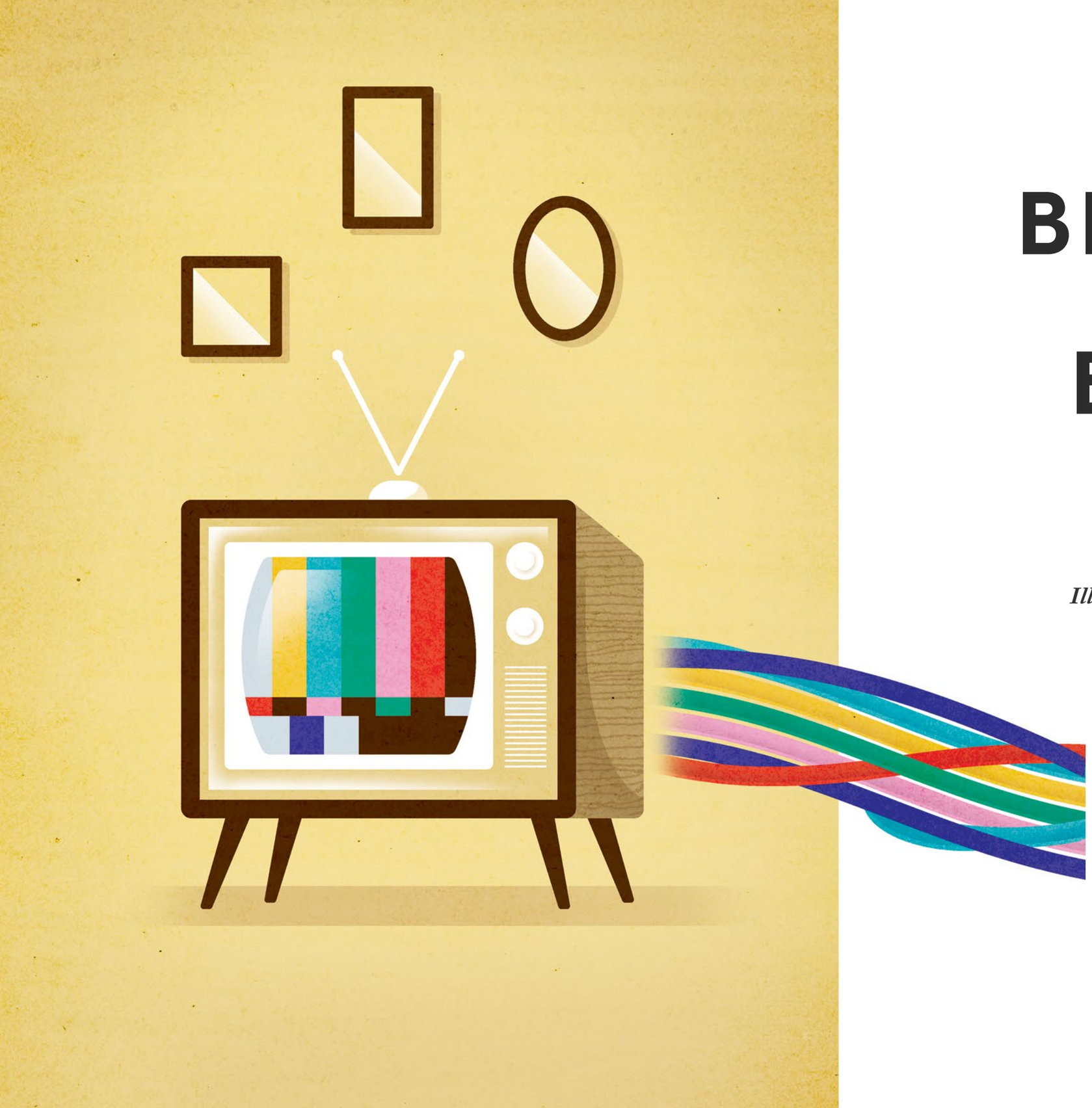

BREAKING *the* BUNDLE

What would happen if Big Cable was forced to offer a la carte pricing? According to industry experts, you might not like it.

