



Free markets. Real solutions.

R STREET POLICY STUDY NO. 37
June 2015

TV REGULATION IN THE AGE OF DIGITAL DOWNLOADS

Steven Titch

EXECUTIVE SUMMARY

Television viewing must now be added to the long list of activities the Internet has changed. The time when audiences across the country simultaneously experienced a televised event—such as the Beatles on *The Ed Sullivan Show* or the finale of *M*A*S*H*—is almost entirely over. Today, such event viewing typically is limited to annual pageants like the Super Bowl.

The living room flat screen is now just one of a variety of ways to watch what we still call “television.” On-demand episodic series and digitally distributed movies can be streamed via the Internet anytime and anywhere on a smartphone or tablet, or simply downloaded for later viewing.

The rationale for broadcast regulation long has been based on scarcity. Simple physics limited the amount of spectrum available for television and radio broadcast. In passing the Communications Act of 1934, which created the Federal Communications Commission, the government maintained that limited spectrum justified broadcast regulation in the public interest.

CONTENTS

Executive summary	1
The cord-cutting phenomenon	2
A call to regulate OTT?	3
Another case of convergence	4
OTT and the ‘a la carte’ option	4
Competition through differentiation	5
Retransmission and must-carry	6
Content provider/content distributor disputes	6
Content regulation	7
No regulatory fees	8
Conclusion	8
About the author	9
Figure 1: OTT viewing is growing	2
Figure 2: Popularity of unbundled networks	5
Sidebar 1: YouTube as a “your own TV” channel	3
Sidebar 2: Will the FCC play favorites?	7
Sidebar 3: Internet advertising regulation	8

The Internet has obliterated scarcity. Today’s video on-demand platforms allow anyone to produce and distribute content. That’s why extending the FCC’s broadcast authority to Internet television should be considered carefully. Old rationales for regulation no longer apply and may be obsolete. If imposed on new models of video entertainment and information, they likely would be counterproductive to the growth and expansion of these new platforms.

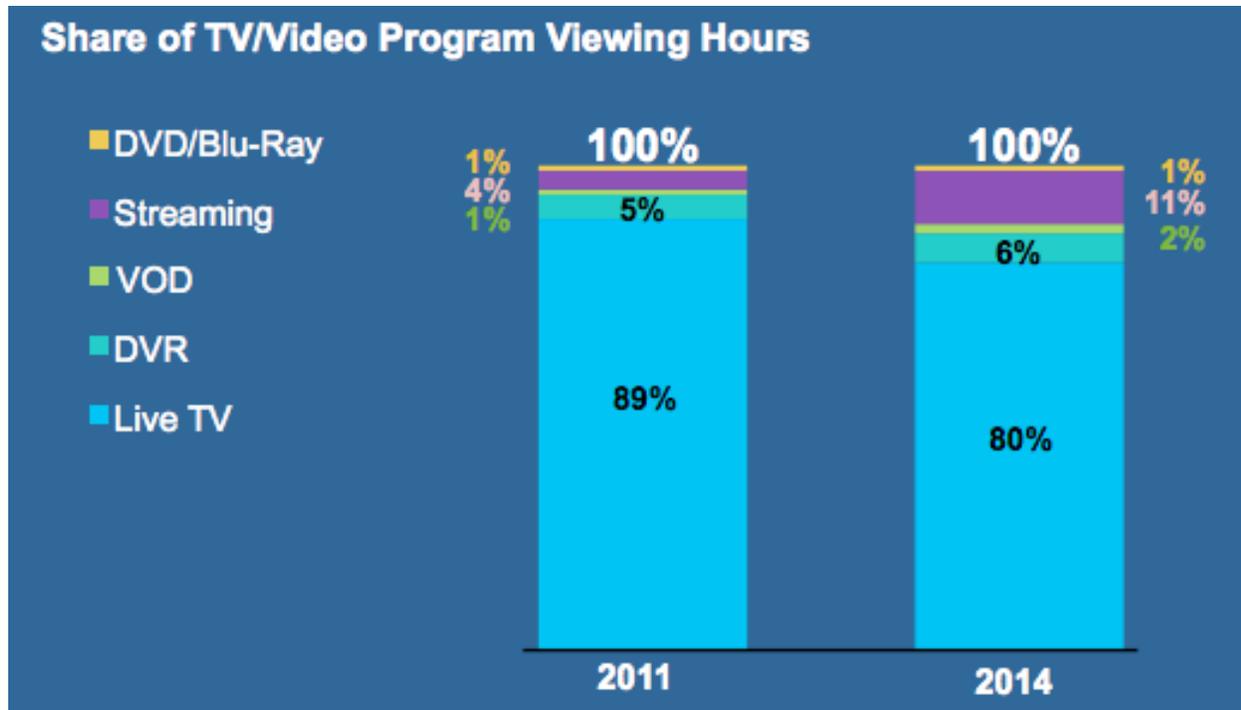
The nearly century-old broadcast model—in which a radio or television station dictated a programming schedule around which listeners and viewers planned their evenings—is dying. It is being replaced by an unprecedented set of choices and methods consumers have when it comes to accessing their favorite programming. According to a June 2015 projection by investment banking firm FBR Capital Markets, if it continues its current rate of growth, top video streaming service Netflix within a year will surpass all of the four major broadcast networks – ABC, CBS, NBC and Fox – in the size of its 24-hour audience in the United States.¹

Terms like “binge viewing” and “spoiler alert” have become part of the modern vocabulary. The programming grid found online and in daily newspapers serves today less as a calendar and more as a download menu for a digital video recorder.

