

THE WALL STREET JOURNAL.

Underdog Turns Uberdog

February 17, 2004

By Thomas W. Hazlett

That Comcast, a cable company with 21 million subscribers, could launch a take-over of Disney, a conglomerate owning one of America's "big three" television networks, constitutes a massive tectonic shift in the geology of media regulation.

For decades, broadcast TV was protected by federal regulations, while cable was hindered. In the early '60s, the FCC blocked cable's emergence, based on its judgment that "the prohibitive cost of extending the cables beyond heavily built-up areas" meant the medium would never be more than a niche service. Which is exactly what the agency's rules mandated, on the grounds that cable "not be permitted to curtail the viability of [new or] existing local service" by TV stations.

It wasn't until the Ford and Carter administrations that the shackles on cable were removed, clearing the way for a wired America. By 1987, more than half of all households subscribed to cable, and by 2002, cable network programs attracted more viewers than did broadcast TV shows. Today, the aggregate value of cable TV systems is about \$300 billion, while TV stations are worth in the neighborhood of \$100 billion. Little wonder the upstarts are poised to acquire the bully whose regulatory bodyguards once kicked sand in their faces.

But the motivation behind the acquisition is not vengeance; it's projected efficiencies. When Roy Disney quit Disney's board recently, he cited the failure of the Michael Eisner-led company to build constructive relationships with "the cable companies distributing our products." With the great tilting of video economics, cable programming has emerged as a key part of the "broadcasting" business. About 70% of the programs on cable networks are owned by broadcasters, just 30% by cable operators. Disney is relatively strong here, owning four ESPN networks, the Disney Channel, and SoapNet, along with major pieces of A&E, Lifetime, Biography and the History Channel.

Comcast, whose major program holding is QVC, the home shopping network, is relatively bare -- although it does own the Golf Channel. Combining that with ESPN could create a monopoly behemoth sending chills through sports bars across America. Stocking up on content to go with its conduits (passing 39 million of America's 107 million TV households) blends two parts of the television business and eliminates coordination problems between them.

Political reaction to the merger will surely pose problems. Regulators at both the FCC and whichever antitrust agency reviews it are not immune. Opposing a combination of this size is profitable; objecting players can often affect spin-offs, conditions or outright greenmail, making it lucrative to be disagreeable. And as the election season heats up, do not be shocked if "outrageous media concentration" moves the merger from the financial section to front-page news. Already the New York Times has raised the concern that Comcast-Disney, following the Fox-DirecTV and Turner-Time Warner mergers, leaves Viacom (owner of CBS) desperate to join the vertical integration party.

Such talk is loose. Viacom, an early cable operator, actually sold off its systems in 1995. And the 1996 Time Warner acquisition of cable-program powerhouse Turner (with CNN, TBS, TNT, TCM and Toon) has hardly shielded the media conglomerate from the wrath of competitive markets. Fox News, CNBC and MSNBC have bludgeoned CNN's ratings. With the tragicomedy of AOL-Time Warner (consummated in 2001), the gains from aggregation are put in perspective. Ted Turner, on joining Time Warner, exclaimed: "I'm tired of being small. I want to be big." Sorry, Ted, you're small again.

The Comcast-Disney "underdog eats uberdog" merger should get a new generation of regulators to lean

back and view a wide screen. The industry they once cast aside has now emerged as dominant, bringing consumers a cornucopia of new services, despite regulators' best efforts. Likewise, the emerging information technologies of tomorrow are barely on today's radar screen, and are typically dismissed in FCC deliberations. Rules are crafted that are not only indifferent to innovators, but downright brutal.

Internet TV promises to deliver video programs on demand, removing the network middleman, hugely boosting consumer choice. Indeed, the top-down network programming function today appears odd; why can't viewers just click in programs they like, 24/7? Some Web sites -- and cable operators' video-on-demand -- offer a glimmer of this now. But it's currently just a niche service, until investors sink in the capital to build big, bold, high-bandwidth networks able to deliver the vast quantity of content desired.

* * *

Sadly, regulations still block countless opportunities. In wireless, broadband deployment is suffocated by the industrial policy now known as "the Digital TV transition," an official FCC proceeding now in its 17th year. During that time, a vast swath of bandwidth has been wasted, and the emergence of wireless broadband -- by many measures, a potentially dominant competitor -- has been thwarted, bottling up a "third path" for high-speed networks.

In wireline, access regulations continue to discriminate against firms investing billions to build networks. TV broadcasters are bestowed with must-carry rights appropriating bandwidth from cable operators. More happily, cable modem services have thus far escaped "open access" obligations, which would force them to share their networks with rivals, and have sped to a 2-1 lead in broadband subscribership. Runner-up phone companies offer DSL (digital subscriber line) service on "open access" platforms. Investors prefer cable's proprietary model.

So should regulators, because only by inducing the creation of new networks will better alternatives be offered. Phenomenally great alternatives are on the horizon. Instead of defending existing market structures as in the '60s, regulators ought to dare a surprise ending -- and welcome the emerging technologies of tomorrow.

Mr. Hazlett, former chief economist at the FCC, is a senior fellow at the Manhattan Institute.

©2004 [The Wall Street Journal](#)

[About Thomas Hazlett: articles, bio, and photo](#)