By ADAM K. RAYMOND
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LAST FALL, Esquire Network quietly arrived in the homes of 75 million American cable subscribers with a slate of cooking, travel and reality shows that sought to capture the viewers advertisers love most: young men with money to spend. Six months after the launch, it was clear the network was an unwelcome, if well-dressed, guest.

A spinoff of the iconic men's magazine, Esquire Network was regularly attracting a measly 78,000 viewers to its prime-time programming. Yet despite those dismal ratings—a little more than half of what was enjoyed by Style Network, which was killed to start the guy-friendly station—the channel will be given time to grow, because even if those 75 million subscribers aren't watching, they'll continue paying for the privilege to skip over its offerings.

At fault is a decades-old business practice that allows NBCUniversal, which owns Esquire Network, to make cable providers carry its less popular channels if it also wants the popular ones, like USA Network and Bravo. The practice is called bundling, and it's the reason millions of Americans are clamoring for a new way to watch TV.

"There's a frustration that the music industry has changed, the video-rental industry has changed and >

cable is the same as it's always been," says Ali Yurukoglu, an assistant professor of economics at the Stanford Graduate School of Business who has studied what would happen if Big Cable were forced to "unbundle"—that is, allow consumers to purchase only the specific channels they want.

In recent years, Big Cable has felt its monopoly over U.S. television distribution threatened by the rise of a number of popular streaming services: Netflix and Hulu provide inexpensive subscriptions to seemingly infinite libraries; iTunes and Amazon allow the purchase of individual episodes those sites don't have; and Roku, PlayStation, Xbox and Chromecast will put all that video on your TV.

Even newer startups are addressing the limitations of those services, albeit not without legal challenges. A company called Aereo was the most revolutionary. For $8 a month, users received on-demand access to over-the-air content transmitted by major networks and smaller broadcast channels. But in June, Aereo lost a Supreme Court case, with the Justices ruling that the company violates copyright laws. Prior to that, with an Aereo account, you could watch TV, with DVR functionality, from your computer, tablet or phone.

For years, Big Cable's main counter to these technologies was access to the best content. If you wanted to watch "The Sopranos" as soon as it aired, you had no choice but to subscribe to a cable provider (and then HBO). But now that Netflix's "House of Cards" and "Orange Is the New Black" are certifiable hits—and other tech companies, including Yahoo! and Microsoft, are entering the original content game—Big Cable is losing its monopoly on quality content. Furthermore, critically acclaimed hits like FX's "Louie" and AMC's "Mad Men" are available to stream on Amazon (which is also developing its own original content), and HBO even recently struck a deal to bring some of its most beloved shows to Jeff Bezos' e-commerce powerhouse.

For Big Cable, the growing number of streaming options is starting to take a toll. A survey released late last year showed that nearly 8 million American homes can be classified as cord cutters, up 150 percent from 2010. The movement away from cable reached a tipping point in 2013, the first year ever to see an overall decline in the number of Americans buying cable. Ask most cord cutters why and they'll point to cable's ever-increasing price, which has outpaced inflation by $1,760 over the past 15 years.

"The American people are being ripped off," Senator John McCain wrote last year in a *Los Angeles Times* op-ed, when he introduced his Television Consumer Freedom Act, his second attempt (after a failed effort in 2006) to create a la carte cable. According to the FCC, the average rate for the most popular cable packages in 2012 was $61.63 for 150 channels. At 41 cents a channel, that may sound like a bargain. But when you consider that the typical household watches somewhere between just 12 and 18 channels, it's easy to understand why McCain—for whom cable TV has become a pet issue—told a Senate panel, "A la carte options are the right thing to do." And consumers agree. A 2012 survey of more than 1,000 cable-watchers found that 92 percent wanted to order from the a la carte menu. McCain's bill, which is languishing in committee and likely won't pass, would have required cable companies to at least offer an a la carte option.

The only problem is this: The intuitive desire to pay only for what you want seems to be pointless when it comes to cable. One study determined that the ultimate price reduction between bundles and a la carte offerings would be only 35 cents. Here's why: ESPN gets an estimated $5.54 a month from the 98.9 million Americans who receive the sports network as a part of their bundle, or $547.9 million a month total. Now consider an a la carte marketplace in which, research suggests, only 20 million "super fans" would be willing to pay for ESPN. In order to maintain its revenue stream, ESPN would have to charge each of those households around $30 a month. Tack on 12 more channels, each with a comparable jump in fee, and cable bills end up about the same.

