers entering a Wisconsin market to make video service available to at least 35.0 percent of area households, of which at least 30.0 percent must be low-income households, within three years of entering the market, and to make video service available to at least 50.0 percent of area households within five years of entering the market. Video service providers are required to file annual reports with DFI regarding their compliance with these requirements.

The 28 video service providers listed in Appendix 1 were approved for state franchises as of August 2009. It should be noted that a provider doing business under one name but providing service in different geographic areas may be approved for multiple franchises. For example, Charter Communications is a major provider with four Wisconsin franchises for the four areas in which it provides service.

Some Wisconsin video service providers are not listed in Appendix 1 because they are not required to operate under state franchises until their municipal franchises expire, which may be for as long as 15 years. We could not readily identify these providers, but information provided by the Wisconsin Cable Communications Association indicates that at least 16 are currently operating but have not yet obtained state franchises.

Analysis of Charges

Most providers offer two levels of service, basic and expanded basic. In general, basic service includes local channels that may be free without the use of a land-based technology, as well as certain other news or sports channels offered on a fee-for-service basis. Expanded basic service typically includes the basic-level channels and other news, sports, and entertainment channels. However, the number of channels offered varies significantly by provider. For example, Comcast in the City of Hudson offers basic service with 25 channels, while CenturyTel in the City of La Crosse offers basic service with only 10 channels. In addition, some providers offer features with their video programming that others do not. For example, in both its basic and its expanded basic service, AT&T includes features that allow subscribers to view their own photos through their televisions and provides access to weather, sports, stock, and traffic information.

Because of promotions offered to new and continuing subscribers, including free equipment rentals, reduced introductory rates, digital service upgrades, free months of service, and discounted movie channels for limited periods of time, everyone receiving the same type of service from the same provider does not necessarily pay the same rate or receive identical services. In addition, some providers “bundle” video, Internet, and telephone services for a monthly charge that is lower than their standard rate for each component. It is common for subscribers to purchase multiple services. For example, representatives of Time Warner Cable told us that more than 60.0 percent of its customers subscribe to more than one type of service.

We reviewed three recent studies analyzing the rates charged by video service providers and their potential effects on market competition. The federal Government Accountability Office reported in 2004 that charges for expanded basic service were from 15.0 percent to 41.0 percent lower in five of six markets in which there was competition among providers. That study also found that competition benefited consumers by lowering prices for bundled video, Internet, and telephone services.

Data reported in the Federal Communications Commission’s (FCC’s) most recent annual report on nationwide charges for basic and expanded basic service show that competition appeared to have had little or no effect on charges for basic service within a community, but did appear to have affected charges for expanded basic service. The FCC reported that as of January 2008, the average charge for basic service was 8.9 percent lower for communities the FCC determined to be “non-competitive” than for communities the FCC determined to have “effective competition.” However, the average charge for expanded basic service was 3.7 percent higher in non-competitive communities than in communities with effective competition. Nationwide, charges for basic cable services increased 5.1 percent from January 2007 to January 2008, from \$15.33 to \$16.11 per month, and charges for expanded basic service increased 5.0 percent during the same period, from \$47.27 to \$49.65. From 1995 to 2008, the average charge for expanded basic service increased 122.1 percent, while the consumer price index increased 38.4 percent.

A 2009 study based on FCC data and conducted by the University of Minnesota found that charges for expanded basic service increased from December 2006 to February 2009 in 45 of the 47 states for which data were available. That study noted that price increases ranged from 0.2 percent in New Hampshire to 79.8 percent in California and reported an increase of 27.6 percent for Wisconsin.

As shown in Table 1, since the passage of 2007 Wisconsin Act 42, the average monthly charge for basic service in the 17 Wisconsin municipalities included in our review increased by 21.2 percent, and the average monthly charge for expanded basic service increased by 11.5 percent. Some portion of these increases can be attributed to a 35.0 percent increase in the average number of channels included in basic service and a 14.7 percent increase in the average number of channels included in expanded basic service. The monthly charges and the number of channels offered by video service providers included in our review are shown in Appendix 2 and Appendix 3.

Table 1

Video Service Charges and Channels in 17 Wisconsin Municipalities¹

Month	Basic Service		Expanded Basic Service	
	Average Charge	Average Number of Channels	Average Charge	Average Number of Channels
July 2007	\$13.93	20	\$45.97	75
July 2009	16.89	27	51.24	86
Change	\$ 2.96	7	\$ 5.27	11
Percentage Change	21.2%	35.0%	11.5%	14.7%

¹ Represents self-reported data from ten video service providers.

