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U.S. Senate Committee on Commerce, Science, and Transportation
“The Emergence of Online Video: Is it the Future?”

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Chairman Rockefeller, Ranking Member Hutchison, Members of the Committee, thank you for the opportunity to testify today on the emergence of online video.

I am Blair Westlake, and I serve as the Corporate Vice President of Media & Entertainment in Microsoft’s Interactive Entertainment Business group. Microsoft engages with video in several different ways, including through our Mediaroom IPTV product which we license to various telephone operators around the world, through MSN, and through our Windows operating system and Windows Phone product, but I am here to discuss video from the perspective of Microsoft’s Xbox and Xbox LIVE service.

As you may know, Xbox is a video game console that Microsoft first introduced in 2001. Xbox quickly developed into a leading gaming platform which, coupled with the Xbox LIVE service, offers users the ability to engage online in multi-player games.

Over the past several years, Xbox, Xbox LIVE, and, more recently, the Xbox Apps Marketplace, which launched in December 2011, have transformed Xbox from a leading gaming platform to a revolutionary entertainment hub, increasingly used by Microsoft’s Xbox users to view movies and television shows. With more than 40 million Xbox LIVE users across the globe, Microsoft is very much part of the video *present*, coupling online gaming with digital content delivery, and we are pleased to share our perspective on what we think the video *future* will look like.

I. The Video Marketplace Today

Before we look to the future, it is important to understand the market today, and how that market has evolved in a relatively short period of time.

In 1992, when this Committee looked closely at the video marketplace, the Committee found that the sole cable company providing service in a community offered consumers about 60 channels, and typically required the consumer to rent a set-top box. Ten years later, that picture had changed, but only a little. Satellite providers had entered the business, but consumers still had few choices for video programming providers and devices to use to access that programming.

The past few years, by contrast, have produced a huge wave of innovation and change, making available to consumers new “over the top” (“OTT”) video offerings. Today, Microsoft’s Xbox LIVE is one of several services that delivers OTT high-definition, high-quality video content to consumers for viewing on televisions or monitors, something that was not possible ten years

ago, and was still considered a future goal five years ago. Consumers access OTT services, such as Xbox LIVE, using broadband connectivity they obtain from an internet service provider (“ISP”), such as their cable or telephone operator, and so the expansion of broadband has made OTT services possible.

In the past two years, these phenomenal changes have migrated to new mobile platforms as smartphones, slates, and tablets and have forever changed when, how and where consumers enjoy video content. From the perspective of 1992, or 2002, or even just five years ago, the increase in the number of consumers watching long-form video content, such as movies and TV shows, online and on mobile devices is staggering, and the increase in the number of video hours viewed online each day is amazing.

Although it is difficult to pinpoint a specific event, I believe that the “tipping point” of the video ecosystem revolution took place in November 2008, when Netflix made its streaming service widely available to televisions via Microsoft’s Xbox. Since that time, innovation and change have moved at least twice as fast as the pace during the prior five years. Xbox, for example, initially was a gaming device that might have been found in the den, a child’s bedroom, or in the basement. As streaming video on Xbox LIVE was rolled out several years ago and as Xbox video apps, described below, were introduced, the Xbox device gradually moved out of areas of the home dedicated to individual family members and into the proverbial “family room.”

Today, Xbox truly has become a household entertainment hub. In December 2011 alone, more than 60 percent of U.S. Xbox LIVE Gold¹ members used Xbox LIVE entertainment video apps, such as Hulu Plus, ESPN3, and HBO GO, for an average of an hour each day.

To underscore how much OTT video viewing is occurring today, consider the following numbers: Netflix recently announced that during the fourth quarter of 2011, its subscribers consumed *2 billion hours* of video.² Xbox LIVE subscribers are fast approaching 300 million hours per month in viewing video apps, and viewing hours are increasing by the day. Indeed, the hours of video consumed by Xbox LIVE members increased 140 percent from 2010 to 2011.

The entry by Microsoft and others into the video aggregation and online delivery market has contributed to consumer choice. The Xbox device gives consumers access to a platform

¹ Xbox LIVE has two services: a free service known as Xbox Live Free and a paid service known as Xbox LIVE Gold. “Gold” – a \$5 per month subscription service – enables subscribers to access social media services, such as Facebook and Twitter, compete in multiplayer games with up to eight gamers in other locations, stream music from services such as iHeart radio, video chat using the Kinect accessory, and watch video content such as Netflix, Hulu and Comcast’s video-on-demand cable service.

