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September 30, 2014

VIA ECFS

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W., Room TW-B204
Washington, DC 20554

Re: *Applications of Comcast Corp., Time Warner Inc., Charter Communications, Inc. and SpinCo*
MB Docket No. 14-57

Madam Secretary:

In accordance with Section 1.1206 of the Commission's rules, 47 C.F.R. § 1.1206, we hereby provide you with notice of an oral ex parte presentation in connection with the above-captioned proceeding. On September 26, 2014, Ross Lieberman of the American Cable Association ("ACA"), Dr. Gary Biglaiser of the University of North Carolina (economist to ACA), Barbara Esbin of Cinnamon Mueller (counsel to ACA), Brooks Harlow of Lukas, Nace, Gutierrez & Sachs, LLP (counsel to ACA), Jeff Nourse of the National Cable Television Cooperative and undersigned counsel met with Octavian Carare, Tim Brennan, Jake Riehm, Julie Saulnier, Lisa Gelb, Betsy McIntyre, Hillary DeNigro, Hillary Burchuk, Susan Singer, William Rogerson, Johanna Thomas, Bill Dever, William Lake, Adam Copeland, Eric Ralph, Brenda D. Villanueva, Jeff Neumann, Jim Bird, Virginia Metallo, Ty Bream, Alex Marinello, and Phil Verveer. Ben Childers, Sarah Whitesell, and Alison Neplokh, participated via telephone.

In our meeting, we discussed the vertical and horizontal harms that will result from the proposed transactions involving Comcast Corp., Time Warner Cable, Inc., Charter Communications, Inc. and SpinCo identified in ACA's Comments, filed in the above-referenced proceeding on August 25, 2014.[1] In addition we discussed the reasons, cited in ACA's Comments, why the arbitration remedy the Commission has used to ameliorate competitive

[1] In the Matter of Applications of Comcast Corp., Time Warner Cable, Inc., Charter Communications, Inc. and SpinCo For Consent to Transfer Control of Licenses and Authorizations, MB Docket No. 14-57, Comments of the American Cable Association at 11-31 (filed Aug. 25, 2014) ("ACA Comments").

harms of other transactions is inadequate to protect smaller multichannel video programming distributors from the harms of this transaction.[2] Our discussion followed a written presentation, a copy of which is enclosed for the record. In addition, we provided Ms. Burchuk with a revised copy of ACA's Comments, removing redactions of material that is not confidential or highly confidential, a copy of which is enclosed as well.

If you have any questions or require any additional information, please contact undersigned counsel directly.

Sincerely,

David A. LaFuria
Counsel for American Cable Association

Enclosures

cc (email):
Octavian Carare
Tim Brennan
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Julie Saulnier
Lisa Gelb
Betsy McIntyre
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Ty Bream
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Phil Verveer
Ben Childers (via telephone)
Sarah Whitesell (via telephone)
Allison Neplokh (via telephone)

[2] ACA Comments at 31-39.

CONNECTING HOMETOWN AMERICA

The Vertical and Horizontal Harms of the Proposed Comcast-TWC-Charter Transactions

(… and the lack of adequate safeguards to protect consumers and competition)

September 26, 2014

American Cable Association

I. Description of the Merging Parties

Comcast

- As an MVPD, it's the
    - largest MVPD serving approximately 22.6 million MVPD subscribers; and
    - holds a 50% interest in Midcontinent Communications, serving approximately 212,000 residential subscribers. Provides programming negotiation services to Midcontinent.
- As a programmer, it
    - owns 10 NBC-owned and operated (O&O) local broadcast television stations, all located in major metropolitan markets;
    - wholly owns or has an attributable interest in regional sports networks ("RSNs") carrying live professional sporting events in ten major metropolitan markets; and
    - wholly owns or has an attributable interest in a large number of the most popular national cable programming networks, including top-rated USA Network, along with other powerful brands like CNBC, Golf Channel, Syfy, Bravo, E! Entertainment, and MSNBC.

