BCAP NewsClips

August 4, 2014

If you're confused by the "net neutrality" debate roiling Washington, you're in good company. The editors of Wired magazine realized that even their high-tech readers needed help understanding what passes for political debate on the topic. **They published a graphic in June** with the heading "What you think the Internet looks like" alongside "What the Internet really looks like." It debunked the key claim of net-neutrality lobbyists that allowing "fast lanes" would undermine the open Internet.

The Wired graphic shows that the Internet is already full of fast lanes. In the early days, websites simply connected to the Internet backbone, which consumers accessed through Internet service providers. But as Internet use grew, sites like Google created their own fast lanes by sending data directly to ISPs such as phone and cable companies via what are called "peering" arrangements. Sites like Netflix created another set of fast lanes using "content delivery networks" to place their computer servers inside local ISPs so that video and other bandwidth-hoggers can be delivered smoothly.

In other words, fast lanes won't kill the Internet. They've saved the Internet.

If it weren't for these fast lanes, the Web would have screeched to a halt when photos and video began to supplement text-based traffic. At peak times, Netflix alone now accounts for one-third of all Internet traffic. If it weren't using its own network to cache video locally around the world, other traffic on the Web would get hung up or delayed. Fast lanes keep everything else flowing smoothly, from email to security cameras to remote surgery. "Net neutrality" has become a meaningless plaint of "Unfair!" Activist groups in Washington with benign names like Free Press and Public Knowledge want the Internet reclassified as a public utility, subject to the sort of regulations that micromanaged railroad monopolies in the late 19th century and the phone monopoly in the 20th.

That would spell the end of permissionless innovation on the Internet. Bureaucrats would have authority to dictate how networks operate, which technologies can be used, and what prices can be charged. Regulators would approve or disapprove innovation in business terms as well as in technology. If Netflix wanted to charge ISPs for the right to carry its video, regulators and not the market would decide. Regulators could limit the number of photos individuals can post to Facebook or order the deletion of Uber apps on mobile phones in cities where taxi regulators oppose the service.

Net-neutrality lobbyists are to the left of President Obama's new chairman of the Federal Communications Commission, Tom Wheeler, who has opposed treating the Internet as a

Philadelphia Inquirer
Senator said he learned from marijuana research trip

Lancaster New Era
Editorial: Same old same old from Tom Wolf

utility. Some of his colleagues have gone public to beg not to be given the power to undermine the Internet. Commissioner Ajit Pai, a Republican, gave a speech in Washington last month saying the campaign to treat the Internet as a utility "is being driven by a parade of horribles that is entirely hypothetical." He opposed "dramatic regulatory change solely for the purpose of assuaging fears that have not materialized." The other Republican commissioner, Michael O'Rielly, has pointed out that fast lanes are "necessary for network management."

Robert McDowell, who was an FCC commissioner for seven years, wrote in the Washington Post last month that net-neutrality activists have been warning for a decade of the imminent danger of an unregulated Internet. Fast lanes are just their latest boogeyman. "Nothing is broken that needs fixing," he wrote. Broadband providers pledge in their terms of service with consumers that they will keep the Internet open. Antitrust and competition laws would apply if there were abuses. Nor have net-neutrality lobbyists explained how reclassifying the Internet as a utility would stop any fast lanes, even if these were a problem instead of a salvation. The government regulates the postal system, bridges, tunnels and toll roads, all of which have fast lanes and slow lanes.

The FCC's Mr. Pai warned in his speech that endless debates over net neutrality are now a "distraction" from the larger issue. With demand for bandwidth growing dramatically, he argued, regulators "should prioritize policies that will encourage the private sector to expand and upgrade high-speed broadband networks." This includes ending local broadband duopolies of cable and phone companies, easing access for new broadband providers such as Google. Net-neutrality advocates demanding to have the Internet regulated as a public utility should explain the source of their faith in big government. The rest of us understand the clear lesson of history: Granting bureaucrats control over the Internet would undermine the world's greatest engine of innovation. – ***Wall Street Journal***

In the media-merger puzzle, only some of the pieces are interchangeable.

Time Warner may face that reality as it stands its ground in the face of an unwanted $80 billion bid from 21st Century Fox. As the government weighs pending mergers by pay-TV providers, including Comcast and Time Warner Cable and AT&T and DirecTV, it seems only a matter of time before content owners will begin to tie up too. The first to be thrown into play, Time Warner now has two other options besides a deal with Fox: show it can create more value on its own or wait for another bidder offering more. The latter could be a challenge. There are few other obvious candidates with both the motivation and wherewithal in the near term.

Among fellow content companies, Walt Disney is the only one that clearly has the financial firepower for a Time Warner deal. But it already has all the heft it needs to negotiate with pay-TV providers. That is true even against the backdrop of pay-TV consolidation. Disney chief Robert Iger, who has focused on smaller deals for proven franchises such as Pixar and Lucasfilm, may also not be interested in doing big deals ahead of his expected retirement in July 2016.

Strategically, a CBS -Time Warner tie-up would make more sense. Time Warner could benefit from CBS's must-have broadcast network, while CBS could get exposure to cable-affiliate fees through Turner's cable networks. A number of shows that already air on CBS are from Warner Bros. HBO and Showtime could coordinate instead of compete, and the companies could possibly consolidate complementary sports offerings. But even if CBS could execute a reverse merger, Time Warner would be a stretch, according to Neil Begley of Moody's. The cyclicality of CBS's business on a stand-alone basis constrains the amount of debt it can take on relative to peers without risking a credit downgrade, Mr. Begley says. It also has lower free-cash flow and less cash on hand than Fox. Deal synergies would also likely be less, and the company might not be open to selling assets like CNN as Fox would likely have to do. CBS could use a higher proportion of stock. But like Fox, it has a controlling shareholder, potentially making its shares less attractive to

Time Warner investors. Until last year, 21st Century Fox and The Wall Street Journal owner News Corp. were part of the same company.

