Open Access to Broadband Networks: A Case Study of the AOL/Time Warner Merger

by Daniel Rubinfeld and Hal Singer

Presented by Philipp Zimmermann

Agenda

- Background of the Broadband Technology subscribers in the USA
- Background of the AOL / Time Warner Merger
- Anticompetitive Strategies
  - Conduit Discrimination
  - Content Discrimination
- Regulatory solutions to prevent the anticompetitive strategies
- Major question set by the person presenting
Background of the Broadband Technology
subscribers in the United States

What is Broadband?...

Definition of Broadband and Narrowband

<table>
<thead>
<tr>
<th>Broadband</th>
<th>Narrowband</th>
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<tbody>
<tr>
<td><strong>Definition</strong>: Loosely used to describe signals of high bandwidth (speed), usually referring to speeds of 200 kilobits per second or above</td>
<td><strong>Definition</strong>: Loosely used to describe signals of high bandwidth (speed), usually referring to speeds of less than 200 kilobits per second</td>
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<tr>
<td><strong>Examples</strong>: DSL, Cable modems (Ethernet), Satellite transfer</td>
<td><strong>Examples</strong>: Copper Cable, Modem, ISDN</td>
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The US broadband market structure consists of two major groups of competitors which reflect underlying infrastructure and historical competencies.

The USA Broadband Industry Structure in the year 2000

- **Baby Bells**
  - Verizon (Bell Atlantic, Nynex, GTE)
  - BellSouth
  - Qwest/USWest
  - SBC (Ameritech, Pac Bell, SNE)
  - Third Party Carriers (Covad, Northpoint, etc)

- **Affiliated and Third Party ISPs**

- **Cable Companies**
  - AT&T Broadband
  - Cablevision
  - Charter
  - Comcast
  - Cox
  - MediaOne
  - Time Warner
  - AOL

- **Satellite**
  - Hughes (64 000 subs)

- **DSL**
  - (1 Mio Subs)

- **Cable**
  - (2 Mio subs)

Background to the AOL/Time Warner Merger
The AOL / Time Warner merger represents a vertical integration along the broadband media value chain starting from content provision, ending with the final link to the customer.

### Media Value Chain

**Time Warner**

**AOL**

#### Broadband Content:
- Videos, Music, Interactive games

#### Aggregation of Broadband Content:
- Chat Rooms, Instant Messaging, Portals

#### Internet Service Provider (ISP):
- Connectivity to the Internet

#### Highspeed last mile transport:
- Transport from home to the ISP, provided by:
  - Cable provider

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The Combined Asset Sets of AOL and Time Warner are unique in the World...

**Unparalleled Internet Positioning**
- AOL has 26 million paying subscribers across all brands
- Time Warner has 21 million cable homes passed.

**Great Brands**
- Time, CNN, HBO, TNT, TBS, The WB Network, Warner Bros., AOL, ICQ, Netscape, CompuServe

**Great Management Team**
- Steve Case (AOL)
- Ted Turner (TBS)
- Gerald Levin (HBO)

**Strong Technology Focus**
- 2 million modems nationwide, with access in over 100 countries,
- handles approximately 60 million user sessions per day

**Product Reach and Stickiness**
- AOL and Time Warner have high frequency products with relatively long duration usage, faster access,
### Anticompetitive Strategies of AOL/Time Warner

... therefore the authors of the article believe that AOL/Time Warner could take advantage of its excellent strategic position by engaging into anticompetitive behaviour.

#### Anticompetitive Strategies

| Conduit Discrimination | Definition: Insulating its own conduit (Channel) by limiting its distribution of affiliated content and services over rival platforms  
| Example: AOL/Time Warner could for downsize its marketing of AOL’s service over Digital Subscriber Line (DSL) while actively promoting the service over cable |
| Content Discrimination | Definition: Insulating its own affiliated content by blocking or degrading the quality of outside content  
| Example: AOL/Time Warner could for example provide preferential Internet links to its affiliated CNN/Sports illustrated site and provide inferior links to ESPN site of Walt Disney Corporation |
It seems to be quite reasonable for AOL/Time Warner to engage into Conduit Discrimination … but very likely on the consumers expense

Revenue Structure of AOL/Time Warner

- AOL/Time Warner will engage in conduit discrimination if the gain of from additional access revenues from broadband users offsets the loss in content revenues from narrower distribution

Consumer implications
- Higher cable transport prices for AOL/Time Warner customers
- Out/of region customers have will have less oppotunity to buy good content

Revenue Structure of AOL/Time Warner with Content Discrimination

- AOL/Time Warner will engage in content discrimination if the gain of from additional portal, content and advertising sales offset the reduction in broadband access revenues

Consumer implications
- Consumers will pay more for broadband content
- Some consumers will have to switch to their second best broadband alternative
The government has set up several regulatory issues on the merger to avoid the anticompetitive behaviour of AOL/Time Warner

**Anticompetitive Strategies**

<table>
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<tr>
<th><strong>Open Access Condition</strong></th>
<th><strong>Consent Decree</strong></th>
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<td><strong>Vs.</strong> Conduit Discrimination</td>
<td><strong>Vs.</strong> Content Discrimination</td>
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<td>• Open Access Condition: The regulatory body imposed a rule that AOL/Time Warner would afford unaffiliated ISPs equal access to the combined company’s cable modem platform.</td>
<td>• Consent Decree: requires that AOL/TimeWarner make EarthLink (competitors content) available to AOL/Time Warner Customers before they begin offering their services themselves</td>
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<td>• Effect: This should promote investment in the broadband portal market by giving new entrants certain access to the merged company’s cable customer</td>
<td>• Effect: Customers seeking access to foreclosed content will not have to switch to another transport conduit that suffers from a lower rate of market penetration</td>
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The plummeting share price of AOL/TimeWarner indicates an unsuccessful merger story partly due to bad Post Merger Integration but definitely also partly because of overregulation.

There has some overregulation been going on for that company, the presenter believes that in this case a laissez faire approach would have been the better regulatory option to take.
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