

**Remarks of
Commissioner Michael O’Rielly, Federal Communications Commission**

Media Institute Luncheon

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“The Video Marketplace: A Modern Viewpoint”

Introduction

Before I begin, let me extend my deep appreciation to Patrick Maines for his invitation to speak at this event. With more than 20 years under my belt, I like to think that I have been working in the Washington, D.C. policy arena for a fair amount of time. But anyone who can reference their career back to Senator Barry Goldwater, as Patrick can, is the one with the real institutional knowledge. The Media Institute’s lasting tenure is a credit to Patrick’s fortitude and congeniality. His real accomplishments, however, are not measured by the Institute’s longevity but rather by his steadfast defense of the First Amendment and its protections for American citizens.

Patrick, in getting ready for this speech, I was told that one of your all-time favorite shows is *Breaking Bad*, which I have heard is phenomenal, but have yet to watch. So, the other night I was scrolling through the TV channel guide and low and behold, there it was airing on one of the channels. I quickly tuned in expecting to be impressed. But a few minutes later, I thought, wow, I don’t think I share Patrick’s taste in shows. This is nothing but an infomercial with a bunch of men talking about their hair problems. And then I realized...*wait a minute...*This isn’t *Breaking BAD*, it’s *Breaking BALD!*

Anyway, that brings me to the topic I’d like to discuss with all of you: the incredible vitality of today’s video marketplace and how the FCC needs to modernize its rules to reflect current realities. Digitization and the Internet have driven a proliferation of new platforms for consumers, especially in the last decade. To win subscribers, video providers are seeking to offer more types of content in order to differentiate themselves in the marketplace. And programming production and distribution businesses have started converging to meet the growing demand for high quality original programming. As a result, we are living in the “Platinum Age” of video. To realize the full benefits of this dynamism, the FCC should acknowledge the fierce competition that exists and it should get rid of regulations that no longer make sense.

Proliferation of Platforms

When it comes to the delivery of video programming, our nation’s free over-the-air broadcasters used to be the only game in town. Then came cable systems, and consumers could get up to 30 channels, if they were lucky. Over the years, cable operators grew and upgraded their services to provide hundreds of channels, on-demand offerings, and high-speed broadband. And a whole host of other “pay-TV” systems arrived, including satellite (Direct TV and Dish), traditional telcos such as AT&T U-verse and Verizon FiOS, as well as various cable “overbuilders.” Programming has mushroomed to the point that a

new market of navigation tools is emerging—such as Google Chromecast, Roku and TiVo—to help viewers locate content they want to watch.

Meanwhile, the Internet offers a new world of video options. Besides the ability to watch Grumpy Cat and other special interest videos on YouTube,¹ Americans can also subscribe to a number of online video distributors or OVDs, such as Netflix, Apple TV, Hulu, and Amazon Prime Instant Video, to name just a few.

In addition, with the rise of tablets and smartphones, wireless companies are becoming an increasingly popular medium for video delivery. In order to compete, cable operators are establishing Wi-Fi hot spots throughout their footprints so that their customers can easily access content. It is not surprising then, that Cisco released data last week predicting that IP traffic will continue to grow 21 percent annually and that an incredible 79 percent of it will be video by 2018.²

Content is King

No one is certain who first coined the phrase “content is king.” But back in 1996, Bill Gates used it as the title for a prophetic speech. He envisioned a coming “television revolution,” and said, “Content is where I expect much of the real money will be made on the Internet, just as it was in broadcasting.... In a sense, the Internet is the multimedia equivalent of the photocopier.... The Internet also allows information to be distributed worldwide at basically zero marginal cost to the publisher.”³ He predicted that those who could figure out how to provide relevant content would “propel the Internet forward as a marketplace of ideas, experiences, and products—a marketplace of content.”⁴

Great stories have always been the key to popular “hit” programming. As Viacom’s Sumner Redstone said, “people don’t watch CBS, they watch CSI.”⁵ During a recent trip to Los Angeles for NCTA’s cable show, I had the chance to meet with professionals from a number of our nation’s finest content companies. They reiterated that future success in content production is directly tied to the quality of the storytelling. As the number of channels and shows increasingly “fractionalize” the video marketplace, competition for the same viewers and advertising dollars has become intense. In order to rise above the crowd, distributors are working harder than ever to distinguish themselves by offering more high quality original programming.

¹ Real Grumpy Cat, YOUTUBE.COM, http://www.youtube.com/channel/UCTzVrd9ExsI3Zgnlh3_btLg (last visited June 18, 2014) (recording that more than 165,000 people subscribe to Grumpy Cat’s YouTube channel and some of Grumpy Cat’s videos exceed 2 million views each).