The trend has not escaped notice of the Federal Communications Commission. The FCC has suggested extending its regulatory reach to companies that distribute video entertainment over the Internet, or “over the top” (OTT), independent of local broadcast stations and local cable franchises. These companies could include Netflix, Hulu and Amazon, which

1. Todd Spangler, “Netflix U.S. Viewing to Surpass ABC, CBS, Fox and NBC by 2016: Analysts,” *Variety*, June 24, 2015. <http://variety.com/2015/digital/news/netflix-viewing-abc-cbs-fox-nbc-1201527442/>

Figure I: OTT viewing is growing



SOURCE: Nielsen Cross Platform Report, Q1 2014

to varying degrees, offer viewers a selection of movies and television shows for monthly “all-you-can-view” subscription rates. They also will include forthcoming services like Apple TV, which will introduce a level of content aggregation. This September, Apple plans to begin offering 25 broadcast and cable channels via the Web, simulcasting the same content at the same time it is transmitted by conventional networks.

In addition, the TV and cable networks themselves have begun to make programming available over the Internet in real-time. Of these entries, ESPN was considered the most significant, because it brought live sports, traditionally thought to be among cable companies’ biggest competitive advantages, to OTT.

Meanwhile, Google’s YouTube not only offers free content to viewers, but an extremely cost-effective platform for independent content producers, who can create YouTube channels to grow their viewer base. Most YouTube downloads are free, as the platform is built to monetize advertising, but Google has begun to experiment with subscription models, as well.

This paper will look at the how the OTT trend is changing television viewership; how it brings competition in the form of choice and value differentiation; and how it serves as an example of a market-engineered response to changing cus-

tomers demands. It will recommend that, rather than rush to expand regulatory definitions, the FCC go slow, allowing consumer decision-making to direct the evolution of OTT providers and services. In fact, as alternative methods in program distribution challenge broadcast and cable, it may instead be time to scale back the FCC’s regulatory role, especially in such areas as:

1. Retransmission, must-carry and other programming requirements;
2. Resolution of content provider/content distributor disputes;
3. Content regulation; and
4. Regulatory fees.

THE CORD-CUTTING PHENOMENON

Quantitatively speaking, viewership of traditional television dropped nearly 4 percent in the third quarter of 2014, while online OTT video streaming jumped 60 percent, according to a report from Nielsen Holdings N.V.² The report showed the average American still watched more than 141 hours of live television a month, more than four hours a day. But that

2. Shalini Ramachandran, “TV Viewing Slips as Streaming Booms, Nielsen Report Shows,” Wall Street Journal, Dec. 3, 2014. <http://www.wsj.com/articles/tv-viewing-slips-as-streaming-booms-nielsen-report-shows-1417604401>

number is down 4 percent from the third quarter of 2013, when Americans watched an average of 147 hours a month.

These results continue a trend that began in the 1980s, when the introduction of video cassette recorders let viewers record a show for later viewing. Video on-demand only intensifies this “time-shifting.” In the past three years, the percentage of viewers watching live television has fallen from 89 percent to 80 percent, while Internet streaming has increased from 4 to 11 percent, and DVR viewing has jumped from 5 percent to 6 percent of total viewing. Over that same three-year period, per-week streaming grew from 4 hours and 13 minutes to 4 hours and 17 minutes (see Figure 1).³

About 8.6 million U.S. households have broadband Internet but no pay-TV subscription, according to a February 2015 report from Experian Marketing Services. That’s 7.3 percent of households, up from 4.2 percent in 2010. Cable television “cord-cutting” is concentrated among young people—13.5 percent of broadband households with an adult under 35 have no pay-TV. It is concentrated further among people who own smartphones, Experian said. Millennials are almost four times more likely than other adults to watch streaming video.⁴

OTT is not just convenient for video on phones and tablets. Internet video can be ported to large-screen televisions through devices like Chromecast, Roku, Apple TV and Amazon Fire TV, as well as through most major gaming consoles and Blu-ray DVD players.