Only one video service provider is available in most municipalities in Wisconsin, but larger cities are likely to have multiple providers. As shown in Table 2, 9 of 17 municipalities included in our review were served by multiple land-based providers, while the remaining 8 municipalities were served by one land-based provider.

Table 2

Municipalities Included in Our Review¹

One Provider	Multiple Providers
Beloit	Green Bay
Eau Claire	Kenosha
Hudson	La Crosse
Manitowoc	Madison
Marinette	Milwaukee
Platteville	Village of Mount Horeb
Rhineland	Reedsburg
Wausau	Rice Lake
	Wisconsin Rapids

¹ All municipalities are cities, except for the Village of Mount Horeb.

During both periods we reviewed—July 2007 and July 2009—the average charge for basic service was lower in municipalities with only one land-based video service provider, as shown in Table 3, while the average charge for expanded basic service was slightly higher. The average charge for expanded basic service increased at nearly the same rate regardless of whether competition existed; it was 11.5 percent in municipalities with one provider and 11.6 percent in municipalities with multiple providers. For basic service, the increase was 2.8 percentage points higher for municipalities served by multiple providers. It should be noted that many subscribers receive services as part of a bundled package, so the average charges shown may not always represent what they actually paid, and that Charter Communications had the largest effect on average charges because it provides service in 10 of the 17 municipalities we reviewed.

Table 3

Changes in Video Service Charges¹
July 2007 to July 2009

Level of Service	One Provider in Municipality ²	Multiple Providers in Municipality ²
Basic Service		
Average Charge, July 2007	\$12.42	\$14.68
Average Charge, July 2009	14.72	17.81
Change	\$ 2.30	\$ 3.13
Percentage Change	18.5%	21.3%
Expanded Basic Service		
Average Charge, July 2007	\$46.70	\$45.61
Average Charge, July 2009	52.05	50.90
Change	\$ 5.35	\$ 5.29
Percentage Change	11.5%	11.6%

¹ Represents self-reported data from ten video service providers.

² Eight municipalities had one provider, and nine had more than one.

In July 2009, municipalities served by only one provider had more basic channels, on average, than municipalities served by multiple providers. Municipalities served by multiple providers had more expanded basic channels during both time periods, as shown in Table 4, but the percentage increase in available channels for both basic service and expanded basic service was greater for municipalities with only one provider. However, it should be noted that Charter Communications provided service in four of the eight municipalities with only one provider that were included in our review, and Charter Communications significantly increased the number of basic channels provided in each of these communities. The number of basic channels available in three of the other four municipalities with one provider did not increase, and basic service was not available in the fourth municipality in July 2007.

Table 4

Average Number of Channels¹
July 2007 to July 2009

Level of Service	One Provider in Municipality ²	Multiple Providers in Municipality ²
Basic Service		
July 2007 Average Number of Channels	19	20
July 2009 Average Number of Channels	30	26
Change	11	6
Percentage Change	57.9%	30.0%
Expanded Basic Service		
July 2007 Average Number of Channels	69	78
July 2009 Average Number of Channels	82	87
Change	13	9
Percentage Change	18.8%	11.5%

¹ Represents self-reported data from ten video service providers.

² Eight municipalities had one provider, and nine had more than one.

It does not appear that competition has had a substantial effect in reducing either basic or expanded basic video service charges or in slowing their rates of growth from July 2007 to July 2009. This is likely because service charges are affected by numerous factors, including providers' programming decisions, which can significantly affect video service costs for subscribers. Providers noted that their service charges typically increase as a result of contract negotiations with television networks and, in some cases, because they provide additional programming in order to remain competitive or to address consumer requests. For example, some providers added the Big Ten Network to their channel offerings when it was launched in August 2007, while others added it only after significant public pressure. In addition, some indicated that in January 2009 the principal local networks began charging them retransmission fees for programming that had previously been free. One provider indicated that these retransmission fees were currently \$1.23 per customer but noted that they vary depending upon the agreements reached with the networks.

Some land-based video service providers believe that 2007 Wisconsin Act 42 is not likely to affect subscribers' costs because land-based providers already faced competition from satellite providers prior to its implementation. Satellite providers are not required to pay franchise fees or to register with DFI, although they are regulated by the FCC. Moreover, of the nine municipalities in our review that were served by multiple land-based providers in July 2009, six were already being served by multiple providers in July 2007, prior to passage of the Act.