² Sue Marek, *Cisco Study: 79% of All IP Traffic Will Be Video by 2018*, FIERCECABLE, June 9, 2014, <http://www.fiercecable.com/story/cisco-study-79-all-ip-traffic-will-be-video-2018/2014-06-09>.

³ Bill Gates, *Content is King*, INTERNET ARCHIVE WAYBACK MACHINE, <http://web.archive.org/web/20010126005200/http://www.microsoft.com/billgates/columns/1996essay/essay960103.asp> (last visited June 18, 2014).

⁴ *Id.*

⁵ *I Am American Business: Sumner Redstone*, CNBC.COM, Apr. 27, 2012, <http://www.cnbc.com/id/100000726>.

There are countless examples of the growth in quality shows. As Wall Street analyst Michael Nathanson recently declared: “We are witnessing an arms race in original content.”⁶ HBO thrived in the past with edgy productions like *The Sopranos* and *Sex in the City*, and is seeing continued success with *True Blood* and *Game of Thrones*. Showtime has *Homeland*. FX is getting strong reviews for *The Americans* and *Fargo* and AMC has *The Walking Dead*. Online distributors are also taking the high risk, high reward strategy of obtaining their own exclusive programming. Netflix introduced its own original series, *House of Cards*— for which it quickly won 3 Emmy Awards— and now offers *Orange is the New Black*.⁷ Moreover, the public has been told to expect exciting things from a new venture formed by AT&T and The Chernin Group in April that has dedicated \$500 million to invest in online video programming services.⁸ Columnist Daniel Holloway observes that these are significant developments because they signal a marketplace shift whereby cable, satellite, phone and online companies are increasingly becoming both distributors *and* producers of content.⁹

But economics apply even to the magical ways of Hollywood. The simple fact is there is only a finite pool of top notch talent that can operate in front of and behind the camera. This means there is a limit to the amount of high quality content that can be produced at any one time, which makes each production that much more expensive. As David Bank of RBC Capital Markets stated, “[s]o yes, you could argue that the cost of content is going up. And oh, by the way, there’s only so many people in Hollywood that can do this stuff.”¹⁰

Programming has, therefore, become more expensive. Each episode of *Mad Men* costs around \$2.5 to 3 million,¹¹ the *Big Bang Theory* costs around \$2 million per episode,¹² and *Downton Abbey*

⁶ Jon Lafayette, *Original Programming Costs Raise Concern*, BROADCASTING & CABLE, Jan. 20, 2014, <http://www.broadcastingcable.com/news/currency/original-programming-costs-raise-concern/128593>.

⁷ Paige Albiniak, *SVOD Services’ New Originals Shake Up the Market*, BROADCASTING & CABLE, Apr. 14, 2014, <http://www.broadcastingcable.com/news/syndication-and-distribution/svod-services-new-originals-shake-market/130471>.

⁸ Thomas Gryta, *AT&T Forms Online Video Venture With the Chernin Group*, WALL ST. J., Apr. 22, 2014, <http://online.wsj.com/news/articles/SB10001424052702303825604579517482597001284>; Todd Spangler, *AT&T, Chernin Group Invest \$500 Million in Over-the-Top Video Venture*, VARIETY, Apr. 22, 2014, <http://variety.com/2014/digital/news/att-chernin-group-invest-500-million-to-form-over-the-top-tv-venture-1201160876/#>.

⁹ *Id.*

¹⁰ *Original Programming Costs Raise Concern*, BROADCAST & CABLE, Jan. 20, 2014, at 3.

¹¹ Rebecca Greenfield, *Inside the ‘Mad Men’ Economy*, THE WIRE, Mar. 26, 2012, <http://www.thewire.com/entertainment/2012/03/inside-mad-men-economy/50354/>.

¹² Elena Sheppard, *Here’s How Much It Costs to Make a ‘Game of Thrones’ Episode*, POLICYMIC, Apr. 8, 2014, <http://www.policymic.com/articles/87169/here-s-how-much-it-costs-to-make-a-game-of-thrones-episode>.

reportedly costs £1 million per episode.¹³ On the higher range, *Game of Thrones* runs between \$6 million and \$8 million an episode.¹⁴

Sports programming also commands a special premium. It is popular, limited, and highly valued by advertisers because it is one of the only types of content left (aside from local news) that viewers still like to watch live, including the commercials. With more distributors competing for a set pool of sporting events, we're seeing costs increase dramatically.