While cable companies have been offering on-demand programming for some time, viewer selection was limited and terms generally were pay-per-view. Netflix, Hulu and Amazon dramatically altered the on-demand model, immensely broadening video selection and introducing monthly “all-you-can-view” subscription rates. In response, broadcast and cable networks have begun streaming regularly scheduled programming directly to Internet devices. Of these entries, ESPN was considered the most significant, because it brought live sports, a traditional advantage cable companies retained, to cord cutters in real time. Apple’s new OTT entry, scheduled to launch in September, combines the two: offering 25 broadcast and cable channels via the Web in addition to its sizable iTunes library.

Meanwhile, Google’s YouTube not only offers free content to viewers, but an extremely cost-effective platform for independent content producers, who can create YouTube channels to grow their viewer base. In general, the YouTube plat-

3. Jason Lynch, “Charts: How we watch TV now,” Quartz.com, July 21, 2014. <http://qz.com/237600/charts-how-we-watch-tv-now/>

4. Tim Mullaney, “Cord-cutters: Why It’s Apple’s New Key Demographic,” CNBC, March 17, 2015. <http://www.cnbc.com/id/102512659>.

SIDEBAR 1: YOUTUBE AS A “YOUR OWN TV” CHANNEL

For any kid who is into Minecraft, a sandbox application that lets players create virtual landscapes either in creative mode or more competitive mode, Stampy Longnose is a star.

A British gaming enthusiast whose real name is Joseph Garrett, Longnose is beloved in Minecraft circles for his YouTube videos offering tours of his Minecraft world. His channel has 3.8 million subscribers and new videos get 300,000 views within 48 hours of posting. He has parlayed that popularity beyond video into merchandising.¹

Garrett’s YouTube channel² is one of the top 10 most-viewed in the world, ahead of Katy Perry, One Direction and Justin Bieber, and independent estimates place its ad revenue at \$300,000 a month.

Stampy Longhead is also Exhibit A when it comes to demonstrating the fundamental changes at work when consumers receive video content that once was the exclusive purview of broadcast networks.

Not long ago, networks were the exclusive gatekeepers. Even when cable network expansion added additional platforms, any programming idea still had to be sold to one of a small group of corporate conglomerates. That reality required scale. To get in the door at a network, a producer had to have a production plan, a budget, some talent committed and enough credibility and salesmanship to convince a group of risk-averse executives to invest more than \$1 million in a pilot.

Platforms like YouTube have changed that dynamic. For very little investment, even a young man who works in a pub and lives with his parents can become a successful TV producer.³ While this allows for a huge variance in quality, it also allows niche programming to reach a small but highly receptive audience.

1. Theo Merz, “Stampylongnose: The YouTube Star You’ve Never Heard Of,” The (London) Telegraph, July 23, 2014, available at <http://www.telegraph.co.uk/men/the-filter/10980512/Stampylongnose-the-Youtube-star-youve-never-heard-of.html>.

2. <https://www.youtube.com/user/channelstampylonghea>.

3. Ibid.

form is built to monetize advertising. If a video is sufficiently popular, Google’s algorithms will begin to play an ad with it. That revenue is split between YouTube and the original poster of the video. While commercial success is still a long shot, a number of content entrepreneurs are making a living from their YouTube channels (see Sidebar 1).

A CALL TO REGULATE OTT?

These developments have not escaped notice of the Federal Communications Commission, the federal agency charged with regulating broadcast and cable TV providers. With its February 2015 decision to reclassify Internet service providers as utilities under Title II of the Communications Act, the FCC also is looking to expand its regulatory reach to the Internet and World Wide Web.

Yet even before the Title II vote, the commission was eyeing regulation of OTT in particular and perhaps Internet video

in general. Chairman Thomas Wheeler wrote in October 2014 on the FCC blog:

Specifically, I am asking the Commission to start a rulemaking proceeding in which we would modernize our interpretation of the term “multichannel video programming distributor” (MVPD) so that it is technology-neutral... This proposal recognizes that a cable system would continue to be regulated as a cable system, even if it migrates to IP delivery.⁵

Although his use of “cable system” and “continue” seem to suggest the rulemaking would be about regulation of existing cable providers, it’s hard to fathom why the FCC would see any difference between a legacy provider who “migrates” to IP delivery and a new market entrant that launches IP delivery from the get-go. This is particularly true when Wheeler broaches the topic of how regulators could “modernize” the definition of MVPD, the FCC’s term for cable companies and telephone company fiber-to-the-home and DSL providers.

It’s reasonable to ask what the goal is—to continue to regulate cable systems or to introduce regulation to all IP video delivery and all of the diverse platforms and content that entails?

Will the FCC declare Google Play and YouTube, Netflix, Amazon, Hulu and Apple—companies that never have been regulated by the FCC—functionally equivalent to facilities-based cable/ISPs such as Comcast, Verizon and AT&T?

This lack of clarity demands immediate challenge. None of the current OTT providers have characteristics that give the FCC lawful jurisdiction over their operations. They do not own or maintain last-mile cable or wireless networks,⁶ nor do they hold any broadcast licenses like TV network stations and affiliates.

