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Video Report Data Undermine the FCC's Rationale for New Device Regulation

by

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Introduction and Summary

On May 6, the Federal Communications Commission released its *Seventeenth Video Competition Report*. Regrettably, the FCC fell back into its pattern of problems in generating its statutory mandated reports. This time around, the FCC Media Bureau released the video competition report on its own. At FCC Chairman's Tom Wheeler's direction, the four other Commissioners were bypassed and never voted to approve the report's release.

Skipping the Commissioners' vote may reduce the video competition report's public visibility. So this paper will take the opportunity to highlight two key aspects of the report that deserve increased visibility. First, trends reflected in the report evidence a video services market characterized by competition and innovation – offering consumers a variety of choices for video services. Second, although the report overlooks some well-known evidence concerning available choices for video devices, information cited in the report still reveals a market for video devices that is likewise characterized by competition and innovation.

All told, existing competition for the video services and available choices for video devices – much of which is reflected in the report – undermine the Commission's flimsy rationale for imposing costly new technical mandates on video devices. This may be why Chairman Wheeler wants to downgrade the report and reduce its visibility.

The report reconfirms that there is effective competition in the multi-channel video programming distributor (MVPD) market. In 2014, direct broadcast satellite **(**DBS) providers' market share increased to 33.8% of MVPD subscribers. Former telephone company entrants or "telco" MVPDs increased their market share to 13% while also increasing their nationwide footprint by 5%. Emerging broadband service providers such as Google Fiber also expanded their footprints. Meanwhile, cable operators' market share declined to 52.8% of MVPD subscribers.

The report also clearly identifies the increasing popularity of online video distributor (OVD) services. In 2014, Netflix reached the 37.7 million mark for U.S. subscribers to its streaming service. Hulu had 6.9 million subscribers. And Amazon had an estimated 40 million subscribers. More recent numbers – not included in the report – indicate that Netflix now has 75 million or more subscribers, Amazon Prime has 54 million, and Hulu has close to 12 million.

Report data and analysis reveal the potency of OVD competition with MVPD services. In 2014, OVD competitive effects became increasingly evident. An estimated 7.8% of households watched TV programs or movies via OVDs rather than MVPDs. About 150,000 subscribers eliminated their MVPD service in the third quarter of 2014 – and 190,000 eliminated their service in the third quarter of 2015. Indeed, 2014 marked a second year of overall declines in MVPD subscriptions. Cable MVPD subscriptions dropped from 55.1 million to 53.7 million households. Furthermore, nearly 15% of surveyed adult broadband and MVPD subscribers said they were likely to cancel their MVPD service. Among households that kept their MVPD service, 15% decreased their level of service. The report noted that MVPDs began offering "skinny bundles" of video channels and reduced rates "[i]n response to competition from OVDs, stagnant household incomes, and higher programming costs."

The *Seventeenth Video Competition Report* also sheds some important light on advancements in video devices and the device options currently available to consumers. As the report reveals, there is a proliferation of IP device viewing options. The nearly 91 million U.S. households with broadband connections used an average of 7.3 Internet devices for video, including game consoles like the Xbox One and Playstation 4, streaming media devices such as Roku and TiVo, Internet-connected televisions and Blu-ray players, and home computers. Mobile device viewing also grew in popularity. The report observes that smartphones and tablets "typically have high-resolution screens for consumers to watch video" and increasing screen sizes are "making those phones more practical for watching high-resolution video" enabled by 4G networks.

However, the report essentially overlooks the fact that consumers can choose different device offerings from among competing MVPDs. Cable, DBS, and telco MVPDs offer consumers devices that are unique to their own networks. The report neglects to mention the availability of choices among the Comcast X1 DVR set-top box, DIRECTV's HR 44 Genie Server, Charter's Worldbox, or others. Although the report highlights the TiVo BOLT, it downplayed the reality that cable subscribers can purchase and use that device or other CableCARD-enabled third-party video devices for viewing cable MVPD services. The report also relegates to a footnote Comcast's announcement of its partnership with Roku for making its Xfinity video service available to interested subscribers exclusively through video apps on Roku devices.

The FCC's February 2016 proposed set-top box rulemaking would impose new technical mandates on MVPD-provided video devices and apps. The proposed rulemaking focuses myopically on estimates that 99% of cable consumers lease set top boxes from their cable operators rather than purchase their own devices at retail. That figure disregards the real choices and the broader context of competition and innovation in video devices and video apps revealed by the report.

An eyes-wide-open look at the video services market and today's variety of video device options reveals no actual market failure or problem that can justify the FCC's proposed device regulations. It's more likely the proposed regulations would inhibit the video market's progress toward an apps-centric approach to content viewing. If imposed, such rules would impose heavy financial costs on cable, DBS, and other MVPDs. Ultimately those costs will be paid for by consumers in the form of higher prices.

