

NETFLIX V. SK BROADBAND

SQUIDGAME'S INFLUENCE & NET NEUTRALITY

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WHO BEARS THE FINANCIAL BURDEN OF INCREASED TRAFFIC FOR VIRAL CONTENT?

South Korean originals' success abroad open negotiations over network usage fees, obligations of broadband providers given net neutrality, and exporting of cultural influence between OTT service Netflix and network provider SK Broadband.

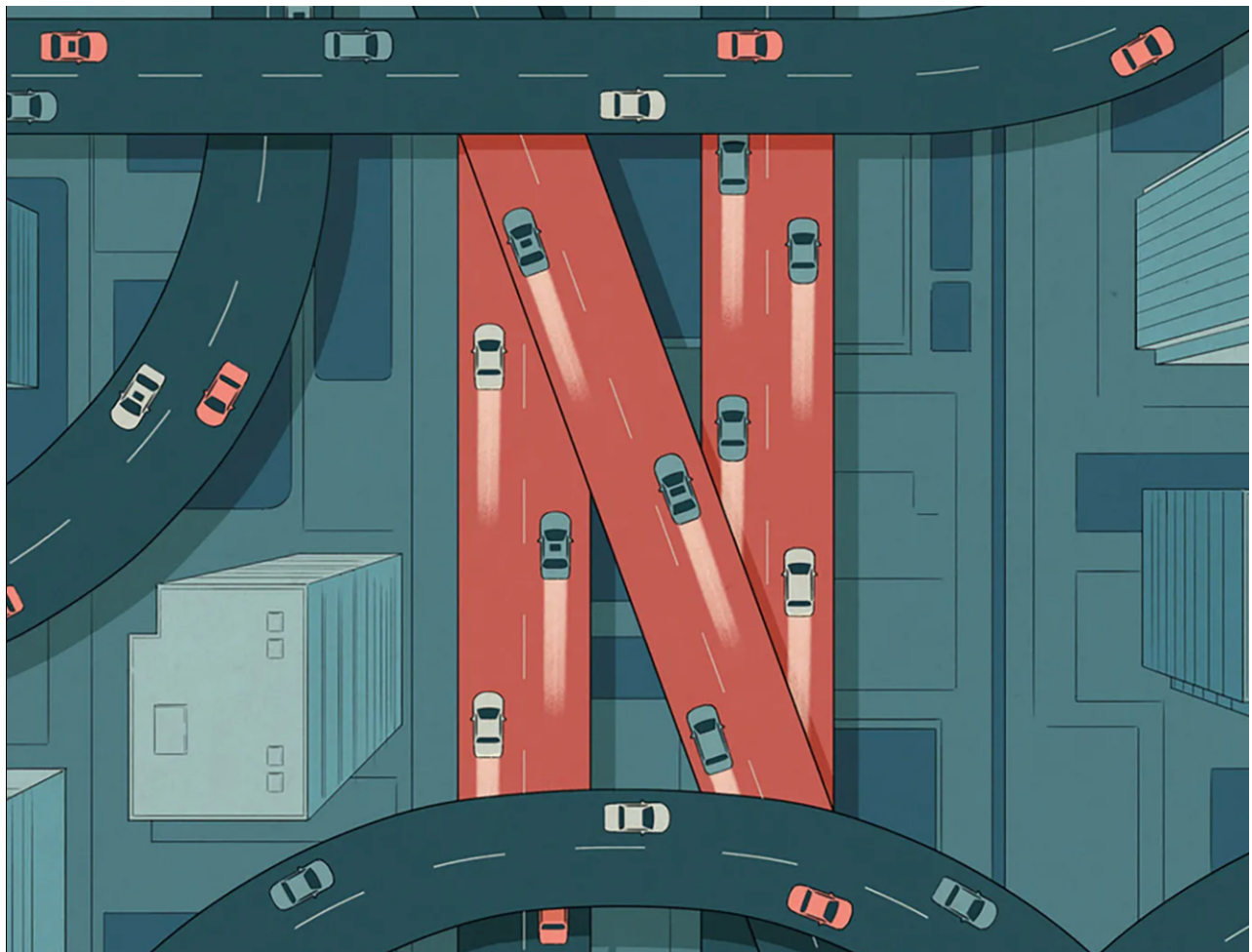


Image 1 : Shrestha, Anuj. (2021). *Netflix*. [Digital]. The Verge.