ANOTHER CASE OF CONVERGENCE

In taking a step back, we can see that OTT is yet another example of technology “convergence” spurred by the Internet that goes all the way back to voice and data. It’s a convergence that regulators in the 1980s astutely grasped and which resulted in a 30-year deregulatory trend.

OTT converges two home entertainment models that took hold commercially in the 1920s—radio and phonographs. For the remainder of the century, the two served as separate models for home entertainment.

5. Tom Wheeler, “Tech Transitions, Video, and the Future,” FCC blog, Oct. 28, 2014. <https://www.fcc.gov/blog/tech-transitions-video-and-future>.

6. While Google Fiber can be legitimately considered a facilities-based ISP, it operates as a business unit separate from YouTube.

Broadcast required the purchased of a radio, and later, a television. But after that, all entertainment was free to the consumer. The trade-off was that the broadcaster made the programming decisions.

Phonographs, and later, CD, VHS and DVD players, allowed consumers to choose their own entertainment. But it was a costlier alternative. Not only must the consumer purchase the appliance, but the various imprinted disks that appliance played required additional outlays. The payoff was that a song, an album, a movie or a television show was at your fingertips, whenever you wanted to listen or watch.

OTT continues the phonograph tradition by allowing consumers to program their own entertainment. The difference is that the recording is stored digitally in the cloud instead of on the shelf at home. To download their entertainment from the cloud, consumers use facilities owned by companies traditionally regulated by the FCC. That does not warrant extending FCC regulation to cloud-based content providers.

By virtue of the staggering volume of programming choices alone, OTT is closer to the phonograph/DVD model. Netflix, Hulu, YouTube, Amazon and others like them are virtual jukeboxes. What they mirror is not broadcast television, but cloud-based versions of applications associated with personal computing, such as Dropbox (document storage), Salesforce.com (account management) and Photobucket (images). These characteristics argue for little or no jurisdiction over OTT providers by broadcast regulators.

OTT AND THE ‘A LA CARTE’ OPTION

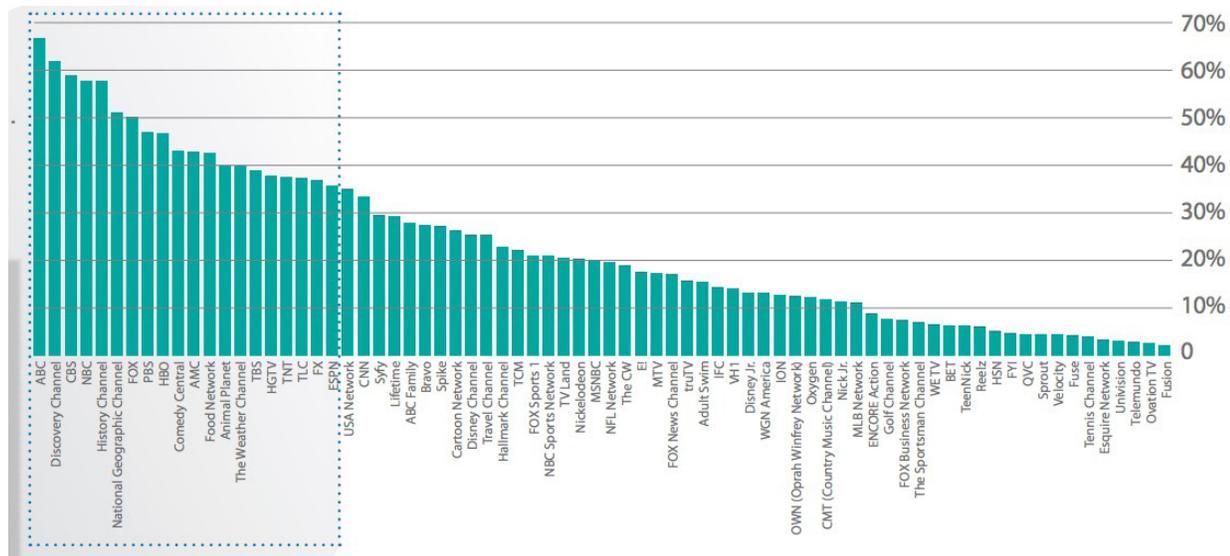
OTT also is an organic, market-based response to the current dominance cable and telephone companies have in customer account control. While there is competition in cable and broadband – and particularly, between cable, broadband and satellite providers – it can be costly and cumbersome for consumers to change providers. This reality has been central to complaints brought over the years. It’s a characteristic of the market the FCC has been trying to counter unsuccessfully (and often unwisely) for years through regulatory policy. These attempts have ranged from the infrastructure unbundling orders of the 1990s to the blocking of mergers to the recent Title II reclassification decision.