While programming costs have gone up, advertising revenues have weakened over the years due to more competition in the market. As a result, we are seeing more broadcasters obtaining a growing percentage of their annual revenues from retransmission consent fees. According to analysis by SNL Kagan, retransmission fee revenue grew by 45.8 percent in 2013 and is now 18.5 percent of total TV revenue.¹⁵

OVDs are also not immune from the content arms race. Hulu reportedly paid \$500 million for content in 2012, which was significantly more than the \$420 million it made in revenues.¹⁶ And Netflix has stated that it will spend \$3 billion on TV and film content this year alone and \$6 billion over the next three years.¹⁷

News

Even local news can't escape the growing pressure to produce more compelling content. According to a Pew research study, between 2006 and 2012, the number of people watching local news dropped by 6 percent overall and by 14 percent among those aged 18 to 29.¹⁸ This is an issue for local broadcasters because news is an important way for stations to stay relevant in a local community, and, if done right, it can make good business sense. In fact, a recent NBCUniversal study shows that TV news viewers are more likely to make a decision to buy a product while watching the news than other

¹³ Adam Sherwin, *The US Couples Who Bought Their Own Slice of Downton Abbey*, INDEPENDENT, Jan. 17, 2011, <http://www.independent.co.uk/arts-entertainment/tv/news/the-us-couples-who-bought-their-own-slice-of-downton-abbey-2186298.html>.

¹⁴ Sheppard, *supra* note 12; Frank Pallotta, *How 'Game of Thrones' Producers Persuaded HBO to Let Them Make an \$8 Million Episode*, BUSINESSINSIDER, Apr. 7, 2014, <http://www.businessinsider.com/game-of-thrones-how-blackwater-help-make-the-series-one-of-the-most-popular-on-tv-2014-4>.

¹⁵ Justin Nielson, *TV Retrans Revenues End 2013 on a High Note, Up 49% in Q4 and 46% for Full Year*, SNL Kagan, Apr. 7, 2014, <http://www.snl.com/interactivex/article.aspx?id=27596218>.

¹⁶ Jennifer Van Grove, *Hulu to Drop \$500M on Content in 2012, More Than It Earned in 2011*, VENTURE BEAT, Jan. 12, 2012, <http://venturebeat.com/2012/01/12/hulu-2011-performance/>.

¹⁷ Mark Sweney, *Netflix to Spend \$3bn on TV and Film Content in 2014*, THE GUARDIAN, Feb. 5, 2014, <http://www.theguardian.com/media/2014/feb/05/netflix-spend-3-billion-tv-film-content-2014>.

¹⁸ Michael Malone, *Out with the Old, In with the News*, BROADCASTING & CABLE, May 26, 2014, <http://www.broadcastingcable.com/news/local-tv/out-old-news/131388>.

programming.¹⁹ Moreover, a station ranked number one in news in a market tends to be number one overall and can demand higher ad rates.

Younger audiences are getting their news in other ways and have different sensibilities. To bring these viewers back, Jack Abernethy of FOX Television Stations announced last year that FOX is “retiring the typical anchorman” and experimenting with new styles.²⁰ In January, WJZY Charlotte, a FOX owned-and-operated station, started doing its 10 pm news segment with a more “conversational approach,” without an anchor desk or microwave trucks in the field. Another station, WWOR in New Jersey, launched a novel approach called *Chasing New Jersey*, where a so-called “ringleader” takes viewers through the day’s issues.²¹

Regulatory Response

Now, given all of these changes I just described, how does this apply to the FCC and its work? I will make the analogy that the FCC is poised at this pivotal moment just like the proverbial ostrich. As many of you know, the ostrich is one of the fastest birds on land, able to reach 45 miles per hour in short bursts. This bird is also known for being stubborn and sticking its head in the sand. Instead of speeding forward to recognize the marketplace realities, I worry the FCC is desperately clinging to existing rules—Rules that were written prior to the digital revolution, prior to Wi-Fi, and prior to the Internet. These regulations treat the various video providers that offer the same, or very similar, services, in different ways. To be fair, many of these rules—if not the most impactful ones—are the result of statutory provisions. Fortunately, the House Energy and Commerce Committee and the Senate Commerce Committee are looking towards reform. I defer to the Congress on the timing and content of any changes it deems appropriate. In the meantime, there is a great deal the FCC can do on its own accord to clear out the regulatory underbrush.

I will start with broadcasting since it is the most heavily regulated.