Then there are pay-TV providers. While Verizon Communications appears to be pursuing a strategy of remaining focused on wireless, AT&T is pushing deeper into TV and likely would be interested in owning Time Warner. Comcast, which already owns NBCUniversal, might also be intrigued. But all three are tied up with deals of their own. Verizon is paying down debt related to its recent acquisition of Verizon Wireless. AT&T and Comcast are awaiting regulatory approval for their proposed mergers. That likely explains NBCUniversal chief Stephen Burke's recent comment on a conference call that the company didn't need to bulk up in content.

For Time Warner, the wild card may be tech companies. Industry behemoths such as Apple or Google aim to push deeper into TV but face the hurdle of negotiating with big media companies. Owning content could prove valuable in the continuing battle for control of the living room. Still, tech companies seem more likely to spend a few billion dollars generating their own content than investing $80 billion in a company tied to the very industry they want to disrupt. It might make more sense for them to own an asset like Time Warner's HBO, which already has a successful digital platform. But there is no indication that HBO would be sold separately. The upshot: Time Warner, if it sticks to its rejection of Fox's offer, may have little choice but to go it alone. – ***Wall Street Journal***

TVdom has entered the third stage of grief, bargaining with a higher power. In this case, the higher power is the Washington political establishment, to which Time Warner Cable is looking to help bail it out of the big price it paid to carry the Los Angeles Dodgers and support the team's exclusive TV network.

Now before we go any further, some may already be looking at the episode as a topping out of the sports bubble. It's probably not. Steve Ballmer just paid $2 billion for the Los Angeles Clippers, who aren't even the city's premier NBA franchise. Mr. Ballmer may be doing it partly for the jockstrap camaraderie of ownership, and has plenty of money to waste indulging himself. But he will probably do OK on a future TV contract: Live sports is the one kind of programming that the coveted audience of young men with disposable income and unformed brand preferences will watch on traditional TV even though it means enduring commercials.

So why is Time Warner Cable having such a hard time making its investment in Dodger broadcast rights pay off? Even amid the housing boom, somebody somewhere overpaid and took a bath trying to flip a mansion, though housing prices continued to rise generally. Time Warner—which forked up more than $8 billion over 25 years—may just have overpaid for the Dodgers. Another misconception is that all viewers are increasingly being soaked to subsidize sportsaholics. The truth is slightly different. More than half of cable's overhead isn't content at all, it's the capital, marketing, billing and scutwork of maintaining a physical network. Without millions of sports addicts to justify these costs, all the lesser programming might not be provided at all.

The real problem isn't the rising value of sports, but the declining value of everything else, which is increasingly available on demand on Netflix or Amazon, without commercials. The shrinking value that viewers attribute to standard cable fare is the force that threatens to pull apart the pay-TV bundle and thus the industry's traditional economics. Which brings us to Time Warner Cable's standoff with DirecTV, its most crucial non-partner. The duo's inability to reach an agreement, which would likely be adopted by other Southern California pay-TV providers, has kept the Dodgers out of 70% of area homes even as Vin Scully narrates the team's pennant run, encouraged by the impressive Clayton Kershaw and antic Yasiel Puig.

DirecTV doesn't just reject the $4-plus per subscriber fee that Time Warner Cable is reportedly asking. It rejects Time Warner's insistence that the Dodgers channel be part of

the standard cable package, saying the Dodgers should be a premium channel that viewers can opt not to pay for. Now some money, you might think, is better than no money for Time Warner Cable. But if Time Warner lets DirecTV subscribers opt out, how can it deny the same choice to its own subscribers? Poof. The cable bundle, which is held together today by sports, would be kaput.

Hence the big news this week: the wholesale intervention of congressional Democrats and the Federal Communications Commission to lean on Time Warner Cable to accept binding arbitration—which Time Warner Cable "gratefully" accepted. Why? Because any arbitrator is likely to look at industry-wide existing arraignments—i.e., those that characterized the past—and find that regional sports networks are typically carried as basic cable.

DirecTV high-handed the political intervention, rightly so, saying, "Rather than force everyone to bail Time Warner Cable out, the simplest solution is to enable only those who want to pay to see the remaining Dodgers games to do so at the price Time Warner Cable wants to set." Between these parties a business negotiation is taking place, an important one for TV's evolution toward a model that most of us think we want (though we haven't seen the price tag yet), in which everything becomes an à-la-carte option. Sadly, Time Warner Cable is seeking approval of a merger with Comcast. DirecTV is seeking approval for a merger with AT&T. Which means all the players—except the Dodgers themselves—are especially vulnerable to political pressure right now. A political kludge is inevitable. Unlike the Almighty, who is wisely silent in the face of our deathbed bargaining, Washington always intervenes in ways that prolong the pain and prop up dying business models. – ***Wall Street Journal***

BCAP
Broadband
Cable Association
of Pennsylvania
127 State Street, Harrisburg, PA 17101
717.214.2000 • bcapa.com

First in Broadband.
The Future of Broadband.®