Time Warner Cable

- As an MVPD, it's the
    - second largest cable operator serving approximately 11.4 million MVPD subscribers.; and
    - provides programming negotiation services to Bright House Networks, which serves approximately 2.1 million MVPD subscribers.
- As a programmer, it
    - wholly owns or has an attributable interest in four regional sports networks carrying live professional sporting events in two markets. In Los Angeles, these networks include Time Warner SportNet, Time Warner Cable Deportes, and SportsNetLA. In New York, it's SportsNet New York.

Charter Communications

- As an MVPD, it's the
    - fourth largest cable operator serving approximately 4.2 million video customers.
- As a programmer,
    - because media mogul John Malone holds a substantial interest in Charter through his stake in Liberty Media, and in cable programmers Discovery Communications and Starz, all are effective operated under his control under the FCC's attribution rules.

II. Overview of the Harms

- From an economic perspective, the transaction has both vertical and horizontal components and a complete analysis of the potential competitive harms must consider both aspects.

- ACA is most concerned with three components of the transaction.

- **<u>Harm #1</u>**:

  The vertical harm arising from the integration of Comcast's programming assets with the distribution assets Comcast acquires from TWC and Charter.

  - The transaction will increase the merged entity's incentive and ability to charge its MVPD rivals higher fees for its programming, and these higher costs will be passed on to subscribers in the form of higher subscription TV prices.

- **<u>Harm #2</u>**:

  The downstream horizontal harm arising from the combination of Comcast's distribution assets with the distribution assets Comcast acquires from TWC and Charter.

  - The transaction will lower the merged entities' programming costs in two ways resulting in competitive harm to other MVPDs in the market.

    - First, to the extent permissible, the merged entity will bring the TWC systems under the Comcast programming agreements where the per subscriber fees are lower.

    - Second, the transactions will increase the merged entity's bargaining power with respect to the video programming industry, allowing combined company to demand and receive lower prices from programmers.

  - By Comcast receiving lower prices and larger volume discounts than its rivals, the competitive position of its rivals will be weakened.

    - First, by obtaining lower prices through better bargaining and by achieving other merger-created efficiencies, Comcast will increase its video profits per subscriber and this will increase Comcast's incentive to sell its programming at higher prices to its rivals.

    - Second, these rivals' competitive positions will be weakened by Comcast obtaining larger volume discounts than its rivals are able to obtain.

    - Third, programmers subject to enhanced bargaining power of Comcast/TWC will seek to make up for lost revenues by charging higher prices to other MVPDs, according to the belief of smaller cable operators.

- **Harm #3**:

  The upstream horizontal harm arising from the combination of Comcast's programming assets with TWC's programming assets.

  - By controlling an expanded block of must have programming in key media markets, the merged entity will be able to charge higher programming fees to MVPDs.

  - These higher fees will be passed on to subscribers in the form of higher prices.

III. Harm #1- Vertical Harm

- In its Comcast-NBCU merger review, the FCC found that the vertical integration of Comcast as an MVPD with NBCU programming would create significant competitive harm. The FCC concluded:

    - When NBCU sells programming to MVPDs that compete with Comcast, this reduces Comcast's profit.

    - The merged entity will take this effect into account.

    - The merged entity will view Comcast's lost profits as an opportunity cost of providing programming to MVPDs that compete with Comcast.

    - This will result in the merged entity charging higher fees for its programming to MVPDs that compete with Comcast.

    - These fee increases incurred by Comcast's rivals will be substantially passed through to their subscribers in the form of higher subscription prices.

- To calculate the increase in programming fees, the FCC relied upon a bargaining model framework.

IV. FCC's Bargaining Framework to Analyze Vertical Harm

- The FCC's bargaining model framework computed the opportunity cost that a vertically integrated MVPD incurs by selling affiliated programming to a rival MVPD.