BREAKDOWN BY: CAITLYN DOUR

NEGOTIATION FEATURES:

PARTIES:

1. **Netflix** is a US based subscription streaming service, a **global content provider (CP)**.
2. **SK Broadband** is the 2nd largest **internet service provider (ISP)** in South Korea.

CONTEXT:

- **Netflix previously lost a lawsuit filed by SK Broadband**, in June 2021, and was instructed to pay network usage fees; this is given 1) SK Broadband's services are provided at cost, 2) only 5 million out of 23 million SK customers subscribe to Netflix (Layton, 2022), and 3) the Telecommunications Business Act was amended in 2020 to place the onus of network stability on CPs (Park et al, 2022).
 - *Netflix appealed*, leveraging Net Neutrality. From the CPs perspective, the ISP needs to provide internet to their users, regardless of what they happen to watch.
- **Debating Net Neutrality:**
 - CPs like Netflix claim they add value by increasing consumer demand for high-speed internet. The streaming giant measures "prime time Netflix performance" around the world, via a proprietary ISP Speed Index (*Netflix ISP Speed Index*). South Korea's speed is top tier at 3.6 bits per second (*Netflix ISP Speed Index*).
 - SK's traffic jumped 24 times, tracking upwards of 1.2 trillion bps. For "Squid Game," 117.48 million households streamed more than 1 episode, and 87 million finished the series within its first 23 days (Spangler, 2021). Surges of this volume impact a service provider's expected operating and maintenance costs. Preliminary research estimated that ISPs lose forty-eight cents of every dollar CPs make from streaming. These are defined as unrecoverable costs. (Layton et al, 2021). SK stipulates \$23 million would cover 2020s costs associated with Netflix (Yoon, 2022), since charging consumers would harm net income more.
- **CDNs and Bearing Bandwidth Burden:** Netflix provides Content Delivery Network devices that contain the entire Netflix catalogue, updated daily based on expected demand per property, to reduce the demand on bandwidth (Lobato, 2019). Netflix's Open Connect Devices provide users direct access to the catalogue, helping to avoid the data-heavy burden on ISPs by at least 95% (*Netflix Open Connect*). Netflix has 17,000 such devices in 158 countries (Keck, 2021). *SK Broadband has refused to use these devices.*
 - **Open Connect Devices are provided to ISP partners free.** Netflix has invested close to \$1 billion in the devices to date; these devices provide value to ISPs, reducing the costs and strain on Networks' "fetching copies of content themselves" (Keck, 2021).
- **Netflix's Relationship with South Korea:** South Korea's creative industry has blossomed with access to Netflix's production companies' large budgets: "the average production cost allotted to studios is [about] \$25,000 to \$250,000 per episode" and is quite dependent on product placement for that investment money (Yoon, 2021). Comparatively, Netflix budgeted \$21.4 million to produce nine episodes of Squid Game (Spangler, 2021). Deloitte estimates Netflix's economic impact on South Korea to be around \$4.7 billion, with 16,000 jobs created; Netflix earned \$356 million in revenue in 2021, up 123.5 percent from 2019 (Stangarone, 2021).

ISSUES:

- Tiered Access: Installing Netflix's proprietary Open Connect Devices
- Net Neutrality Adherence
- Responsibility for Network Usage Fees: Past and Future

NATURE OF RELATIONSHIP:

- Netflix began delivering content in 2018 via SK Broadband's lines (Lee, 2021).
- SK Broadband provides internet connection; Netflix delivers its core services through internet-based streaming. WiseApp estimates the streaming giant's subscription base in South Korea grew from 3.16 to 5.14 million in the last year (Lee, 2021).
- Netflix is SK's second largest data traffic generator, following Alphabet's YouTube (Ray, 2021). Netflix helped popularize K-content in western countries, increasing traffic through the ISP's networks with viral shows like "Squid Game." Traffic from Netflix increased from 50 GBPS in 2018 to 1,200 GBPS by September 2021 (Ray, 2021).

