THE WALL STREET JOURNAL. THURSDAY, AUGUST 10, 1989 B1

MARKETPLACE

Technology: *Automation robs phone strikers of bargaining clout* *Page B5.*

Law: *U.S. conducts antitrust probe of prestigious colleges, universities* *Page B7.*

Prying Open the Cable-TV Monopolies

Prices, Lawsuits Place Pressure On the Industry

By JOHN R. EMSHWILLER
Staff Reporter of THE WALL STREET JOURNAL

LOS ANGELES—The city of Los Angeles has spent roughly $1 million so far to keep some local entrepreneurs from competing against a cable-TV monopoly controlled out of Boston.

It apparently doesn't matter that the entrepreneurs are black, in a city with a black mayor and a stated policy of encouraging minority-owned businesses. It's more that this is the tightly sealed world of cable television.

With a handful of exceptions, the roughly 9,000 cable franchises in the U.S. are monopolies, granted by local governments to a favored company, one usually partly owned by politically well-connected people. Governments pass out such monopolies and fiercely defend them, yet don't regulate prices charged to customers. The "franchise fees" that local governments charge cable operators rise with the revenues, and total hundreds of millions of dollars annually.

Soaring Prices

But the winds of competition are rustling in the cable business. Two or three dozen communities now allow second cable companies to compete, estimates John Mansell, a senior analyst with Paul Kagan Associates, a media research firm. Public unhappiness over service and rising prices is fueling the push for competition. Just last week, the General Accounting Office released a study saying rates charged by cable operators for basic service jumped 29% between December 1986 and October 1988.

Preferred Communications Inc. has a suit pending in federal district court here aimed at forcing the city to grant it a franchise. Preferred is owned by a group of local, mostly black investors, headed by two brothers, Clinton and Carl Galloway. A win by Preferred could make it easier for competitors to get in the door nationwide.

Nationally, the status quo is a recipe for bad government and bad cable service, critics contend. "It is one of the most corrupt processes imaginable," says Sol Schildhause, former chief of the cable-TV branch of the Federal Communications Commission and now a private attorney whose firm represents Preferred in its suit.

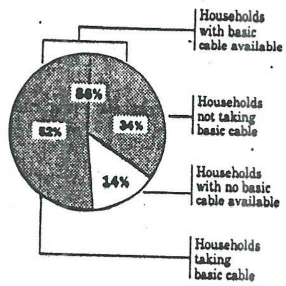
Defenders argue that cable television is one of those businesses, like a utility, that works best as a monopoly. Given the expense and street disruption required to lay cable to every home in an area, putting in more than one system is simply a waste of resources and an annoyance for residents in the area, they say.

Operators argue that in some places competition was tried, but it failed, leaving a monopoly anyway. "It's simply not viable to have two franchises in one area," says Marc Nathanson, chairman of Los Angeles-based Falcon Cable TV, which operates cable franchises nationwide.

Nor is price regulation necessary, cable operators say, because cable prices are held down by competition with regular, free broadcasters and other media. Recent price surges were simply a "catch-up" for prior years when cable rates were regulated and artificially depressed, operators contend.

Cable Television's Growing Reach

As cable becomes widespread ...



Users pay more for the service

	AVERAGE MONTHLY PRICE OF BASIC CABLE (In dollars)	CABLE REVENUE FROM BASIC SERVICES (In millions of dollars)
1980	$7.85	$1,648.5
1981	8.14	2,100.1
1982	8.46	2,678.6
1983	8.76	3,101.0
1984	9.20	3,632.2
1985	10.25	4,366.5
1986	11.09	5,083.7
1987	13.27	6,552.7
1988	14.40	7,724.7

Source: Paul Kagan Associates, Inc., Cable TV Investor

In Vidalia, Ga., John Collins and his Southland Cablevision Inc. are going head to head with a unit of Tele-Communications Inc., the biggest cable operator in the U.S. Since Southland was launched in March 1988, it has taken about 2,000 of TCI's 4,800 cable customers, according to Mr. Collins, a former building contractor. TCI says the number is lower than that, but won't be more specific.

Faced with a rival, TCI has slashed prices. Mr. Collins says he meets those cuts in the parts of his service where he can afford to and resorts to guerrilla tactics when he can't cut prices. After a recent 37% price cut by TCI on basic monthly service, Mr. Collins trumpeted his competitor's action in newspaper ads that ran in Georgia cities where TCI has cable monopolies and *didn't* cut prices. "That should get them a few phone calls," Mr. Collins says.