- The opportunity cost, C, for an MVPD to sell its programming assets to a rival MVPD is equal to:

$$C = \alpha d \pi$$

- The variables in the equation are defined as follows:

    - α is the share of subscribers that leave the rival MVPD that go to the affiliated MVPD

    - d is the diversion rate; the probability that a given consumer leaves the rival provider if the programming is withdrawn

    - π is the affiliated MVPD's monthly profits per subscriber

- Following the Nash Bargaining Model, a rival MVPD purchasing the programming of the vertically integrated MVPD will see its programming fees increase by ½ of opportunity cost.

- To calculate α in the market of the affiliated programming being sold to a non-DBS rival, the FCC assumed that switching from a rival MVPD to each MVPD that serves the market would be in proportion to that firm's share of the non-foreclosed MVPD subscribers within the market, namely

$$\alpha = \frac{\theta s_C}{1 - s_r}$$

- The variables in the equation are defined as follows

    - s_c is Comcast's market share;

    - s_r is the market share of the rival MVPD;

    - θ is the proportion of a rival MVPD's footprint in Comcast's footprint

V. Calculating the Incremental Vertical Harm

- Consider the following model for determining the *incremental* increase in programming prices, H, that an individual MVPD (or bargaining agent) would face when purchasing Comcast programming as a result of the Comcast/TWC/Charter transaction:

$$H = N(\alpha_M - \alpha_N)\, d\pi/2$$

- The new variables in the equation are defined as follows:
    - N, is the rival MVPD's total number of subscribers.
    - α is replaced by the difference between α pre-merger, α_N, and post-merger, α_M.
    - The 2 represents half of the increased opportunity cost that will be passed on as a higher cost to the MVPD; Nash Bargaining Solution.

- Notes in for determining the harm before and after the merger:
    - It's reasonable to assume the diversion rate of the programming Comcast owns and acquires is the same as before the merger.
    - It's reasonable to assume that the profits per subscriber of the systems being acquired are relatively similar as those of Comcast, and if there are differences that these differences would be quickly eliminated once Comcast takes control.
    - It's also reasonable to assume that large incumbent cable firm's market share whether they are Comcast, Time Warner Cable or Charter are roughly the same in the markets they serve, suggesting that the quality of their systems in relation to rival MVPDs are similar. If there are differences, one would expect these differences to be closed once Comcast takes control of the systems.

- **Accordingly, the incremental harm boils down to how many more subscribers are now potential customers for Comcast compared with the pre-merger situation. This is represented by Comcast's α going from a pre-merger situation of α_N to a post-merger α_M.**

VI. Evidence of Incremental Vertical Harm

- Two groups of MVPDs are potentially affected by the incremental vertical harm.
    - Large MVPDs that currently have substantial overlap with Comcast and generally negotiate programming deals on their own:
        - Two DBS Providers (DirecTV and Dish)
        - Two Largest Telcos (AT&T and Verizon)
    - More than 900 small and medium-sized MVPDs that generally buy a substantial share of their programming through the National Cable Television Cooperative (NCTC)
        - Some of these MVPDs compete with the merging parties.
        - Some of these MVPDs do not compete with the merging parties.
        - Given that Comcast negotiates a single master agreement with NCTC and it generally expects all but NCTC's largest members to opt into the agreement, to the extent that Comcast has an incentive to charge higher prices to one or more of its members, Comcast will charge these higher prices to NCTC. This means that operators who do not compete directly with Comcast, but opt-in to NCTC's master agreements, will likely be harmed.

- The MVPDs who are not impacted by the incremental vertical harm are the large MVPDs that generally negotiate programming deals on their own, but do not currently have significant competitive overlap with the parties to the merger:
    - <u>With respect to Comcast programming</u>, these operators include Charter (including SpinCo), Cox, Cablevision, BHN, and Midcontinent.
    - <u>With respect to Charter programming</u>, these operators will include: Comcast, Cox, Cablevision, and BHN, and Midcontinent.