Although it did not take the form that was expected, OTT delivers the competition and consumer choice in cable and wireless services the FCC long has sought. Rather than tinkering with a process that’s already working, the FCC should simply co-opt the credit and declare victory.

For years, consumers have complained about being forced to pay for high-priced service tiers that bundle hundreds of cable channels, when they watch only a handful. Federal and

Figure 2: Popularity of unbundled networks

- If **YES** which channels would you be interested in including in your TV package? (choose all that apply)



Source: Digitalsmiths

state regulator long have sought a la carte options from multichannel providers, which would allow viewers to choose the specific channels they want.

Of course, consumers don't necessarily understand how the cable business model works, and often reason that if 100 channels cost \$100 a month, 10 channels should cost only \$10. Acquiring popular networks – such as ESPN, AMC and Fox News – costs cable companies far more than channels like Planet Green, Soapnet or Deutsche Welle, which cater to more narrow interests. Of course, it isn't necessarily the case that the most expensive channels are those that would do best in an a la carte format. A June 2015 survey by Digitalsmiths asking consumers which channels they would elect to keep in a hypothetical a la carte menu found that ESPN – currently the costliest basic cable network, with pay-TV companies paying about \$6 a subscriber to carry it – ranked only number 20, behind lower-profile stations like Animal Planet, HGTV and The Weather Channel (see Figure 2).⁷

Much like a daily newspaper includes news, sports, business and local interest articles, many of which have interest only to a narrow subset of readers, cable companies spread the cost of service provision over a large range of entertainment options. The economics of programming acquisition have been such that it would be more expensive, for most consumers, to buy a la carte options than a bundle of channels.

7. Janko Ruetters, "À La Carte: These Are the TV Channels People Would Actually Pay For," *Variety*, June 17, 2015. <http://variety.com/2015/digital/news/a-la-carte-these-are-the-tv-channels-people-would-actually-pay-for-1201520900/>

That's why, despite periodic regulatory pressure, a la carte never happened.

That is, until now. Since OTT video is selected directly by the viewer, it bypasses the cable provider's chief revenue source—bundled cable television subscriptions. The cord-cutting viewer *can* select only the channels they want to watch, and it may indeed be cheaper. Nonetheless, the economics need to shake out. Demand and value may dictate that some OTT services cost more than others. Although it has yet to announce a price, analysts believe HBO, which carries a premium charge on cable, will charge \$15 to \$18 a month for its stand-alone HBO Now service. CBS, which is part of basic cable and is free outright over the air, will charge \$5.99 a month for OTT subscriptions.⁸ As cord-cutting becomes more popular, consumer reporters are comparing costs and providing tips to consumers as to whether cord cutting is the right choice for them.⁹

COMPETITION THROUGH DIFFERENTIATION

This is what consumer choice looks like and it's why the FCC should resist the temptation to regulate. Cord-cutting offers a value proposition and that's what makes it real diversity.

8. Lisa Richwine and Liana Baker, "Analyst: HBO's Streaming Channel Could Cost Up to \$18/Month," *Reuters*, Oct. 17, 2014. <https://www.yahoo.com/tech/analyst-hbos-streaming-channel-could-cost-up-to-100252287689.html>

9. Sharon Profis, "7 Things to Consider Before Canceling Cable," *CNET*, March 25, 2015. <http://www.cnet.com/how-to/what-to-consider-before-canceling-cable-cutting-cord/>

There is no doubt this shift is going to disrupt the traditional “triple-play” revenue model of offering phone, television and Internet service, on which current cable providers have built their business. That might mean higher prices for customers who consume great amounts of bandwidth. At the same time, it might mean low-price options and more attractive video packages for those who aren’t big OTT consumers.

Such disintermediation has a proper market role. Too often, regulators define competition as an arbitrary number of providers offering identical services. The FCC has proved no exception. Witness the FCC staff’s discourse about the necessity for at least four wireless competitors in its 2011 recommendation against the AT&T/T-Mobile merger.¹⁰

If anything, the new ways consumers can download and watch video recommends instead a revisit of broadcast and cable regulation generally. The sheer capacity of broadband, combined with way the Internet can support decentralized sources of content, undermines the rationale behind the Communications Act and its establishment of the FCC. The inherent scarcity of broadcast spectrum drove U.S. broadcast regulation, not the idea that electronic media itself must be regulated. That scarcity led to restrictions on media ownership, the (now-repealed) Fairness Doctrine, “community service” considerations in license renewal, set-asides for locally produced programming during the broadcast day and pressure for “standards and practices” in program content that limited producers in the type of entertainment they could broadcast and the subjects and characters they could dramatize. All of these regulatory mandates, and perhaps others, should be reviewed.

Retransmission and must-carry

The introduction of cable television expanded program choices. It also brought moves by the FCC to expand its regulatory power, requiring that cable systems carry local stations and set aside channels for public, educational and government (PEG) use, even though these provisions were rarely used by the public. In the early 1990s, the FCC’s regulatory authority was expanded further, with the requirement that cable companies and other MVPDs need to get the consent of broadcasters before retransmitting their otherwise-free signals.