Subscribers' costs are also affected by the availability of infrastructure to provide land-based video service. For new providers, installing technology for video service requires substantial capital investment. For example, AT&T upgraded its existing telecommunications networks to provide video service over its existing telephone lines in the Green Bay, Madison, and Milwaukee areas, but company officials indicated that for reasons of profitability, video service is currently limited to where it can reach many households with existing landlines, and it is unlikely that places outside an existing AT&T service area will be able to receive video service from AT&T in the near future.

Finally, we note that the effects of 2007 Wisconsin Act 42 on competition among video service providers may change as more time passes and if additional providers offer video service in Wisconsin. The Act did resolve some legal disputes regarding the ability of telecommunications companies to provide video service, which allowed AT&T to continue providing video service in Milwaukee and other areas and to expand more easily into new markets, including Green Bay and Madison, and it also allowed Mosaic Telecom to enter the Wisconsin video service market. However, the extent to which competition may reduce prices or slow their rate of growth may be limited and remains difficult to ascertain because:

- developing the needed infrastructure to enter a market or serve additional areas may be prohibitively costly for some video service providers;
- the extent to which meaningful competition from both satellite and land-based providers already exists in municipalities may reduce the effects of additional competition; and
- the growing popularity of bundled services will make it even more difficult to determine the effect of competition on video service charges and for consumers to assess the relative value of different packages, given variation in video content, Internet speed, and telephone calling plans.

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Appendix 1

Video Service Providers with Franchises in Wisconsin
(As of August 2009)

	Application Received by DFI	Provider Size ¹	
		10,000 or Fewer Subscribers	More than 10,000 Subscribers
Baldwin Telecom, Inc.	April 9, 2008	✓	
CCI Systems, Inc. (Doing business as Packerland Broadband)	May 29, 2008	✓	
Celect Communications, LLC	May 19, 2008	✓	
CenturyTel Broadband Services, LLC	February 29, 2008	✓	
CenturyTel Televideo, Inc. (Doing business as CenturyTel)	February 29, 2008	✓	
CC VIII Operating, LLC (Doing business as Charter Communications)	February 27, 2008		✓
Charter Cable Partners, LLC (Doing business as Charter Communications)	February 27, 2008		✓
Charter Communications VI, LLC (Doing business as Charter Communications)	February 27, 2008	✓	
Charter Video Electronics, Inc. (Doing business as Charter Communications)	February 27, 2008	✓	
Comcast of Minnesota/Wisconsin, Inc. (Doing business as Comcast)	March 3, 2008	✓	
Comcast of Wisconsin, Inc. (Doing business as Comcast)	March 3, 2008	✓	
CTC TelCom, Inc. (Doing business as Mosaic Telecom and Mosaic Media)	March 10, 2008	✓	
Howard Cable	August 6, 2009	✓	
Lakeland Telecom, LLC	April 22, 2009	✓	
Manawa Telecom, Inc. (Doing business as Manawa Telecom Video)	March 30, 2009	✓	
MCC Illinois, LLC (Doing business as Mediacom)	February 9, 2009	✓	
Mediacom Wisconsin, LLC (Doing business as Mediacom)	August 6, 2008		✓
Merrimac Communications, Ltd.	February 5, 2008	✓	
MH Telecom, LLC	August 27, 2008	✓	
Niagara Telephone Company (Doing business as Borderland Communications, LLC)	June 22, 2009	✓	

	Application Received by DFI	Provider Size ¹	
		10,000 or Fewer Subscribers	More than 10,000 Subscribers
Northeast Communications of Wisconsin, Inc. <i>(Doing business as Nsight)</i>	April 7, 2008	✓	
Price County Telephone Company <i>(Doing Business as Price County Telcom)</i>	April 23, 2008	✓	
S & K TV Systems, Inc.	February 28, 2008	✓	
Time Warner Entertainment Company, LP	February 26, 2008		✓
Western Wisconsin Communications, LLC	March 3, 2008	✓	
Windjammer Communications, LLC	October 3, 2008	✓	
Wisconsin Bell, Inc. <i>(Doing business as AT&T)</i>	February 21, 2008		✓
Wood County Telephone Company	July 21, 2008	✓	

¹ As reported on initial application to DFI.