Going forward, the Commission should take its cue from the existing choices among MVPDs and OVDs, as well as continuing innovation in video apps, mobility, and multi-functional devices – many of which are identified in the *Seventeenth Video Competition Report*. The Commission can best serve consumers by letting the video market's innovative and competitive forces continue fostering the launch of new services and viewing options, free from costly regulations.

Report Evidence of Effective Competition in the Video Services Market

The competitive and innovative state of the video service markets is amply shown by estimates, surveys, and other data for 2014 collected in the *Seventeenth Video Competition Report*:

- **Effective competition among MVPDs.** Cable MVPDs' market share declined to 52.8% of all MVPD subscribers. DBS providers' share slightly increased to 33.8% of MVPD subscribers. And telco MVPDs' share increased to 13.0%.

- **Expanded MVPD alternatives**. Telco MVPDs increased availability to over 51 million households, a 5% increase in footprint. Emerging broadband service providers offering video services are also expanding footprint. Google Fiber reached about 427,000 homes, and 96,000 businesses locations.

- **Decline of MVPD subscriptions.** Total MVPD video subscriptions dropped from 101.7 million to 101.6 million households. That is, MVPD subscriptions fell by about 176,000. While DBS and telco MVPD subscriptions increased, cable MVPD subscriptions dropped from 55.1 million to 53.7 million households. Survey indicates 14.8% of adult broadband and MVPD subscribers said they were likely to cancel their MVPD service. According to another report, among pay-TV households that kept their MVPD service, 15% decreased their level of service.

- **Increasing popularity of OVDs.** Netflix had 37.7 million U.S. subscribers to its streaming service, a 19% increase from the prior year. Hulu had 6.9 million subscribers, up from 5.1 million a year earlier. Amazon Prime had an estimated 40 million subscribers. (Report numbers don't take stock of OVD subscriber growth over the last 18 months. Netflix now has 75 million or more subscribers, Amazon Prime has 54 million, and Hulu has close to 12 million.)

- **OVDs' competition with MVPDs.** An estimated 7.8% of occupied U.S. households watched TV programs or movies via OVDs in lieu of MVPDs, up from 4.9% a year before. Market research suggests about 190,000 subscribers eliminated their MVPD service in the third quarter of 2015, compared with 150,000 subscribers in the third quarter of 2014.

- **Over-the-air (OTA) alternatives to MVPDs.** The number of households relying on over-the-air broadcast service exclusive of any MVPD service increased to 11.4 million. That represents an increase from 9.8% to 9.9% of all TV households. Some 25.1 million TV households, or 21.9% of all TV households, rely exclusively on OTA service on at least one TV set. The report also observed, "[o]ther households … may seek to use a combination of OVDs and broadcast services to replicate the programming packages and products of an MVPD. This was impossible in years past, but it is becoming less difficult."

- **MVPD response to OVD competition.** The report explains that "[i]n response to competition from OVDs, stagnant household incomes, and higher programming costs, MVPDs have begun offering 'skinny' video packages, which include a limited selection of channels with add-on options revolving around specific subscriber interests such as sports, children's entertainment, or movies."

Competitive Conditions in Video Market Justify a Deregulatory Policy Approach

The competitive market conditions identified in the *Seventeenth Video Competition Report* go above and beyond the findings upon which the Commission based its *Effective Competition Order* (2015). In that order, the Commission recognized that there is effective competition in local MVPD markets. The order acknowledged the competitive choices offered by two nationwide DBS providers possessing a nationwide market share of 34% and competing head-to-head with incumbent cable operators. Based on those findings, the Commission reversed the pro-regulatory presumption that local cable video services and cable operator-provided equipment can be rate regulated. The order shifted to a deregulatory presumption that local cable markets are subject to effective competition. The burden is now on would-be regulating local franchises to marshal actual evidence of ineffective competition.

As data collected in the *Seventeenth Video Competition Report* reveals, MVPD competition is even stronger than when the *Effective Competition Order* was released, with additional choices enabled by telco MPVD and broadband service provider build-outs. Moreover, the order didn't take stock of competition to MVPD services from OVD services such as Netflix, Amazon Prime, and Hulu. As market data now indicates, OVD subscriptions outnumber MPVD subscriptions and MVPDs are even showing modest declines that are projected to continue.

The *Effective Competition Order* offers a model approach to video competition and video policy that the Commission should adopt more generally. Data compiled in the *Seventeenth Video Competition Report* strongly supports such an approach. That is, competitive conditions among MVPD services and OVD services justifies a non-regulatory or deregulatory presumption toward those video services. When any future regulation of the video services market is contemplated, the burden should be on the Commission or supporters of regulation to produce actual evidence of market failure or consumer harm. And any such regulation should be carefully targeted to anticompetitive problems that actually exist.

Report and Non-Report Evidence of Competitive Choices for Video Devices

The *Seventeenth Video Competition Report* also sheds some important light on advancements in video devices and the device options currently available to consumers. Continuing advancements and existing choices, as will be discussed further below, undermine the Commission's rationale for imposing new technical mandates and other restrictions on video devices and video apps.