The retransmission requirement resurfaces every few years when a cable provider gets into a dispute with a broadcast network over retransmission fees. It can sometimes lead to a temporary blackout of a station in some local markets, as was the case in a fight between the Fox Network and Cablevision

in New York City in 2010. That led to congressional hearings and overwrought calls for more regulation.¹¹

Internet television makes the justification for intervention even more tenuous now than five years ago. Regulators must understand that choice means differentiation. Forcing every service to offer the same content under the same terms is only superficially fair and would actually reduce competition to a least-common denominator set by government. Moreover, the Internet itself gives local television stations direct access to viewers. Indeed, most stations post their televised news and feature reports to their websites (sometimes with additional material). At one time, it could be argued that cable providers were the only way local stations could reach audiences. Today, local stations can become their own OTT providers and reach more viewers at far less cost.

Likewise, hosting services like YouTube have all but eliminated the need for PEG channels. As far back at 2008, the need for public access television was being questioned. YouTube now provides an easy outlet and libraries provide media training, equipment and access.¹² As with local news and content, the Internet makes for a superior medium with greater reach.

In the past, a PEG channel may have carried a city council hearing or school board meeting. But like all conventional TV, it was broadcast at a specific time and therefore available to limited viewership. Now, the meeting can be taped and uploaded to the Internet without thousands of dollars in equipment or the participation of a television engineer and crew. Interested constituents, who easily can keep up with real-time developments via social media, can watch the video at any time. Without any government oversight, YouTube and social media are meeting community needs for local news and information far better than PEG channels ever did.

Resolution of content provider/content distributor disputes

As with the case of network retransmission, it can be very tempting for the government to get involved in disputes between content providers and content distributors. When a cable company drops a network to protest a change in pricing or other contractual terms, viewers suffer. Unfortunately, OTT is going to lead to more of these disputes, principally because of the way it upends cable business models. There will be genuine points of friction between content producers,

10. cf. Federal Communications Commission, Staff Analysis and Findings, Bureau Dismissal Without Prejudice of AT&T’s Applications for Transfer of Control of T-Mobile USA, Inc. WT Docket No. 11-65, Nov. 29, 2011.

11. See Andrew Moylan, “Government Screws Up Your TV,” National Taxpayers Union blog, Nov. 11, 2010. www.ntu.org/governmentbytes/detail/Government-screws-up-your-TV

12. Mike Rosen-Molina, “Public-Access TV Fights for Relevance in the YouTube Age,” PBS, Dec. 17, 2008. <http://www.pbs.org/mediashift/2008/12/public-access-tv-fights-for-relevance-in-the-youtube-age352/>

e.g., studios and networks; and content distributors, e.g., cable, phone and satellite companies, because each has revenue streams to protect.

When the cable network AMC began distributing programming through Netflix, DirecTV threatened not to renew its agreement to carry the network. Both sides had legitimate interests. AMC has the right to seek alternative channels to viewers. DirecTV was correct in asserting that the Netflix deal diminished the value and appeal of its own service, because it allowed viewers to go elsewhere for the same entertainment. Just as it's counterproductive for an adult to step in when two siblings argue, the FCC should let these businesses work out their differences themselves. That's the only way to assure a win-win as the market adjusts to the reality of OTT. At this point, government action can only favor one market player over the other and encourage future rent-seeking (see Sidebar 2). This will distort markets, leading to later reverberations that affect consumers more adversely than the original disputes.

A few years ago, Congress wisely demurred when the National Football League asked it to order cable companies to include the fledgling NFL Network in their bundled tiers, instead of asking consumers to pay extra. Ultimately, cable companies did so on their own because of customer demand. The FCC should heed this precedent.

Content regulation

The First Amendment prevents the FCC from outright censorship of any broadcaster. Through the years, the FCC has used various bureaucratic carrot-and-stick methods to cajole broadcasters into maintaining voluntary standards of “decency.” But the record of content disputes that went to court heavily favors the Constitution over FCC fines and mandates. Content standards today have become far more liberal than they were in the past and it is mostly by convention that over-the-air broadcast networks hold to PG-13 and TV-14-level content, while cable networks, premium pay services like HBO and OTT providers offer much more adult-level programming.

The voluntary ratings systems used by the Motion Picture Association of America and broadcast and cable networks have carried over to on-demand. For example, Netflix places TV-MA on “House of Cards,” even though the series streams via the Internet.

The notion of policing content on hosting services like YouTube conjures visions of a bureaucratic quagmire. YouTube hosts thousands of content providers with their own “channels” that have anywhere from a handful of regular viewers to millions. While Google monitors the site for pornography and copyright violations, it will not judge content on

SIDEBAR 2: WILL THE FCC PLAY FAVORITES?

