The New York Times

December 12, 2010

Time Warner Views Netflix as a Fading Star

By TIM ARANGO

For the past year, executives at big media companies have watched Netflix with growing resentment — for its success in delivering movies and television shows via the Internet, for its stock price nearly quadrupling, for its chief executive being named businessperson of the year by Fortune magazine.

Now many of the companies that make the shows and movies that Netflix delivers to mailboxes, computer screens and televisions — companies whose stocks have not enjoyed the same frothy rise, and whose chief executives have not won the same accolades — are pushing back, arguing that the company is overhyped, and vowing to charge much more to license their content.

“It’s a little bit like, is the Albanian army going to take over the world?” said Jeffrey L. Bewkes, the chief executive of Time Warner, in an interview last week. “I don’t think so.”

Netflix has been a business partner to the movie and television studios through licensing deals, but increasingly it is seen as a partner with its hands far deeper in the pockets of the media companies than anyone thought. Through its success, the company has positioned itself at the center of the media universe — at the nexus of technology and content — and is now finding it a place increasingly under attack.

The relationship between Netflix and the media companies will most likely change drastically, beginning next year when a deal between the company and Starz, the pay-TV channel, to stream movies from Sony and Disney expires.

The original deal from 2008, in which Netflix paid an estimated $25 million annually — a paltry sum, executives say, compared with the hundreds of millions of dollars cable and satellite companies pay Starz for the same movies — is now seen as a major coup for Netflix, and a major mistake by Starz.

Michael Nathanson, a media analyst at Nomura, called it “probably one of the dumbest deals ever. Starz gave up valuable content for tens of millions of dollars.”

Mr. Bewkes said that deal, which gave Netflix significant momentum into the new world of online video, potentially undermined the business model of cable television, based on the subscription fees that have steadily flowed even as other media businesses have suffered in the digital age. “Why should anyone subscribe to Starz when they can basically get the whole thing for about nothing?” he said. “That doesn’t make much sense.”

Mr. Bewkes explained that in the late 1990s the media industry embraced Netflix as a new distribution outlet for renting DVDs — without foreseeing that the company would eventually accelerate the decline in the sales of DVDs, which for years had been the lifeblood of the film industry. Now, with its success online, Netflix has raised fears that consumers may stop paying for cable television — the much-debated phenomenon of cord-cutting.

Mr. Nathanson agreed, saying, “The first engagement the industry had with Netflix was innocent. DVDs were selling, and it didn’t seem like much of a problem.”

Now, however, Netflix is increasingly seen as potentially a very big problem.

“In the past six months, and because of concerns of Wall Street and concerns of cord-cutting, it’s influencing the investor conversations about the future of media,” Mr. Nathanson said. “Now, the industry is very focused on Netflix, and what they can do.”

A media conference last week in New York held by the investment bank UBS became a platform for executives to express their grievances and emphasize that they will now aggressively try to tilt the economic balance between Netflix and content creators back toward the media conglomerates.

“When Netflix first came around, the dog was the discs and the baggie,” said Robert S. Wiesenthal, executive vice president and chief financial officer at the Sony Corporation of America, referring to the envelopes the discs are mailed in, “and the streaming was the tail.” But very quickly, he added, that situation was reversed. “And now the economics for the content companies are going to reflect that.”

Ted Sarandos, the chief content officer for Netflix who negotiates all the deals with Hollywood, attributed the comments to the media industry’s efforts to understand the future of television and movie-watching.

“I don’t think they feel threatened,” he said. “They are not very sure of the outcome of what appears to be a very major shift in consumer behavior.” He described the shift as toward “on-demand, instant gratification video.”

“Netflix is the leader in that space,” he said. “So we become the center of the rhetoric.”

If Netflix is to renew the Starz pact — and thus keep a steady flow of Hollywood movies — it will probably pay many times the current $25 million a year. Richard Greenfield, an analyst at BTIG research, estimated a new deal could cost Netflix more than $250 million a year. Mr. Bewkes suggested a new deal may not be reached, because Netflix’s subscription streaming service, which costs about $8 a month, isn’t high enough for the company to pay top dollar for movies.

“At $8 to $10, it doesn’t have the economics to support high-value programming,” he said.

As evidence of Netflix's growing importance, Mr. Bewkes said decisions about deals that might have been made two years ago by a junior employee in a studio's digital division are now reaching his desk. For example, Mr. Bewkes himself approved a deal to allow Netflix to stream "Nip/Tuck," a drama produced by Warner Brothers' TV studio.

The most contentious clash between Netflix and the media industry will probably center on Netflix's ambition of expanding its television offerings.

Netflix announced last week a new deal to stream ABC shows, like old episodes of "Lost" and "Desperate Housewives." But cable subscriptions in the United States are down this year — a trend some attribute to Netflix — so studios will be reluctant to make any deals, like offering current episodes of shows that would upset cable TV economics.

"Once you put it on Netflix, you really can't sell it anywhere else," said Mr. Bewkes.

The media industry is also vowing to offer its own alternatives to Netflix as a way to watch shows online. Time Warner's HBO is in the process of introducing a new online service, HBO GO, which will be available to authenticated HBO subscribers. Mr. Bewkes has also led an industry initiative he has called TV Everywhere, whose idea is to offer cable network programming online for anyone who is a verified cable subscriber.

Of the many deals the industry has made with Netflix — at lower prices than companies charge other distributors, like cable companies — Mr. Bewkes said, "this has been an era of experimentation, and I think it's coming to a close."