At the outset, however, it is worth considering video device alternatives that the report essentially overlooks. First, consumers can choose different device offerings from among competing MVPDs. Video devices leased by MVPDs are not all the same. Cable, DBS, and telco MVPDs offer consumers video devices that are unique to their own respective video service networks. For example, Comcast offers its subscribers its X1 DVR set-top box. DIRECTV offers subscribers, among other options, its HR 44 Genie Server. Charter Communications offers subscribers its Worldbox. These choices are effectively absent from the report.

Second, cable subscribers can purchase and use third-party video devices for viewing MVPD services. One of the video devices highlighted in the report, the TiVo BOLT, can access cable MVPD services with the use of a CableCARD. (The TiVo BOLT and other third-party CableCARD-enabled devices can also access Verizon's FiOS service.) Despite the report's emphasis that as much as 99% of cable subscribers lease devices from their cable operators, the option to buy a third-party device for accessing cable MVPD services is entirely real. Moreover, new device viewing options for MVPD services are on the horizon. Relegated to a footnote in the report is Comcast's announcement of its partnership with Roku for making its Xfinity video service available to interested subscribers exclusively through video apps on Roku devices.

Bearing those two important aspects to the video device market in mind, the dynamism of the video market is further revealed by report information about the increasing variety of device options for viewing content:

- **Proliferation of IP device viewing options.** The 90.9 million U.S. households with high-speed data connections used an average of 7.3 Internet devices, including game consoles, streaming media devices, Internet-connected televisions and Blu-ray players, tablets, and home computers.

- **Smart TV viewing.** According to the report, "[t]oday 45 percent of U.S. television households receive some programming on their televisions via the Internet.

- **Multi-functional streaming media devices.** As the report observes, many devices for viewing video are multi-functional. Such devices include gaming consoles like the Xbox One and Playstation 4, the Google Chromecast, Apple TV, and TiVo BOLT.

- **Mobile device viewing.** "Broadband connected devices, such as laptops, netbooks, smartphones, and tablets, typically have high-resolution screens for consumers to watch video." The report observed that average smartphone screens continued to increase significantly in size "making those phones more practical for watching high-resolution video" enabled by 4G networks. The report notes there were 183 million active 4G-connected devices as of June 2015. And the report acknowledged "MVPDs continue to make their video content accessible over a host of portable devices through the mobile IP marketplace."

Video Market Conditions and Device Options Do Not Support New Device Regulations

The FCC's February 2016 proposed rulemaking would impose new technical mandates on MVPD-provided video devices and apps. The proposed rulemaking focuses myopically on estimates that 99% of cable consumers lease set top boxes from their cable operators rather than purchase their own devices at retail. That figure disregards the broader context of competition and innovation in video devices and video apps revealed by the report and summarized above.

The 99% leasing figure also ignores the fact that purchases of third-party retail devices are typically a costlier alternative. The TiVo BOLT retails for $199 to $299, depending on the storage model. And TiVo service costs $14.99 per month. For some consumers, this may be an attractive price given the value of the device and its advanced multi-functionality. But it is also conceivable that consumers might prefer a less advanced option at a cheaper cost.

Indeed, the *Seventeenth Video Competition Report* identifies cost-savings and value-conscious trends among video consumers. Those trends are reflected both in the growth of less OVD expensive services vis-à-vis more expensive MVPD services as well as MVPD offerings of "skinny bundle" packages intended to retain subscribers by offering fewer channels at a reduced cost. The report cites a 2015 survey finding that "three-quarters of television households that dropped MVPD service cited cutting costs as their reason for stopping service," and that "among pay-TV households that kept their service, 15 percent decreased their level of service." In sum, purchase figures for third-party devices for MVPD services provide no justification for concluding that the market is uncompetitive – or that new regulations are needed.

FSF President Randolph May and I have explained in published writings and public comments filed with the Commission that there are a number of problems with the FCC's proposed video device and video app regulations. To name but a few, the proposed regulations impair the contract rights and the intellectual property rights of video programmers, impose privacy regulations that give preferential treatment to third-party device makers while leaving consumers potentially vulnerable, and infringe on the free speech rights of MVPDs. Data summarized in the

Seventeenth Video Competition Report highlights further problems with the Commission's proposed video device and video app regulations. Its proposal would subject a dynamic, well-functioning market to a swath of tech mandates imposing unknown costs on industry for which consumers will ultimately have to pay for.

Conclusion

Market data contained in the *Seventeenth Video Competition Report* offers an important reminder about the competition that actually exists among video services and available choices for video devices. Thus, the report offers a fresher look at why the FCC's proposed rulemaking for video devices and apps is backward looking and fails to take seriously the market competition that exists. The Commission can better promote consumer welfare leaving the video market innovation and competition free to continue delivering new services and viewing options to consumers.

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Further Readings

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