- There are three main classes of programming assets that Comcast owns or either will own or be deemed attributed with after the merger that need to be assessed:
    - The suite of national cable programming networks owned by Comcast
    - NBC Network O&Os in ten designated market areas (DMAs); and
    - RSNs that Comcast currently owns and the RSNs that TWC currently owns.

- Using publicly available data and information and information provided by the parties to the merger, ACA calculated the change in rival MVPDs competitive overlap with Comcast resulting from the deal for the first two classes of programming:[1]

[1] With regard to Comcast's ten RSNs, the precise footprint of the RSNs is not publicly available, making an analysis of the impact difficult to quantify or reach qualitative conclusions.

Analysis of Change in Competitive Overlap with Comcast$(\alpha_M - \alpha_N)$ Resulting from Deal with Respect to Comcast's National Cable Programming Assets[2]

MVPDs Other than Comcast, BHN, and Midcont.	Subs	Pre-Merger Competitive Overlap with Comcast	Post-Merger Competitive Overlap with Comcast	Difference	Competitive Overlap with BHN	Total Difference
DIRECTV	20.2M	35%	50%	15%	3%	18%
DISH Network	14.1M	35%	50%	15%	3%	18%
NCTC	9.0M	20%	22%	2%	4%	6%
Verizon	5.4M	41%	67%	26%	7%	33%
AT&T	5.9M	N/A[3]	N/A	N/A	N/A	N/A
Other MVPDs	14.0M	0	0	0	0	0

[2] The same conclusions about Comcast's opportunity cost increasing as a result of this deal may be reached with regard to Charter's opportunity cost with respect to its attributable programming, like Discovery and Starz. The deal increases Charter's homes passed from 12.2 million to 13.7, and when SpinCo is included, which passes 5.6 million homes, Charter's total homes passed totals 19.3 million. With regard to the DBS providers this is an increase of 1.1% for Charter, and 5.2% when the change for Charter is added to the change for SpinCo. With regard to members who regularly participate in NCTC deals, the Charter swaps with Comcast results in these MVPDs' competitive overlap with Charter increasing by 4.36%. Including SpinCo, the combined overlap is an increase of 9.16%. ACA's data for Verizon's competitive overlap with Charter shows it decreasing by 3.5%, and ACA does not have reliable data for AT&T. Given these results, consumers overall will likely be harmed by the Comcast-TWC Charter deal as a result of the increased homes passed of Charter and SpinCo and its competitive impact on MVPDs who serve a majority of customers whose MVPDs are affected by the vertical harm.

[3] Due to a lack of publicly available data and information about the video footprint of AT&T, ACA is unable to determine the company's pre-merger and post-merger footprint with Comcast and its affiliates.

Analysis of Change in Competitive Overlap with Comcast$(\alpha_M - \alpha_N)$ Resulting from Deal with Respect to Comcast's NBC Owned and Operated Broadcast Stations

MVPDs Other than Comcast, BHN, and Midcont.	Subs	Pre-Merger Competitive Overlap with Comcast	Post-Merger Competitive Overlap with Comcast	Difference
DIRECTV	4.9M	43%	75%	32%
DISH Network	2.6M	43%	75%	32%
NCTC	0.6M	37%	56%	19%[4]
Verizon	3.6M	34%	67%	34%
AT&T	2.1M	N/A	N/A	N/A
Other MVPDs	N/A	0	0	0

- Although the incremental harm is mostly driven by the increase in number of rival MVPD's subscribers that will be able to switch to Comcast after the merger, there are other factors that will also increase the vertical harm.
  - Comcast's video profits per subscriber are likely to increase due to the efficiencies created by the deal and Comcast's ability to secure lower programming prices due to its increased bargaining leverage made possible by its substantial increase in subscribership (as discussed later in the presentation). By increasing the profitability of its video service, Comcast's opportunity cost of selling its programming to its rivals will increase. This will result in Comcast charging its rivals even higher prices.
  - As discussed later in the presentation, the deal will allow Comcast to jointly negotiate TWC's RSNs in Los Angeles and New York with its NBC O&Os stations in these markets and its suite of national cable networks. By bundling these "must have" programming assets together, the diversion rate for each class of negotiated programming will be greater than the diversion rate when negotiated separately, increasingly Comcast's opportunity cost of selling its programming to its rivals. This will result in Comcast charging its rivals even higher prices.