Most policymakers agree that a competitive market serves consumers best, but disagree on the means to achieve it. There are potential unintended consequences when regulators try to force the issue and tilt regulations in favor of one group of players to speed a desired outcome. For example, there is concern that network-neutrality rules, which would prevent Internet service providers from charging content providers for the transmission management and optimization necessary for quality, would unfairly transfer costs to service providers that rightfully should belong to the content provider.

This calls for regulators to be neutral referees, not cheerleaders. Unfortunately, the FCC has shown similar inclinations with OTT. Chairman Thomas Wheeler seemed to be openly supportive of Netflix when the FCC intervened in its dispute with ISPs¹. If Wheeler uses Title II authority to prevent ISPs from charging OTT companies for prioritization of their error- and latency-sensitive videos, Netflix will benefit, as its transmission costs will be reduced at the ISPs' expense.

While the media likes to romanticize the notion of scrappy startups challenging entrenched competitors, Netflix is not a fledgling venture that needs special protection from the established carriers. As the *Motley Fool* recently pointed out, by itself, Netflix destroyed the brick-and-mortar video-rental industry, driving Blockbuster Video – which the Federal Trade Commission once considered so powerful that it blocked its proposed merger with Hollywood Video on antitrust grounds – into bankruptcy. Netflix then subverted its own DVD-by-mail model with OTT, a segment where Amazon.com, the standard-setter in nearly all other matters of Web-based commerce, is in its rear-view mirror².

Before taking steps to shield Netflix from the rough-and-tumble nature of the market, the FCC would do well to remember that:

- With 61.4 million subscribers worldwide,³ Netflix claims more subscribers than any other competing video streaming service.
- It has a strong brand name and pipeline of original content.
- It reportedly has the biggest library of any similar Internet TV provider and the relationships with content providers that come with it.
- Its membership is growing fast and is expanding around the world.

The future is going Netflix's way. It also is a big company with significant resources. It doesn't need special regulatory favors from the FCC.

1. Michelle Maisto, “FCC's Wheeler Says He's Looking Into the ISP-Netflix Issue,” *eWeek*, June 13, 2014. <http://www.eweek.com/networking/fccs-wheeler-says-hes-looking-into-the-isp-netflix-issue.html>

2. Jeremy Bowman, “Netflix's Biggest Advantage May Be Hiding in Plain Sight,” *The Motley Fool*, May 13, 2015. <http://www.fool.com/investing/general/2015/05/13/netflixs-biggest-advantage-may-be-hiding-in-plain.aspx>

3. Lauren Gensler, “Netflix Soars On Subscriber Growth,” *Forbes*, Jan 20, 2015. <http://www.forbes.com/sites/laurengensler/2015/01/20/netflix-soars-on-subscriber-growth/>

the basis of taste or age appropriateness. Neither should the government. In addition to the FCC's own ambitions, the Federal Trade Commission, at the request of a coalition of media watchdog and child advocacy groups, plans to investigate YouTube Kids, a new application for preschoolers that

is designed to filter videos containing adult-oriented content and topics (see Sidebar 3).

The FCC should resist calls for mandatory content ratings or other forms of content regulation of the Internet, especially in the area of “offensive” speech – restrictions that are all the rage in academic circles right now.

No regulatory fees

Netflix, Apple, Amazon, YouTube and Hulu are not cable TV companies or broadcasters. They do not run cable to homes, nor do they use the government-granted television spectrum. They store and serve content, which ranges from popular big-budget Hollywood movies to 10-minute how-to videos on a YouTube channel created by a passionate do-it-yourselfer. The idea that they somehow should pay local franchise fees or pay into the Federal Universal Service Fund, implied by Wheeler’s suggestion that OTT providers should be included in the definition of “multichannel video programming distributor,” is ludicrous.

CONCLUSION

Today’s cable television business has competition, but little differentiation. It’s no surprise that consumer awareness of the exclusivity of DirecTV’s NFL Sunday Ticket is high. But few would be able to cite the differences in tiered offerings between Comcast, AT&T and Verizon.

OTT is changing TV viewing habits by using the capabilities of the Internet and the revolution in wireless devices to meet customer needs. They are creating a smorgasbord of choice beyond all dreams of regulators. Netflix, Hulu, Google and Amazon are going to be major forces in this new ecosystem. Regulators should neither give any of them special favorable treatment, nor saddle them with requirements that are irrelevant to consumer needs or what once might have been “the public interest.” That’s particularly true when that notion of public interest developed in a world in which there were only three networks and a handful of independent stations.

If regulators stand aside and allow the market to work, there stands to be more competition and the greater consumer choices and programming diversity once envisioned for broadcast television. This entertainment and programming will come from a decentralized pool of creative talent that won’t need a huge and expensive infrastructure to reach an audience.