Appendix 2

Charges for Basic Service

	July 2007		July 2009	
	Monthly Charge	Number of Channels	Monthly Charge	Number of Channels
Municipalities with One Provider¹				
Beloit				
Charter Communications	\$ 9.71	23	\$15.99	47
Eau Claire				
Charter Communications	10.14	25	11.23	37
Hudson				
Comcast	8.40	25	8.59	24
Manitowoc				
Comcast	14.49	20	15.99	20
Marinette				
Time Warner Entertainment Company, LP	11.72	13	13.99	13
Platteville				
CenturyTel Broadband Services, LLC	N.A. ²	N.A. ²	17.95	15
Rhineland				
Charter Communications	16.25	12	16.99	38
Wausau				
Charter Communications	16.25	18	16.99	42
Municipalities with Multiple Providers¹				
Green Bay				
AT&T	N.A. ³	N.A. ³	19.00	16
Time Warner Entertainment Company, LP	21.59	13	24.85	13
Kenosha				
AT&T	N.A. ²	N.A. ²	19.00	23
Time Warner Entertainment Company, LP	12.15	29	13.97	29
La Crosse				
CenturyTel Broadband Services, LLC	9.99	10	9.99	10
Charter Communications	12.00	25	12.00	44
Mediacom	11.45	16	12.45	17
Madison				
AT&T	N.A. ³	N.A. ³	19.00	15
Charter Communications	14.20	22	15.47	47

	July 2007		July 2009	
	Monthly Charge	Number of Channels	Monthly Charge	Number of Channels
Municipalities with Multiple Providers¹ (continued)				
Milwaukee				
AT&T	N.A. ²	N.A. ²	\$19.00	23
Time Warner Entertainment Company, LP	\$13.50	29	15.73	29
Village of Mount Horeb				
Charter Communications	17.25	22	19.99	47
MH Telecom, LLC	16.95	16	19.95	18
Reedsburg				
Charter Communications	17.25	22	19.99	42
Reedsburg Utility Commission	14.99	18	17.99	18
Rice Lake				
Charter Communications	15.18	22	19.99	35
Mosaic Telecom	N.A. ³	N.A. ³	26.95	15
Wisconsin Rapids				
Charter Communications	11.99	16	14.99	41
Solarus	16.99	16	17.99	18

¹ All municipalities are cities, except for the Village of Mount Horeb.

² Basic service was not offered in July 2007.

³ No video service was provided in July 2007.

Appendix 3

Charges for Expanded Basic Service

	July 2007		July 2009	
	Monthly Charge	Number of Channels	Monthly Charge	Number of Channels
Municipalities with One Provider¹				
Beloit				
Charter Communications	\$49.99	76	\$51.99	103
Eau Claire				
Charter Communications	49.99	81	51.99	96
Hudson				
Comcast	50.49	68	57.50	68
Manitowoc				
Comcast	48.49	64	53.99	64
Marinette				
Time Warner Entertainment Company, LP	48.15	71	55.99	71
Platteville				
CenturyTel Broadband Services, LLC	26.50	42	40.95	60
Rhineland				
Charter Communications	49.99	69	51.99	95
Wausau				
Charter Communications	49.99	80	51.99	101
Municipalities with Multiple Providers¹				
Green Bay				
AT&T	N.A. ²	N.A. ²	49.00	70
Time Warner Entertainment Company, LP	48.15	71	55.99	71
Kenosha				
AT&T	44.00	50	49.00	70
Time Warner Entertainment Company, LP	48.15	78	55.99	78
La Crosse				
CenturyTel Broadband Services, LLC	41.99	129	47.99	128
Charter Communications	43.95	80	43.95	102
Mediacom	48.95	62	54.95	64
Madison				
AT&T	N.A. ²	N.A. ²	49.00	70
Charter Communications	49.99	77	51.99	104

	July 2007		July 2009	
	Monthly Charge	Number of Channels	Monthly Charge	Number of Channels
Municipalities with Multiple Providers¹ (continued)				
Milwaukee				
AT&T	\$44.00	50	\$49.00	70
Time Warner Entertainment Company, LP	48.15	78	55.99	78
Village of Mount Horeb				
Charter Communications	49.99	77	51.99	104
MH Telecom, LLC	50.95	92	56.95	100
Reedsburg				
Charter Communications	49.99	77	51.99	99
Reedsburg Utility Commission	42.99	71	49.49	72
Rice Lake				
Charter Communications	32.55	78	36.99	94
Mosaic Telecom	N.A. ²	N.A. ²	60.95	85
Wisconsin Rapids				
Charter Communications	38.99	79	40.99	100
Solarus	46.99	94	54.99	96

¹ All municipalities are cities, except for the Village of Mount Horeb.

² No video service was provided in July 2007.