[4] ACA under reported the difference in its initial comments as 13%. This reports the correct number.

VII. Harm #2- Horizontal Harm Due to the Combination of MVPD Assets

- The transaction will lower the merged entities' programming costs in two ways resulting in horizontal competitive harm to other MVPDs in the market.

  - First, to the extent permissible, Comcast will bring the TWC and Charter systems it acquires under its existing programming agreements where the per subscriber fees paid by Comcast are lower.

  - Second, the transactions will dramatically increase the merged entity's bargaining power, with respect to and control over the video programming industry, allowing Comcast to demand and receive lower prices from programmers.

    - By increasing the number of MVPD subscribers that the merged entity will be negotiating for from 21 million to more than 31.4 million (to the extent Comcast negotiates on behalf of Bright House Networks and Midcontinent), the merged entity will become a "must have" distribution outlet for programmers.

- By receiving lower prices and larger volume discounts than its rivals are able to obtain, these rivals' competitive position will be weakened.

  - Small and medium-sized cable operators believe that programmers subject to enhanced bargaining power of Comcast/TWC will seek to make up for lost revenues by charging higher prices to other MVPDs, particularly smaller providers.

    - According to the NCTC President and CEO Rich Fickle: "As a result of Comcast's and Charter's ability to pay less for programming, I expect the largest programming/media companies – which have significant bargaining leverage– will extract higher fees and more onerous terms and conditions from other MVPDs in the market and NCTC."

    - Fickle continues, "I see this seesaw effect play out in the market today. Currently, NCTC faces increased demands from programmers resulting from the concessions that they grant large MVPDs such as Comcast and TWC. Programmers acknowledge during negotiations with the NCTC their need to make up the revenue amounts they are not able to secure from Comcast, TWC or other large MVPDs. Specifically, some programmers have stated their intention to make up lost revenues resulting from their negotiations with Comcast, TWC or others directly through their agreements with NCTC members and other small MVPDs. There is no reason to believe that

> programmers won’t continue to seek concessions from NCTC to make up for the increase in lost revenues after the Comcast/TWC/Charter deal is approved. The Comcast/TWC/Charter merger will put programmers in an even worse position in their negotiations with Comcast and Charter. This is why I expect programmers to make up revenues on the backs of small cable operators in the event the Comcast/TWC/Charter deals are approved.”

- Any efficiency gains by Comcast will increase its profitability per subscriber, leading to an increased opportunity cost in selling its programming to rivals – this has the same effect as Comcast achieving lower programming prices.

VIII. Harm #3- Horizontal Harm Due to the Combination of Programming Assets

- The combined ownership of Comcast and TWC programming assets will increase the combined entity's market power over programming.

- This will allow Comcast to charge significantly higher programming fees to MVPDs that purchase the programming.

- The fee increases will be substantially passed through to subscribers in the form of higher prices

- Regions in which the horizontal harm will be most serious are New York and Los Angeles where there is an NBC O&O and TWC RSNs – two forms of programming recognized as "must have" by the FCC.

IX. The Problem with Comcast's Proposed Remedies

- The key remedy used by the FCC in the Comcast/NBCU transaction for addressing the vertical competitive harm and the horizontal harm of combining Comcast and TWC programing assets is to give parties purchasing Comcast's programming the right to ask for binding arbitration with mandatory interim carriage.

- FCC responded to concerns raised by ACA that baseball style arbitration is prohibitively expensive for small and medium-sized MVPDs by adopted a one-way fee shifting provision that required Comcast to reimburse an MVPD with fewer than 600,000 subscribers that prevails in their arbitration for their costs.