The regulatory mindset resists change. It threatens the status quo and fears business models made possible by new technology, but which may escape regulatory oversight. Meanwhile, established players do their best to keep rules in place that prevent market economics from running their natural

SIDEBAR 3: INTERNET ADVERTISING REGULATION - FCC OR FTC?

In a related regulatory development, a new YouTube application designed for preschoolers has drawn the scrutiny of the Federal Trade Commission, which along with the FCC is empowered to regulate broadcast advertising, particularly when it is directed at children.

In the past, the FCC has set rules about the amount of commercial time per hour in kids’ programming, and for differentiation between programming and advertising. The FTC sets truth-in-advertising rules and will intervene in cases of false or misleading claims. Both agencies can enforce the Children’s Online Privacy and Protection Act. In May 2015, the FTC agreed to review a joint complaint from the Center for Digital Democracy and the Campaign for a Commercial Free Childhood about YouTube Kids, a smartphone application YouTube introduced three months earlier. The app is designed as a tool for providing age-appropriate videos for preschoolers. The groups said the application filters were not performing as promised and called for greater regulation of advertising on the Web.

The complaint spotlights the current rush to regulate the Internet without due diligence. YouTube Kids was released Feb. 23, 2015 as a free app for Apple and Android devices that would offer a safer way for young children to avoid stumbling across more adult YouTube content. The May letter from CDD and CCFC to the FTC accused YouTube of “deceptive acts,” claiming the app did not filter content adequately, displayed material that included explicit sexual language and drug use and served ads for alcoholic beverages.¹ The CCFC posted a video compilation of clips and advertising it claims to have collected using YouTube Kids.²

The compilation raises some questions. There is no indication the app displays advertising. In researching this paper, I downloaded YouTube Kids (Version 1.12, updated May 1, 2015, the same version the CCFC says it used) played several videos and was not served any ads. According to Google, ads were included in the app at launch, although limited to public service announcements and ads for other YouTube Kids content. As for inappropriate content, it is implied that CCFC did specific searches for each video by title or keyword. It never claimed that adult material was accessed accidentally, a common complaint parents have with the standard YouTube app. When I searched for the questionable videos, adult-oriented entertainment was blocked. Material that did escape the filter was in non-entertainment context. The search “What is suicide” brought up a serious TED Talk on the subject. “What is red wine” displayed videos on gourmet food preparation. To be fair, this is material that “kid-friendly” filtering algorithms may not catch, especially on an app that is barely three months old, and tasked with filtering millions of videos. Moreover, YouTube Kids allows parents to disable the search function.

Despite some bugs, YouTube Kids appears to be a good-faith effort to provide a mechanism for filtering mature content. Regulators should welcome such apps, not punish companies for taking the initiative. YouTube Kids is likely to get much better, much faster in its subsequent releases than it would take the FTC to investigate, make a ruling and devise its own guidelines.

The groups seem to be angling for the government to regulate Web-based advertising and may have approached the FTC because the agency needs no additional authority to investigate advertising on Web media. FCC jurisdiction over Web advertising is still debatable, as it is not traditionally considered broadcast media. The fact that the FTC can act now, even on complaints of questionable validity, argues against empowering the FCC further.

1. Elizabeth Weise, “YouTube Kids App Doesn’t Filter Raunchy Videos, Complaint Says,” *USA Today*, May 19, 2015. <http://www.usatoday.com/story/tech/2015/05/19/google-youtube-kids-app-inappropriate-videos/27561855/>

2. Campaign for a Commercial-Free Childhood, “Is YouTube Kids A Safe Place for Young Children to Explore?”, available at <https://vimeo.com/127837914>

course. Ten to 15 years ago, many governments unsuccessfully tried to ban the PC-based phone application Skype because it allowed users to avoid the bloated international phone tariffs that were common, even among Western democracies that had privatized their phone companies.

In 2015, “watching TV” doesn’t mean what it meant just a few years ago. If regulators do not allow the market the flexibility to adapt to these changing notions, the inevitable result will be frustration all-around. Rather than redefining them as MVPDs, OTT calls for a judicious, restrained temperament and a regulatory philosophy committed to doing no harm.

ABOUT THE AUTHOR

Steven Titch is an associate fellow of the R Street Institute, focused on telecommunications, the Internet and information technology. He also serves as a policy advisor to the Heartland Institute and is a former policy analyst at the Reason Foundation. His columns have appeared in *Investor’s Business Daily*, the *Washington Examiner* and the *Houston Chronicle*.

Titch also was co-founder and executive producer of *Security Squared*, a business-to-business Web publication covering IT convergence in physical security and surveillance. Previously, Titch was editor of *Network-Centric Security* and director of editorial projects for *Data Communications* magazine. He also has held the positions of editorial director of *Telephony*, editor of *Global Telephony* magazine, Midwest bureau chief of *Communications Week* and associate editor-communications at *Electronic News*.