US cable merger foreshadows Internet TV's rise

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In this Jan. 14, 2014, file photo, Charter Communications CEO Thomas Rutledge is interviewed on the floor of the New York Stock Exchange, in New York. Charter Communications Inc.'s $38 billion bid to take over the much-larger Time Warner Cable Inc. is an attempt to future-proof its business by gaining even more control over the connection between millions of American homes and the Internet. (AP Photo/Richard Drew, File)

Charter Communications Inc.'s $38 billion bid to take over the much-larger Time Warner Cable Inc. is an attempt to future-proof its business by getting its foot in the door of millions more homes wired for Internet service.

As people use more mobile devices, watch more online video and connect everything from thermostats to refrigerators to the Internet, delivering those Internet services will become increasingly valuable.

Gone are the days when one's primary reason for hooking up cable was for TV. Now, it's the Internet, which enables countless online services known collectively as the cloud—everything from movies on Netflix to backup files on Dropbox.

"Broadband is the gatekeeper to the cloud," says Tony Wible, an analyst with Janney Capital Markets. "There's insatiable demand for broadband."

These high-speed Internet services represent the fastest growing and most profitable line of business for cable companies. Last year, providing Internet access was 12 percent more profitable for Time Warner Cable than providing TV packages, despite taking in a third less revenue. Time Warner Cable has so far resisted Charter's overtures, but Charter has vowed to take the bid directly to shareholders if needed.

A combined Charter-Time Warner Cable would occupy a crucial position in more homes. With about 16 million customers, it would become the country's No. 3 provider of both pay TV services and high-speed Internet.

With more pay TV subscribers, the company would be able to negotiate better deals and pay less to carry channels from such companies as Disney, Viacom and Discovery. And the combined company would have more future negotiating power over online video providers like

Netflix—or even Sony Corp., which plans to launch an online TV service this year.

Both companies rely on Internet service providers to transmit data for video and games to consumers. After a federal appeals court ruled last month that cable Internet providers are no longer required to treat all forms of traffic equally, the door has been opened for providers to charge streaming companies for priority access and faster speeds.

"Charter plus Time Warner Cable becomes an entity that is essential from a distribution standpoint for a Netflix or a Sony to exist," says Susan Crawford, a telecoms industry scholar and author of "Captive Audience: The Telecom Industry & Monopoly Power in the New Gilded Age." "It's about access to subscribers they won't get anywhere else."

For cable companies, Internet access services will become even more important if more people drop their TV services in favor of Netflix, Hulu and other online video services. Although subscribers can easily drop TV to save money, they still need the Internet pipes for those online video alternatives.

The long-term value of cable operators "will mainly come from their use to provide broadband Internet service, not a video programming service which mainly comprises content that (has) been produced by others and, increasingly, will be available elsewhere on the Web," writes Andrew Sheehy, chief analyst of U.K.-based research firm Generator Research.

A combined Charter-Time Warner Cable would have a favorable service territory. Although Verizon's FiOS service offers better download speeds than cable, it would serve only about 10 percent of the combined cable company's service territory, according to Charter. That means most households would have to turn to the new company for the best Internet service, and the company could charge top dollars.

So far, cable Internet providers have kept fee increases modest. They prefer having the Internet service become the anchor for which to sell bundles with TV and voice services.

According to Time Warner Cable, its customers' use of Internet bandwidth is up 40 percent from a year ago.

It aims to double top speeds in New York to 100 megabits per second in February and has done so in Los Angeles already. This year, it is also targeting five markets to upgrade to as high as 300 megabits per second to satisfy user demand, although it didn't specify which ones. That faster speed would put it in line with Verizon's offering.

Charter is also in the midst of transforming its service so that the slowest speed across its service territory will be 60 megabits per second—double the current minimum—by the end of the year.

Having more customers would increase the benefit of even a small price hike to consumers. It also sets up cable operators to potentially begin charging the giants of the Internet world. According to Janney's Wible, that sets up a long-term fight between "the collective interests of Google, Facebook, AOL, Netflix, Amazon, Twitter and many others against the cable lobby."