THE INTUITIVE DESIRE TO PAY ONLY FOR WHAT YOU WANT SEEMS TO BE POINTLESS WHEN IT COMES TO CABLE TV.

"Our best guess is that the average consumer would be no better or worse off," Stanford's Yurukoglu says. "But there would be distributional consequences. People who watch a lot of TV are going to end up paying more than they currently do, but people who watch just a few channels would indeed be better off."

This isn't just a theoretical exercise. Laura Martin, a media analyst at investment firm Needham & Company, says that estimating how much unbundled channels would cost is simple because a handful of them already exist. "We now have several data points in the marketplace that suggest that a la carte entertainment channels will each cost $8 to $10 per month," she says, citing the WWE's $10-a-month Internet-only network and Netflix's price hike (to $8.99 a month) for new subscribers. Martin projects a proliferation of web-only networks in the coming years, leading to a marketplace in which Americans >

will be able to "take seven channels for $70 a month or 300 channels in the bundle for $70 a month, as they do now."

Yet Martin sees a bleak future in an a la carte world: $45 billion in TV ad money lost, 1.4 million jobs gone and $20 billion in taxes paid by cable operators that will disappear from government coffers. If those numbers don't scare you, this one will: 20. It's the number of channels Martin says will exist if cable unbundles. "The rest would lose all advertising revenue and probably go out of business," she says. "Obvious niche channels and all foreign-language channels would disappear. In addition, lots of channels you think of as big would also disappear because they are not in the top 20." Any network falling out of this hypothetical top 20 wouldn't be in enough homes to generate the ad revenue necessary to survive, Needham says.

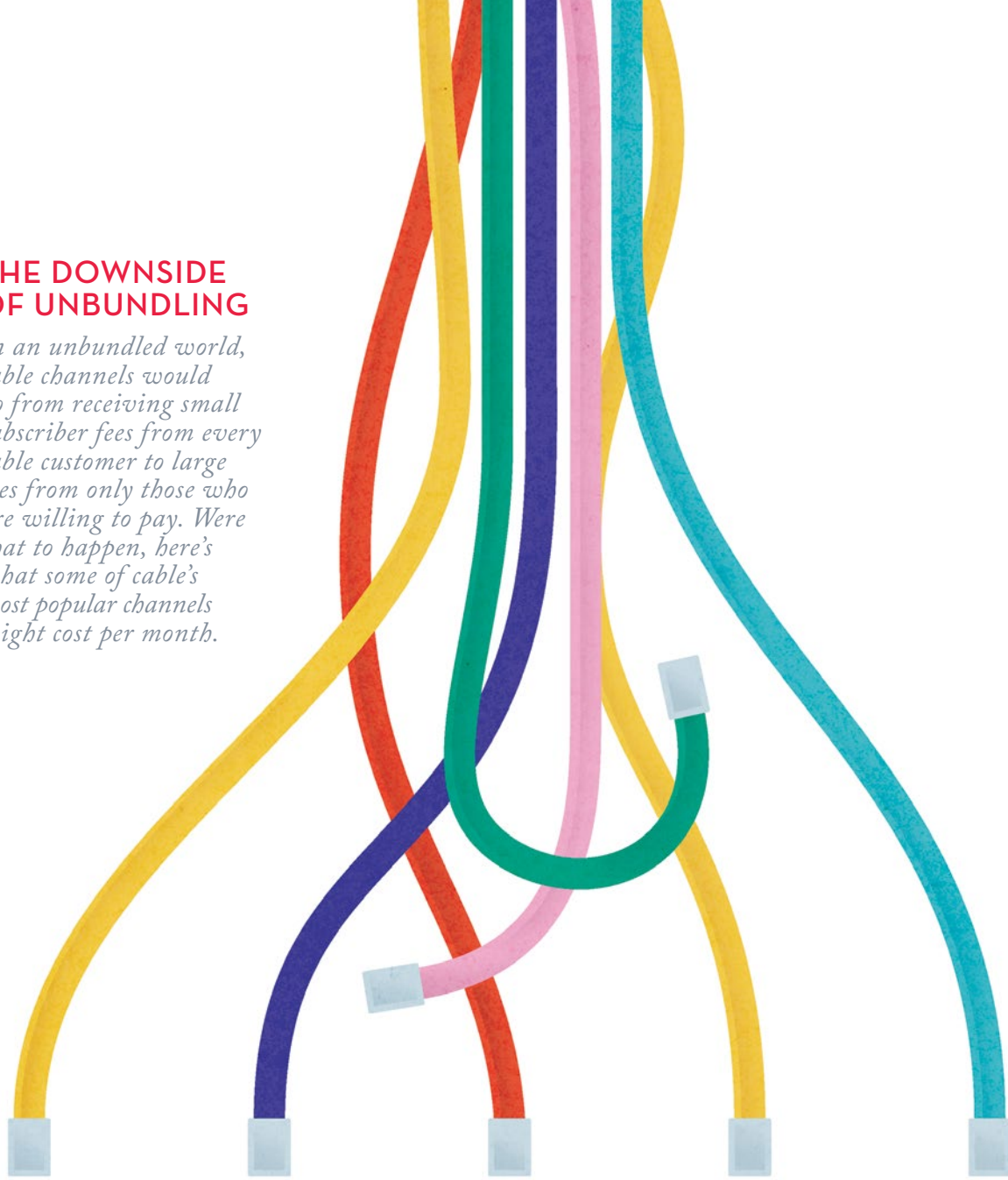
AMC, which in addition to "Mad Men" is home to "The Walking Dead," would likely be one of those high-profile casualties. In 2013, the channel commanded 33 cents per customer. With AMC in the homes of 97 million people, that added up to more than $32 million a month. Yet on its best night ever, last year's season premiere of "The Walking Dead," AMC had only 16 million people watching. Without the contribution of everyone who gets AMC in their bundle, the network's revenues would tank and its critically acclaimed original programming would suffer.