- Comcast denies their transaction creates any program access harms, but states that the existing program access regulations[5] and the Comcast/NBCU conditions would fully mitigate it.

- Despite the fact that the Commission has made an arbitration remedy available to smaller operators as a condition of approval for various vertical mergers since 2004, only a couple have found it worthwhile to even try.
    - The few mid-sized MVPDs that have tried arbitration either would not do so again or would be reluctant to go to arbitration. Therefore, smaller MVPDs effectively have lacked any remedy for the recognized competitive harms created by all previous mergers with vertical effects.

- The primary problems with previously adopted conditions:
    - Smaller MVPDs Lack Critical Information to Identify Bad Behavior
        - The conditions rely upon MVPDs buying Comcast's programming to know when Comcast is acting on its incentive to harm its competitors.
        - However, due to the widespread use of non-disclosure agreements, a smaller MVPD is not adequately informed to be able to identify when Comcast is acting in an anticompetitive manner.
        - In these instances, the harms of the transaction are realized.

[5] Current FCC rules include a definition of a "buying group" that prevents the nation's largest programming buying group, the National Cable Television Cooperative (NCTC), from availing itself of the program access protections Congress intended. As a result, more than 900 MVPDs that rely on NCTC are effectively denied the protection of the program access rules.

- Smaller MVPDs Lack Critical Information to Engage in Arbitration and Comcast Has the Critical Information

  - Even when a smaller MVPD senses Comcast may be overcharging them, the lack of critical information also significantly impedes their ability to choose a final offer in the initial stage of baseball style arbitration.

    - According to ACA President and CEO Rich Fickle, "During our most recent renewal negotiations with Comcast/NBCU at the end of 2012, NCTC considered utilizing the "baseball-style" arbitration condition the FCC imposed on Comcast when it acquired NBCU."

    - "However, after careful consideration, NCTC decided that the arbitration condition was inadequate and ineffective, even with one-way fee shifting in the event we won, to address, the unfair demands of Comcast/NBCU. Following are a few reasons that the conditions were inadequate and ineffective."

    - "NCTC did not feel it could reasonably evaluate its likelihood of success in an arbitration proceeding because we lacked critical information on key factors that an arbitrator would likely use to make its determination of fair-market value. Without this information we could not make an informed "final offer."

    - "At the same time, Comcast/NBCU had perfect information. … Having access to this information in advance of making a "final offer" gives Comcast a huge advantage and makes their chances of winning higher than ours. This information imbalance exacerbates NCTC's problem of a lack of information as described above."

  - Unable to make an informed final offer, these MVPDs believe their chances of prevailing in the arbitration is low, and they are further discouraged knowing that Comcast has significantly more access to the information that is relevant to an arbitrator when determining which final offer they received is closest to the programming's fair market value.

- Other problems with previously adopted conditions:

    - Small MVPDs are Risk Averse: $1 million, the average cost of baseball-style arbitration, is a relatively large share of the amount of money at issue in a programming dispute. Faced with the prospect of losing $1 million in arbitration costs and bearing the burden of higher programming costs, a small MVPD will chose to simply "eat" the higher programming costs. One-way cost shifting may make winning an arbitration more financially attractive, but it does nothing to improve a small MVPD's chances of winning, nor mitigates the significant cost of losing, which for small MVPDs is too great a risk to take.

    - Problems Getting Started: When the conditions are first introduced and there is no track record of arbitration results to consult, small MVPDs will be especially poorly informed. This means that the first few MVPDs who test the one-way fee shifting remedy will have to bear especially high risks. Accordingly, there is a particular risk that such arbitrations will never be tried because the first few will be viewed as excessively risky for any small MVPD.

    - Comcast Likely to Outspend Its Opponents in Arbitration**:** Programmers have an incentive to establish a reputation of being very difficult to take to the arbitration to discourage others from seeking to use the condition, particularly with risk adverse small MVPDs.