² Netflix Members Enjoy More Than Two Billion Hours of Movies and TV Shows in Fourth Quarter, (Jan. 4, 2012), <http://www.prnewswire.com/news-releases/netflix-members-enjoy-more-than-two-billion-hours-of-movies-and-tv-shows-in-fourth-quarter-136652138.html>.

which enables them to view a broad array of video content whenever they want it, including content directly from premium programmers such as Major League Baseball, ESPN, HBO, and MSNBC; from MVPDs such as Verizon FiOS and Comcast; and from other OTT providers such as Netflix and Hulu. The Xbox platform also provides enhanced experiences for consumers, such as our soon-to-be-released interactive *Sesame Street* game. And today, rather than scrolling through 200 channels on your traditional MVPD service, you can use Bing to perform voice-enabled searches for content and then stream selections through your Xbox.

John Skipper, CEO of ESPN, summed it well when he characterized ESPN's distribution through Xbox LIVE as "phenomenal, the usage on that platform has been terrific, the quality of what our networks look like on that platform is terrific, there is a lot of capability and other things you can do around the live games on that platform."³

II. Today's Over-The-Top Video Marketplace Is Dynamic and Vibrant

Some of us before the Committee today are evidence of the vibrancy of the over-the-top video distribution marketplace in 2012. It bears emphasis that a hearing on video competition held only five years ago would have included almost no one on this panel. The OTT providers here have afforded consumers new options and created a new dynamic in the video marketplace.

The revolutionary change brought about by online video providers is reflected in the new level of choice and control in the hands of consumers – choice that goes far beyond DVR time-shifting. Rather than having their viewing experiences tied to a network's schedule of programs, consumers now can be the master of their own TV viewing schedule. Today, consumers can access a vast library of the programming they want, when they want it. Xbox LIVE, Amazon Instant Video, Hulu, Apple's iTunes, and other OTT providers offer consumers movies and TV content at the click of a mouse, the touch of a remote, a wave of their hand, or a voice command. And consumers are not limited to just paying for a month's-worth of programming, but in some instances may select and pay to watch a single program they wish to view.

These choices complement traditional cable, satellite and telco services, and enhance consumer control. For example, with Verizon's FiOS apps, FiOS subscribers who also subscribe to Xbox LIVE, may access an array of TV programming through Microsoft's Xbox platform. Most of the familiar channel-branded apps, such as HBO GO and ESPN, use "TV Everywhere" authentication to verify that the user has a subscription with an MVPD.

Xbox LIVE and the other companies represented here are part of a video ecosystem that gives consumers access to third-party options that were not readily available until just two

³ Interview of John Skipper, CEO of ESPN (January 31, 2012) *available at* http://allthingsd.com/video/?video_id=E672BBB4-F22F-4258-9FF5-0CEE39461E36 (taking place at the All Thing Digital's "Dive Into Media" conference).

or three years ago. Using these new tools, consumers can design the mix of programming options that is right for their household's tastes, time and wallets, augmenting the content and experience available from their monthly MVPD subscription with those enhancements offered by Xbox or other OTT services. For example, consumers may elect to drop premium movie channels and supplement their basic service with OTT services such as Netflix. Industry observers refer to this as "cord shaving."

While consumers are likely to continue to consume video primarily from traditional cable, satellite, and teleco services,⁴ the choices in the market today give all consumers more control over their viewing habits, so they are less tied to linear programming that has been the norm in the television business for several decades.

Consumer demand for high-quality video over multiple devices and platforms is today's reality and defines expectations and a marketplace that are here to stay. To meet and satisfy consumer demand, content owners and key stakeholders must look to exciting new and evolving technologies and rethink traditional business models and distribution strategies.

Today, we are witnessing many companies experimenting with and evaluating different business models, including new approaches to transactional video-on-demand, subscription-based distribution, and electronic sell-thru models. Xbox, for example, currently provides access to content directly from more than a dozen programming services in the U.S., including video apps from Major League Baseball, MSNBC, HBO and ESPN, and the number of video apps we offer is expanding by the month. All these new options enhance choice, and are compelling options for consumers. The challenge remains for content owners and distributors to develop new ways to monetize their products and services.

While many see the old models as under pressure in the long term, the new alternative business models have not yet come into view. The future of video is as much -- or even more -- dependent upon companies devising sustainable and innovative business models that reflect the possibilities of this exciting time than technology deployment.

At Microsoft, our vision for Xbox LIVE is to deliver all the entertainment consumers want, while making the enjoyment of that content easy. The expansion of Xbox LIVE to Windows Phones and our soon to be released Windows 8 operating system, all with a consistent "Metro style" user interface and the ability for consumers to enjoy, control and consume content across their various Microsoft software-enabled devices, are examples of the progress being made in bringing new choices for accessing content to consumers.