PRINCIPAL AGENT RELATIONSHIP:

Principal agents in this negotiation are President Moon Jae, SK Broadband & Netflix's VP of public policy, Dean Garfield. They are engaged in a long-term, recurring negotiation.

PRECEDENTS:

- Global CPs such as Amazon Prime, AppleTV+, Facebook, and local CPs such as Naver and Kakao are already paying fees for increased network usage (Lee, 2021).
- AT&T spotlighted traffic increases resulting from increased use of current subscribers—and of a Netflix user base that increased 33% in one year (AT&T Blog Team, 2014).

COSTS TO DELAY:

- SK's costs to delay are financial and operational. Netflix consumes 47% of SK's bandwidth (Yoon, 2021). Delaying a negotiation could prove disastrous for SK's revenues if Netflix were to consolidate their utility needs to a competitor.
- Netflix's costs to delay are large; the company could be liable for years' or decades' worth of back fees from their global network of ISPs if they continue in courts.
- Netflix could damage an important relationship; Unfavorable given major investments in local-language IP.

OTHER FEATURES:

- The parties are *monolithic*.
- It is *uncertain* if the entities will reach an agreement outside of court
- This negotiation has *public visibility* via court hearings and geo-political implications, but the *contractual discussions are not public*.
- *An on-the-spot commitment is not currently possible*. More discussions are needed within each organization. Moon and Garfield would each need to have the negotiated terms approved internally and legally before drafting a final contract to sign.
- At the time of writing, there are *no threats or offers from third parties* to interrupt or influence this negotiation.

LINKAGES:

- **Issues over industry access:** requiring network use fees can set a precedent that creates a barrier of entry for smaller CPs. Paying for faster services also creates a tiered access system, which goes against a key understanding that the internet is free to use.
 - Questions over “the ethics of bandwidth intensity,” and the significances for CP subscribers and non CP subscribers.
 - “What are the ethics of bandwidth intensity, and what do they mean for consumers and non-consumers of video services? How do we allocate the real costs of internet infrastructure?” (Lobato, 2019).
- **International ISP and CP operational relationships:** Disney delayed launching Disney+ in South Korea until after the June ruling, opting to pay fees (Kim, 2021).
- **Marketing and Content Creation:** Depending on how network usage fees are calculated (per spike, annually, across all CPs on network, etc.) there could be changes to production schedules, delays to releases of localized versions of shows and movies, and the nature in which shows are marketed to audiences. Rather than hoping for a huge influx of interest, CPs might aim for a steadier stream of interest in a show—which may even affect the choice to release a show weekly, monthly, or all at once—just to avoid network overages and assure network stability.

NEGOTIATION PARAMETERS:

INTERESTS:

SK has interest in protecting its consumers, maintaining reliable and secure internet connection, and collecting on prior network overages of at least \$23 million. Netflix’s chief concerns are to deliver a top tier viewing experience, regardless of ISP speed, and to keep Netflix as accessible as possible to every audience member who wants it. A secondary interest is in maintaining strong partnerships with South Korea as it benefits from lucrative investments in local language content.

ASSESSMENT OF NETFLIX

BATNA:

Judging Netflix’s BATNA requires foresight for the financial impact that paying not just SK’s overage fees, but fees from every other ISP in the 158+ countries Netflix offers services. *Paying these fees could open a “Pandora’s box” of past grievances.* Netflix last paid an ISP network feeds in 2014, prior to deploying their proprietary CDN (Seward, 2014). Our only estimate for the unrecovered costs at this moment are \$0.48 per dollar earned by Netflix (Layton, 2019); this could be significant to revenue in the long run. In this case, Netflix may end up walking away from SK Broadband. To bear down on free use of the internet and continue without paying mandated network usage fees, which other CPs like Disney+ are already paying—faces further legal action. **Netflix’s best alternative to the negotiated agreement is paying the previous unrecoverable costs as a one-time net sum and then consolidating future business to competitor ISPs, like KT Corporation and LG U+, with the implementation of Open Connect.**

RESERVATION VALUE:

Netflix may be mandated to pay SK's previous year's unrecoverable costs, an imputed cost of -1,500. If the parties wish to continue business for the mutually beneficial economic relationship between Netflix and South Korea, Netflix can foot a sum on goodwill to develop the ISP's network speeds and capacity (netting 800). Alternatively, Netflix can offer a one-time cash incentive and personnel dedicated towards paperwork and due diligence to install Open Connect.

