Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Applications of Charter Communications, Inc., Time Warner Cable Inc., and Advance/Newhouse Partnership for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 15-149

Reply to Responses/Oppositions of MFRConsulting

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The Case Against New Charter

1. Summary

Approval of New Charter would create an unacceptable risk to the public interest and to consumers for the future of broadband infrastructure and services. Broadband is one of the indispensable foundations for the flourishing of economic and social progress and the pursuit of individual and collective aspirations in the 21st. century United States. The risk associated with New Charter far outweighs any potential plausible transaction-specific benefits.

The benefits generated in the alternative scenario in which the three constituents of New Charter would remain independent are prospectively more substantial and more likely to be realized than those claimed for New Charter. In this alternative scenario benefits such as desirable increased investment in improving broadband performance and coverage, as well as enhancements in customer service and care, would not be vulnerable to the substantial financial risk associated with New Charter. These benefits are specific to rejection of the transaction, not to its consummation.

The New Charter transaction and the decision for its approval or rejection or approval with conditions – assuming, which is far from obvious, that effectively prophylactic and enforceable conditions can be put in place - is predominantly about broadband. A key and controversial question is whether or not the US broadband market is now, and if not today may become effectively competitive in future. The types and extent of foreseeable harm or adverse consequences as well as the potential ensuing transaction-specific benefits flowing from New Charter for the public interest and broadband customers are a function of the answer to this question. A robust answer must be derived from the best available independently verifiable evidence and an understanding of the incentives and constraints and hence the priorities under which a future New Charter would be operating in balancing the several overlapping and sometimes competing interests it has to respond to as well as seek to influence. These diverse constituencies include shareholders, creditors, customers, employees, and franchise authorities among others.

The economists who have produced Declarations in support of the New Charter transaction base their favorable conclusion on the financial incentives that New Charter will allegedly experience. They find that the incentives they perceive will ensure that New Charter is not motivated to act anti-competitively (e.g. to foreclose online video distributors or OVDs) and/or in other ways that will be harmful to consumers. However, compelling rebuttals of the work of these economists are based on demonstrations that the incentives driving New Charter will be different from and have the opposite effect to the incentives on which they base their findings.

The review and assessment of New Charter is fundamentally different from, although having some similarities to, the considerations raised by the earlier Comcast/Time Warner Cable (TWC) transaction.

In Comcast/TWC the possibility of anti-competitive, unreasonable discriminatory practices in the video services market and the potential abuse of power derived from vertical integration were key concerns that fueled strong opposition to its consummation. The force and credibility of these objections eventually led to Comcast's decision to abandon its attempt to acquire TWC[1]. While concerns about competition in the market to deliver video services have also been raised in the context of New Charter, it is the consequences of the formation of the latter for the future development of broadband in the US that should be the predominant focus of analysis of its impact on the public interest and on customers for both broadband and video (as well many other) services delivered online over broadband channels.

Three related and mutually reinforcing findings of the analyses presented in this report support the conclusions that the formation of New Charter would harm the public interest and produce adverse consequences for customers while moreover preempting a superior alternative beneficial scenario:

1. **The US broadband market is not or is at most (location-dependent) only weakly competitive.**
   Hence market forces or the "invisible hand" are insufficient on their own to restrain broadband operators from acting in ways that are harmful to the public interest and to stakeholders other than shareholders and their management. These harmful actions will be motivated by and designed to satisfy the latter group's financial interests and respond to their specific incentives above all other priorities and obligations competing for resources**.** Acceptance of New Charter's claims of the transaction-specific benefits and absence of harmful consequences that will ensue from its formation is tantamount to implicitly trusting this operator to follow a path that is very different from the past behavior of its principals. It requires an unreasonable leap of faith to expect that New Charter will not succumb to powerful temptations and incentives not to adhere to the public interest and to give an unacceptably low priority to the legitimate expectations of its customers (and unserved locations in its franchise areas), when it suits its own financial interests to do so, and from its perspective there are no penalties or other downsides to inhibit this behavior.

[1] Remarks of Jon Sallet, FCC General Counsel, Sept. 25, 2015: "*Simply put, the core concern came down to whether the merged firm would have an increased incentive and ability to safeguard its integrated Pay TV business model and video revenues by limiting the ability of OVDs to compete effectively especially through the use of new business models,*" *http://transition.fcc.gov/Daily_Releases/Daily_Business/2015/db0925/DOC-335494A1.pdf*

2. **New Charter would wield more market power than its separate constituent companies, and its motivation to act in response to the demands and expectations of a small number of interests while giving lower priority to investments to better serve customers and meet public interest obligations and commitments would be enhanced by its need to service the high debt load it will incur on consummating the transaction.**
   New Charter's propensity to subordinate, and then act harmfully towards the public interest and the growing needs and demands of customers in an at best weakly competitive market, will be substantial. It will be fueled by the combination of New Charter's increased market power and a strong debt-based motivation to take decisions that are primarily driven by the incentives of management and the goals of major shareholders and creditors, with no external restraints to curb its behavior or make it pay more attention to other interests.