⁴ NPD Group, January 2012 (noting that 59 percent of cable/satellite TV subscribers prefer having one single provider for their pay video services, and that many consumers continue to prefer convenience over cherry-picking a variety of lower priced subscription video-on-demand services).

This hearing gives the Committee an opportunity to consider the future of video. We have set out our picture of the current online video marketplace. The single most important issue shaping the future of video is the availability of universal, high-speed broadband access. We think the Committee is right to keep an eye on this market as it unfolds and as Internet service providers and content providers adapt to the new market.

While we are not at an “end of history” moment when it comes to the video marketplace, the changes that have taken place, and are underway, in the video ecosystem are truly remarkable and transformative. As we move forward, however, the availability of universal, high-speed broadband will continue to be critical to the health and vibrancy of a market that supports and enables innovation and competition.

III. The Future Video Marketplace: New Forms of Content, Interactivity, Access, and Consumer Choices

Consumers have benefited from significant changes in the past five years. In the next five, change will be even greater. The early 2000s saw predictions for how the Internet, growth of broadband, and IT infrastructure investments (including those further enabling access to the web) were going to change the video marketplace. As we now know, that change did not occur in the first half of the decade, but rather in the second half, and the change has been exponential.

The weekend after this year’s Consumer Electronics Show, I shared some observations with my colleagues. I commented then, and I believe even more today, that we will experience more change in the next 18 months in the TV landscape than we did in the past five years.⁵ And I think we are only in the early innings of the beneficial changes that consumers have yet to see and experience.

While I do not pretend to predict the future, I think the way people access and consume video will continue to evolve in these key categories:

Search and discovery: As we have seen with the integration of Microsoft’s search engine, Bing, enabled by Xbox’s Kinect accessory, which provides a voice and gesture recognition offering, there is an increased focus on making consumers’ experience more intuitive. In only 18 months, Microsoft’s Kinect device has transformed experiencing games and entertainment to a level that was “science fiction” a few years ago, thanks to its natural user interface which recognizes gestures, voice and motions.

⁵ As Bill Gates observed, “We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten.” Bill Gates, *The Road Ahead* (1997).

We are making it easy for consumers to find and enjoy their favorite TV shows, movies and music across a variety of services. Search and discovery will allow the technology to fall into the background and enable the content to be the focal point of the experience. And Kinect for Windows development tools are now in the hands of thousands of creative designers who are building applications that go far beyond anything we could have imagined.⁶

TV will be a two-way interactive experience: Since the first devices were connected to the Internet, people have held out the promise of interactive television. With Xbox and Kinect, we are beginning to see TV experiences that are truly two-way experiences and go way beyond ordering pizza from your TV. To give one example, in the coming months, we will offer programming like our *Sesame Street Kinect* -- we describe it as “playful learning” -- which will be completely interactive for children and will leverage the power of gesture and voice control. Recent innovation in Natural User Interface technology (“NUI”), will enable children to interact directly with Elmo and Cookie Monster, to advance the story line of an episode, to see themselves in the program (thanks to Kinect’s camera), and to learn the alphabet and many other educational offerings -- all interactively versus through traditional, linear, one-way viewing.

This may look like magic to children, but in fact it is hard work and takes considerable time and resources. Microsoft has commissioned the shooting of 50 percent more footage of the linear version of *Sesame Street* so that children will be able to interact fully with the program. The difference between children watching the linear versus interactive versions of the program is simply amazing to see firsthand.

Television will increasingly be a multi-device experience: In a next wave of evolution, we expect that consumers will be able to watch the content they pay for on any and all of their devices. It is envisioned that the second screen will receive increased attention from content owners, which will actively develop new shows with the smartphone and mobile devices in mind.

Many in the creative community have recognized what the future holds. Production houses are already developing concepts for new shows that allow viewers to unlock extra content by following along on their second screens. Creating relevant, engaging second screen experiences will encourage fans to interact more deeply with their favorite TV shows.

⁶ For example, surgeons are using Kinect to practice surgical moves before putting gloves on and researchers are exploring how Kinect can be used to help children with autism, stroke, and physical therapy patients. For more “Kinect Effect” examples, see <http://www.xbox.com/en-US/Kinect/Kinect-Effect>. Microsoft is working with more than 200 innovation leaders around the world including United Health Group, Siemens, American Express, Boeing, Mattel, Houghton Mifflin Harcourt, Citi, Toyota and Unilever to utilize Kinect in revolutionary ways.

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In conclusion, Microsoft is pleased to be part of a vibrant and competitive video marketplace today that is rapidly evolving to a future that will give consumers more choice and more control to use the vast online resources for their education and entertainment.