TCI says it has received some calls because of the advertisements but doesn't expect any lasting damage. The cable giant also vows to do all it can, within the law, to beat competitors. And, a spokesman adds, "We expect to see more competition from the Collinses of the world."

Would-be competitors hope that's the case, but headway has been slow, especially in the courts.

The Galloways, for instance, have been trying for nearly a decade to get a franchise to serve the Watts district of Los Angeles and other parts of the city's largely black south-central area. Their suit, which is already six years old, was originally dismissed. Today, three years after the U.S. Supreme Court ruled in favor of reinstating the case, the brothers are still waiting for the judge in the case to set a trial date. "I sometimes think it would be easier to get a trial in Russia," says Clinton Galloway, president and chief executive officer of Preferred Communications.

Los Angeles city officials say competition hasn't worked in other cities and won't work here. With streets torn up to install lines, "there is a lot of disruption from building a second cable system," says Ed Perez, the assistant city attorney handling the Preferred suit.

The Galloway side argues that the city allows other private interests, from skyscraper construction to movie making, to inconvenience citizens in the pursuit of profit. And as for economic viability, they want the marketplace to be the arbiter.

The Galloways, not surprisingly, say their real mistake was not playing politics with the powers that be. In the late 1970s when the city invited interested parties to compete for the south-central franchise, the Galloways formed an investment group and submitted a bid. But from early on there was city hall pressure to drop that bid and "get on the team," recalls Clinton Galloway. The "team," he says, included friends and political allies of some of the black city council members and Mayor Tom Bradley. At one point, the mayor himself held a private meeting with the Galloways and the others to urge such a combination.

The Galloways declined. "We wanted to run our own cable company," says Clinton Galloway.

Later, in a deposition as part of the suit, Mr. Bradley testified that he was merely trying to "enhance" the chances of the franchise going to a black-owned firm.

In fact, the city council and mayor awarded the franchise to a white-controlled company named A Community Cable Entertainment/Services System Inc., and known as Access. Kaufman & Broad Inc., the big Los Angeles-based homebuilder, originally owned 80% of Access; that stake is now held by Continental Cablevision, a big Boston-based cable operator. (Dow Jones & Co., publisher of this newspaper, formerly owned a 17% stake in Continental.) The remaining 20% of Access went to many of the same parties that had been proposed as partners to the Galloways.

Mr. Perez, the assistant city attorney, says there isn't any evidence of improper political influence in all this. "But is the appearance bad? Yes; the appearance is bad," he concedes.

Nor are appearances helped by two memos from Channing Johnson, one of the leading minority shareholders, to a top Bradley aide. One says that "appropriate political support" might be needed in negotiating details of the deal with Kaufman & Broad. The other memo notes that the distribution of some of the shares had to pass muster with a senior city councilman.

Obvious Improprieties?

The Galloways insist the city simply never looked for improprieties, even though some seemed obvious candidates for review. For instance, Mr. Johnson, before becoming a minority shareholder was a city council aide who actually helped set up the south-central franchise. He then quit his city job and lobbied hard to get a piece of the franchise, despite a municipal ordinance that bars former city employees from certain types of lobbying activities.

Mr. Johnson denies any wrongdoing. The district attorney's office conducted an investigation that consisted of trying to interview Mr. Johnson and his former city council boss. When both refused to talk, the investigation was closed, according to a district attorney's report on the matter that the Galloways obtained.

Mr. Perez, the city official, says he hasn't closely examined the Johnson case, but in similar conflict-of-interest situations the city has interpreted the ordinance to apply only to a former official when he is representing another party. If he is also representing himself as a part owner, it's legal, says Mr. Perez, though he clearly isn't completely comfortable with that interpretation. "It's a loophole you could drive a Mack truck through," he says.

Behind the Cable TV Rip-Off

It's time to pull the plug on price-gouging monopolies and get a little healthy competition into the picture

BY DANIEL R. LEVINE

MELISSA GAZAWAY has had it with her cable-television company, and there's nothing she can do about it. When the Orlando, Fla., woman moved less than two miles to a new neighborhood, she was shocked to find her monthly cable bill had gone up almost 50 percent. For 36 basic cable channels and one movie channel, she pays $35.86 a month. She had been paying $24.32 for the same channels with the same company. Why the difference? Her new neighborhood is served by just one company. Her prior home was in an area where it competed for customers with another company.

Like millions of Americans, Melissa is a captive of monopoly cable. "Because there's no competition here, they can get away with charging whatever they want," she says. "It's ridiculous and unfair. Everyone should be able to get the same low rates."