ASPIRATION VALUE:

- Netflix wins appeal and upholds Net Neutrality
- SK Broadband agrees to use Open Connect to reduce the impact of viral surges to their network and accepts the technology as satisfying the TBC Amendment requiring CPs to assure network stability

STRATEGY:

Prior to Netflix's appeal decision, Garfield can coordinate a "Network Expert Summit" between his Open Connect teams and Moon's technical teams, with a goal of finding a way to leverage current tech to support SK's existing infrastructure. Open Connect has been shown to reduce bandwidth usage up to 90% (Keck, 2021). Garfield should then call chief officers together, to better understand *why SK had originally refused Open Connect*, given the devices pose no security risk. This process is an opportunity for Netflix to demonstrate tactical empathy, listen to, and partner with SK. If successful, he will create value in lowering SK's operating costs while claiming value in avoiding higher costs. If Garfield can better understand Moon's concerns, he can reconcile interests without setting horrible precedents. Both risk higher operation costs threatening their business models, pricing strategies, and quality of service.

While Netflix can walk away from SK Broadband and use competitor networks, SK Broadband cannot walk away from Netflix. 5 million out of their 23 million constituents are subscribers to Netflix. If Netflix pays the network overage fees to date, they can anchor to at maximum pay the fees from the time that the Amendment to the TBC Act was passed. Writing this qualifier into the agreement can protect Netflix from opening the "Pandora's box" of hidden fees and sets a precedent of legal necessity *a priori* network usage fees.

SK Broadband can be written to increase their capacity if they also require network overage fees; Netflix can offer to foot a sum out of goodwill to get this agreement off the ground. A net sum here would still be less costly than setting a long-term precedent. Netflix can walk away from SK, not South Korea. The streaming giant is \$1.2 billion into a longer strategy of promoting South Korean "soft-power," (Frater, 2021) it would be unwise for Dean to walk away from the table without a valued settlement.

If, at this point in the negotiation, Garfield is unable to get a budge from Moon, he should use a take it or leave it strategy; SK losing Netflix's business will bring him persuading power. Additionally, it will help him avoid a dangerous contingency contract (Malhotra, 151). His BATNA is to consolidate his business to other firms if SK doesn't work with him. This strategy takes inspiration from another dominant force with massive market share: Amazon and how it handles vendors. While I may not find this strategy ethical, Netflix cannot under any circumstances, open the Pandora's box of back-costs from 158+ ISPs right as Disney+ has entered the market, and other streamers are quickly increasing the quality and size of their content.

SCORE CARD (WEIGHT; NORMALIZED WEIGHT)

Open Connect (1; 0.25)

SK Installs Open Connect	20,000	5,000
Netflix pays for Open Connect Install	3,500	875
SK Does not Install Open Connect	(1,000)	(250)

Costs to Date (0.6, 0.15)

Netflix wins appeal, does not pay network fees	15,000	2,250
Netflix loses appeal, pays network fees, continuous	(10,000)	(1,500)
Netflix pays fees as a one-time sum	(5,000)	(750)

Future Costs (2, 0.5)

Netflix bears no responsibilities for future costs, on net neutrality Principle	1,000	500
Netflix settles a net sum for future network fees	(1,000)	(500)
Netflix enters an annual, delayed costs contract for network fees by year	(10,000)	(5,000)
Netflix enters a dynamic contract to pay network fees by increase/spike	(14,000)	(7,000)
Netflix continues services without paying, faces legal action	(20,000)	(10,000)

SK ISP Development (0.4; 0.1)

SK Develops its networks at cost to consumers, on net neutrality principle	16,000	1,600
Netflix foots a sum on good will for SK ISP continued development	8,000	800
SK leaves infrastructure as is	0	0

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