Even proponents of breaking the bundle recognize this. Linda Sherry, spokesperson for the advocacy group Consumer Action, says that while a la carte makes sense conceptually, "If indeed it means that there's going to be a lack of production of quality new programming, that might be a drawback." Her favored way forward is smaller, more personalized bundles. "If someone was interested in sports, they could buy a sports bundle, or if someone was interested in education, or home and garden, or foreign TV, they could get those bundles."

For a sense of this possible future we can look northward. The Canadian Radio-television and Telecommunications Commission is considering a model that would allow consumers to build their own cable packages if they so choose. Of course, customization will only be available to those who pay for a required package of local and educational channels—in other words, a bundle.

THE DOWNSIDE OF UNBUNDLING

In an unbundled world, cable channels would go from receiving small subscriber fees from every cable customer to large fees from only those who are willing to pay. Were that to happen, here's what some of cable's most popular channels might cost per month.



HISTORY	AMC	DISCOVERY	TBS	TNT
Number of subscribers: 98.7 MILLION	*Number of subscribers:* 96.7 MILLION	*Number of subscribers:* 99.6 MILLION	*Number of subscribers:* 100 MILLION	*Number of subscribers:* 98.9 MILLION
Current fee per subscriber: $0.26	*Current fee per subscriber:* $0.33	*Current fee per subscriber:* $0.37	*Current fee per subscriber:* $0.62	*Current fee per subscriber:* $1.33
Total subscription fees: $25.7 MILLION	*Total subscription fees:* $32 MILLION	*Total subscription fees:* $36.9 MILLION	*Total subscription fees:* $62 MILLION	*Total subscription fees:* $131.5 MILLION
Average viewership: 2.17 MILLION	*Average viewership:* 1.69 MILLION	*Average viewership:* 1.55 MILLION	*Average viewership:* 2.12 MILLION	*Average viewership:* 1.92 MILLION
Projected unbundled price: $11.84	*Projected unbundled price:* $18.93	*Projected unbundled price:* $23.80	*Projected unbundled price:* $29.25	*Projected unbundled price:* $68.50