When San and Jerry Birch lived in an Orlando-area subdivision where there was no competition, their monthly bill was $28.44 for 35 channels. Two years after they moved to an area where three companies compete, their

monthly bill had dropped by more than $10. "I thought it was a mistake," says San.

Unfortunately, most Americans can relate more easily to Melissa Gazaway than to the Birches. The nation has 11,191 cable systems, but they compete head-on in only about 65 communities. Where competition does exist, bills are 22- to 30-percent lower, channel choices are greater, and service is far more responsive.

Cable is big business, with more than 51 million subscribers and annual revenues of $20 billion—almost two times that of ABC, CBS and NBC combined. Why then is there so little competition for cable dollars?

"Local governments—with the encouragement of cable operators—have thrown up nearly insurmountable barriers to the entry of more than one firm into each market," says John Merline, Washington correspondent for *Investor's Business Daily* who has written extensively on the cable industry.

Not only are the vast majority of America's cable customers at the mercy of government-imposed monopolies, but the awarding of franchises is open to political favoritism and corruption. Just ask Carl and Clinton Galloway, black entrepreneurs who in 1979 sought to bring cable TV to crime-ridden south-central Los Angeles.

Carl, a physician, and Clinton, an accountant, wanted their Universal Cable Company to include shows on health care and child-raising. "I see my race dying in south-central L.A., and it scares me," says Clinton. "We have the opportunity to dramatically change the way people are educated about these issues."

When the Galloways asked the Los Angeles city council for a license, they were told to direct their application to Channing Johnson, an aide to Councilman Robert Farrell. In early 1980, while still awaiting a response, they learned that Johnson had formed his own cable company, Community Telecommunications, Inc. (CTI).

The Galloways demanded an explanation. Several months later, in discussions with Mayor Tom Bradley's office, pressure was put on the Galloways to combine with Johnson's group, which had the mayor's support. It was intimated this was the only way they could share in the cable largess. But the Galloways refused to enter into a sweetheart deal.

Finally, in 1983, Los Angeles awarded the franchise to a company 80-percent owned by the Kaufman & Broad Home Corp., whose chairman, Eli Broad, was a major Bradley fund-raiser. The remaining 20 percent of shares were given to Johnson's CTI, which included two people who were "politically well-connected."

The Galloways sued through their newly formed company, Preferred Communications, Inc., and in January 1990 U.S. District Judge Consuelo Marshall ruled that the city's franchising process was un-

PHOTOS: ERNEST COPPOLINO

constitutional. But Los Angeles has still not approved the Galloways' application, which again must go through the entire convoluted and costly licensing procedure.

Those opposed to competition argue that cable TV is a "natural monopoly"—that high construction costs make competition unviable. Politicians defend this argument to protect the largess that flows from licensing—campaign contributions for themselves and "franchise fees" (usually five percent of a cable company's annual revenues) for their local treasuries.

The situation is radically different, however, in areas served by more than one company. Here are two prime examples of competition at work:

Allentown, Pa. Service Electric Cable and rival Twin County Cable have co-existed since 1963 in this Lehigh Valley city where municipal regulation is minimal and competition is encouraged. As a result, Allentown's 40,000 cable subscribers receive excellent service and pay reasonable rates. Twin County offers 56 channels for $18.50 a month, while Service Electric charges $19 for 60 channels.

At Service Electric, any call to a service representative is answered within three rings. "We can't keep the customer waiting or he may switch companies," explains general manager John J. Capparell.

Competition is equally fierce at Twin County, where the office is staffed and service technicians are on the road until 11 p.m. "Competition keeps rates down and cable companies on their toes," says Twin County vice president Bill Stone, a 43-year veteran of the business.

Montgomery, Ala. Between December 1986 and January 1989, Montgomery's longtime monopoly operator, Storer Cable Communications, raised rates three times. Then William P. Blount, president of a prominent investment banking firm, formed Montgomery Cable-Vision and Entertainment, Inc., which began competing against Storer in August 1990.

Montgomery offered 60 channels for $16.95 plus free installation and remote control. In less than two weeks, Storer announced it was upgrading to 61 channels and lowering its basic price to $16.95. It even created an economy package of 12 channels for $11.95.

In 1984 Congress passed a law prohibiting cities from regulating cable rates. The results were predictable. The average price for basic cable soared 61 percent after the law went into effect in 1986.