Media Ownership

One of the biggest issues facing many broadcasters today is the FCC’s Media Ownership rules. According to Section 202(h) of the Telecommunications Act of 1996 the FCC is *required* to review these rules every four years. It is *supposed* to repeal or modify any rules that can no longer be justified due to competition.²² Even when writing the law 18 years ago, Congress recognized that the media landscape was becoming more competitive and wanted the ownership limits to be only as restrictive as absolutely

¹⁹ Jon Lafayette, *News Makes Viewers More Receptive to Ads*, BROADCASTING & CABLE, May 5, 2014, <http://www.broadcastingcable.com/news/currency/news-makes-viewers-more-receptive-ads/1308>.

²⁰ Malone, *supra* note 18.

²¹ *Id.*

²² Telecommunications Act of 1996, Pub. L. No. 104-104, § 202(h), 110 Stat. 56, 111-12 (1996); Consolidated Appropriations Act, 2004, Pub. L. No. 108-199, § 629, 118 Stat. 3, 99-100 (2004) (“Appropriations Act”) (amending Sections 202(c) and 202(h) of the 1996 Act). In 2004, Congress revised the then-biennial review requirement to require such reviews quadrennially. *See* Appropriations Act § 629, 118 Stat. at 100.

necessary. Unfortunately, this past April, the Commission ignored this requirement and voted to punt this review until June 2016, at the earliest.²³ With the last review completed in 2007,²⁴ the FCC will go almost a decade without updating these rules. I am not aware of any precedent that allows a federal department or agency to decline to meet a statutory deadline simply because it doesn't want to comply.

I would challenge anyone to look in the mirror and with a straight face say that we need to *tighten* the media ownership rules, especially for the struggling newspaper industry. Since my speech is about video, let me focus for a minute on the duopoly rule, which prevents a broadcaster from owning two stations in the same market, except in the larger markets. Competition and the need for scale is even more important in the smaller markets, where small television stations compete not only with other television stations, but with MVPDs (Multichannel Video Programming Distributors), Groupon, Facebook, Living Social and every other entity that caters to local advertisers. In the short-term, some small and medium market stations used Joint Sales Agreements (JSAs or shared ad sales staff) to survive. But instead of helping these struggling stations, the FCC effectively outlawed JSAs in the media ownership order earlier this year and gave the existing JSAs in the marketplace a short time to unwind.²⁵ This *tightened*, rather than *loosened*, the ownership rules. And the FCC did this without even giving a sideways glance at the underlying duopoly rule.

Sadly, not two months later, we are already seeing the devastating effects of this misguided decision. A couple of weeks ago, Sinclair Broadcasting announced its intention to turn in three television station licenses to the FCC because they were unable to operate these stations without the JSA structure or sell them.²⁶ In other words, these stations are going dark and television viewers in two markets are being harmed with the loss of three local stations.

And to further impact the broadcast industry, the Commission served notice last year that it may move forward to eliminate what is known as the "UHF discount."²⁷ Under this rule, a station operating on UHF spectrum is counted as half of a VHF station when calculating total ownership for purposes of the national cap.²⁸ If enacted, this policy could immediately put some broadcasters out of compliance with the cap and could limit their ability to buy and sell stations, jeopardizing the investments they made based on the existing rules. Any update to the UHF discount should be done as part of an overall review of the ownership rules, including the cap.

²³ 2014 Quadrennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, MB Docket No. 14-50, Further Notice of Proposed Rulemaking and Report and Order, 29 FCC Rcd 4371 (2014) ("2014 Media Ownership NPRM and Order").

²⁴ 2006 Quadrennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, MB Docket No. 06-121, Report and Order and Order on Reconsideration, 23 FCC Rcd 2010, 2016-17 ¶ 9 (2008).

²⁵ 2014 Media Ownership NPRM and Order, 29 FCC Rcd at 4527-45 ¶¶ 340-72.

²⁶ Letter from Clifford M. Harrington, Counsel for Sinclair Broadcast Group, Inc. and its subsidiaries, to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket 13-203 (May 29, 2014).

²⁷ Amendment of Section 73.3555(e) of the Commission's Rules, National Television Multiple Ownership Rule, MB Docket No. 13-236, Notice of Proposed Rulemaking, 28 FCC Rcd 14324 (2013).

²⁸ 47 C.F.R. § 73.3555(e).

Sports Blackout Rule

One rule that could be changed without having any demonstrable effect on the marketplace is the Sports Blackout rule,²⁹ which the FCC is considering eliminating.³⁰ Setting aside my personal love of the Buffalo Bills and the number of games I missed over the years due to blackouts, some argue quite compellingly that repealing the rule will not have any impact because the sports leagues and local broadcasters can negotiate this point in their contracts.³¹ If this is the case, the FCC has no role. Instead of using the FCC as a tool to protect the NFL and its revenues, the league and local broadcasters should continue to find ways to ensure consumers have access to content.