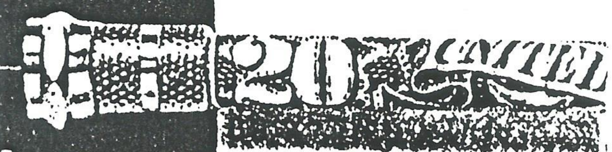
Today, with Americans increasingly angry over monopoly cable service, legislation is moving through Congress that would allow local governments to limit increases in cable rates. But rate regulation cannot eradicate the corrupt franchising process, increase efficiency or make cable companies responsive to their customers.

"Regulation of the cable industry

is a chimera," says economist Thomas W. Hazlett of the University of California at Davis. "There can be no effective regulation of the cable industry beyond active rivalry with other cable companies."

Some lessons for the rest of the nation can be learned from steps taken by Montgomery, Ala. There the city council enacted two ordinances to encourage competition. The first measure, which Storer is challenging in the courts, prohibits discriminatory price-cutting. If Storer Cable wishes to cut rates, it must do so throughout the area, not just where rival Montgomery Cable has service or is about to install it.

In 4½ years, the basic price for cable service soared 61 percent



The second ordinance, also being challenged by Storer, calls for equal access to programming for all cable operators in a given market. If the statute is upheld, programmers will be unable, for instance, to deny Montgomery Cable the right to bid for features such as ESPN's "Sunday Night NFL" or TNT, the Ted Turner channel, which features movies and sporting events.

The FCC has also signaled that increased competition is needed in the marketplace by proposing that telephone companies be permitted to go head-to-head with existing cable companies. Last October, the FCC proposed the adoption of video dial tone, which would enable consumers to receive programming through their telephone companies. It would combine traditional telephone service with video programming and other information services all in a single fiber-optic telephone wire. If the video-dial-tone proposal is adopted, telephone customers could have access to the same programs offered by cable operators and broadcast stations.

Ultimately, however, unrestrained competition is the answer to our cable-TV woes. Waldport, Ore. (pop. 1595), where residents are the beneficiaries of a David versus Goliath rivalry, could serve as a model for cable TV nationwide. Waldport has one traffic light—and two cable companies. Customers can choose between Tele-Communications, Inc. (TCI), the world's largest operator, and Alsea River Cable TV, perhaps the world's smallest.

Alsea River has three employees working out of a three-room house on Waldport's main street. President Dale Haslett takes care of the electrical work and maintenance. Leta, his wife, handles billing and other paper work. Their son Alan hooks up new subscribers and handles trouble calls.

In 1964, Dale was asked to take over a makeshift cable system serving just seven people nearby. He restored third- and fourth-hand equipment to improve the system, and soon word spread of the clear pictures being received from Portland, Corvallis and Salem.

Waldport residents begged Haslett to provide them with a choice. In 1975, after learning that the phone company planned a new underground line to the edge of town, Haslett persuaded the contractor to let him lay his own TV cable alongside the telephone cable.

Liberty Communications Co. was serving the area at the time, and when a clamor arose to grant Haslett a franchise, the city council, under Liberty's influence, voted him down 5–1. Infuriated, Waldport residents petitioned to place the issue on the ballot in a special election. The vote was 266–26 in favor of granting Alsea River Cable a franchise. During more than ten years of competition, Waldport cable customers have been receiving fast, responsive service and a wide range of channels from both systems, while paying some of the lowest rates in the country.

Haslett says that soon after cable giant TCI took over Liberty in 1983, he was told by TCI to either sell out or be put out of business later. TCI denies this. Haslett ignored the proposal, and in 1990 he turned down a $1.35-million offer from TCI. His satisfied customers are glad he did.

Cable subscribers tired of rising prices and indifferent service should write their representatives in Washington. The answer is not to regulate cable prices—it is to remove all barriers that prevent cable competition.

Reprints of this article are available. See page 234.

On the House

AT A NEIGHBORHOOD COCKTAIL PARTY, a new Coronado, Calif., resident who'd just paid $300,000 for a tiny house on a little lot on an alley was seeking reassurance. "Do you think I paid too much?" she asked her host.

"Nah, you can't lose in Coronado," the neighbor replied.

"But $300,000, and it's so small," she persisted.

"If you don't trust me, ask this guy," the neighbor said. "He's one of our top brokers."

"I just bought a house near here, and I'm worried," she blurted out to the real-estate salesman.

"You can't lose in Coronado," he interrupted. "Look, some idiot just paid $300,000 for a tiny house on a little lot fronting on an alley."

—Tom Blair in San Diego *Union*