Foreign Ownership Rules

Additionally, the Commission should revisit its foreign ownership restrictions for broadcast licensees. We've taken the first step. One of my first votes as a new Commissioner in November was for the order that reaffirmed the Commission's previously held, but not universally-known, position that it would consider applications to approve foreign ownership of broadcast licenses above the 25 percent threshold.³² We need to go further and consider ways to expand the foreign ownership rule to attract more investment in broadcasting. Encouraging foreign ownership will not only benefit domestic broadcasters, it will also open doors for U.S. investors abroad.

MVPDs (Multichannel Video Programming Distributors)

Turning to MVPDs, as previously touched on, most of the rules that apply to these video providers reside in Title VI of the Act, which is within the purview of Congress. But I will mention a few principles that should guide the FCC's future.

First and foremost, we should not make the regulatory environment worse by trying to force the market to do what it is not ready or able to do. The FCC almost made this mistake a number of years ago when it tried to impose a la carte rules. Doing so would have been very difficult, if not impossible, legally, not to mention harmful to consumers. It would have decreased the number of channels available overall, especially new and diverse channels with niche programming. There is also no need for regulation because the market is increasingly bringing this feature to consumers. Both MVPDs and OVDs are striving to offer more tailored packages to their subscribers.

²⁹ 47 C.F.R. §§ 76.111 (cable operators), 76.127 (satellite providers), 76.128 (application of sports blackout rules), 76.1506(m) (open video systems).

³⁰ *Sports Blackout Rules*, MB Docket 12-3, Notice of Proposed Rulemaking, 28 FCC Rcd 17214 (2013) ("*Sports Blackout NPRM*").

³¹ See, e.g., Comments of Sports Fans Coalition, Inc. National Consumers League, Public Knowledge, League of Fans, Fanfreedom. Org, MB Docket 12-3 (Feb. 24, 2014); see also *Sports Blackout NPRM*, 28 FCC Rcd at 17231-33 ¶¶ 29-33.

³² *Commission Policies and Procedures Under Section 310(b)(4) of the Communications Act, Foreign Investment in Broadcast Licensees*, MB Docket No. 13-50, Declaratory Ruling, 28 FCC Rcd 16244 (2013); 47 U.S.C. § 310(b)(4).

Second, the FCC should avoid becoming involved in rate disputes for video offerings. The Commission is ill-equipped to determine fair market rates. It is far better to leave these negotiations to the seasoned professionals in the private sector.

Third, the FCC should take advantage of the opportunities to remove barriers when evident, especially in our internal processes. One specific area I see that is ripe for reform is the Commission's rules governing findings of "effective competition." Congress gave the FCC authority to remove rate regulation for cable providers if there is "effective competition" in a market, as defined in the statute.³³ In almost all instances, the statutory test is met by the continued offering of video services by Dish and DirecTV. But today, any cable operator filing a petition for a determination of "effective competition" in an area faces an extensive process to prove that "cable systems are...not...subject to effective competition."³⁴ Overcoming this standard is unnecessarily onerous. It creates needless burdens and expense on cable operators and the FCC. It has led to a sizeable backlog and significant delay. And these added compliance costs are ultimately passed on to consumers. It would seem to make sense for the Commission to address this problem by initiating a new rulemaking proceeding as soon as possible.

Online Video Distributors

Finally, let me say a few words about online video distributors. As competitive pressure builds in the marketplace—as noted by a report last week showing that Netflix is starting to cut into the pay-TV market³⁵—those who face heavy regulation will point to the inequities that this causes. I have real concerns that pressure will build both internally at the FCC and externally to try to reflexively extend legacy regulations to online video distributors. This would undermine these nascent services and limit the valuable competition they provide.

Conclusion

To conclude, if the FCC does not act in a timely fashion, and continues to ignore the incredible transformations in the video marketplace, we will look more foolish than an ostrich that has buried its head in the sand.

Thank you for hosting me here today. I look forward to answering any questions you may have.

³³ 47 U.S.C. § 543(l)(1).

³⁴ 47 C.F.R. § 76.906.

³⁵ Daniel Frankel, *Netflix Cutting into the Pay TV market, Report Says*, FIERCECABLE, June 10, 2014, <http://www.fiercecable.com/story/netflix-cutting-pay-tv-market-report-says/2014-06-10>.