3. **An independent TWC (and BHN) will be more capable of delivering the benefits that Charter claims are transaction-specific to New Charter with fewer foreseeable obstacles, risks, and potential for harm.**
   Charter characterizes TWC as having been prevented from making additional investments in its network and in the development of innovations by its alleged lack of scale. Yet TWC's record of allocation of its resources includes billions of dollars spent on share repurchases since 2010, some or all of which could have been devoted to other purposes directly beneficial for customers and to support public interest obligations. An independent TWC not focused on the goal of maximizing its value to secure the highest price for its acquisition would be able to pursue these purposes without being burdened by the much higher debt load it would have to contribute to servicing as part of New Charter. In addition BHN's current financial and business posture is stronger today, including a long standing relationship with TWC, than it would be as part of a debt-burdened New Charter.

The risks inherent in these findings unmistakably outweigh any potential benefits from the formation of New Charter and point to a better outcome with fewer inherent risks to the public interest and customers if this transaction is rejected than if it is approved.

This conclusion does not require an assumption or belief that the decision makers in New Charter will set out deliberately or with evil intent to undermine the public interest or unreasonably neglect customers. It is a pragmatic assessment, rooted in experience, that humans and the organizations they are in charge of, when faced with powerful incentives and hence temptations as well as often strong pressures to act in their own interest (or that of a small number of closely interwoven constituencies), will typically seek to maximize their own rewards and outcomes.

The probability of such outcomes is magnified when there are no foreseeable remotely comparable adverse consequences for the parties who take these courses of action, however selfish their actions may appear or may damage other parties. This perception of human nature is embedded in the fabric of the US Constitution and the precept of the separation of powers. Application of this precept is designed to limit the ability of any one individual or interest group to take unilateral action free of any influence and/or constraints from other parties. As Oscar Wilde's character Lord Darlington says, " I can resist everything except temptation."[2]

The remainder of this report is focused on matters directly related to the findings and conclusion delineated above. Other issues raised by opponents and critics of New Charter, such as the treatment of OVDs (online video distributors), are not covered in any detail. Broadband is the focus, not because these other issues and concerns about New Charter are not important for some stakeholders or irrelevant, but because the case against New Charter will stand or fall on the central issue of its impact for good or bad on the development and dynamics of the broadband market and infrastructure to serve the public interest and meet the legitimate needs and expectations of customers individually and collectively[3]. Broadband has become one of the foundations for enabling economic and social progress in the 21st. century, and the Commission has recognized that *"…the term "cable" industry" is a bit of a misnomer—these are companies who supply more consumers with the ability to connect to the internet than with the ability to watch proprietary Pay TV"*[4]. Hence how or even whether broadband is regulated, and decisions to approve or reject a major proposed transaction involving cable operators in the broadband arena that will have broad and long lasting effects (New Charter's franchises would cover about 40% of the US population) are matters of enormous significance.

The fate of this Application to form New Charter is therefore critical.
The outcome must reflect the goals of public policy interpreted in light of the best available evidence and analysis. It must not be determined by a powerful special interest or one set of stakeholders dedicated to achieving a specific outcome primarily to serve their own purposes simply because they are able to mount a more powerful, better funded lobbying and propaganda campaign than their critics and opponents. New Charter's campaign is applying formidable resources to coopt supporters and recruit outside experts to produce opinions and analyses that, as

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[2] Act 1 in *"Lady Windermere's Fan,"* a play with a plot about deception and cheating

[3] Cable operators have morphed into being broadband-driven plays in terms of margins and profits, e.g. http://www.hollywoodreporter.com/news/cablevisions-james-dolan-touts-broadband-802745. While there are accounting issues of how common costs (e.g. shared network infrastructure, sales, marketing and customer service) may be allocated to different services (i.e. video, broadband access, and voice) the majority of the profits generated by cable operators seem today and increasingly to come not from video services, that incur substantial and rising programming costs, but from broadband access plus voice services for both of which operating costs are much lower.

[4] Jonathan Sallet, "The Federal Communications Commission and Lessons of Recent Mergers & Acquisitions Reviews," https://www.competitionpolicyinternational.com/the-federal-communications-commission-and-lessons-of-recent-mergers-and-acquisitions-reviews/.

demonstrated in this report, distort the evidence and ignore significant facts that call into question or invalidate the positions they are advocating. The review and assessment of the Application must not be unduly swayed by pressure or the sheer weight and repetition of misleading assertions produced in this campaign. It must instead seek an outcome that achieves a reasonable balance across and between the interests of all stakeholders that are inevitably in some respects competing with each other.

2. Overview

An article in the New York Times published immediately after the conclusion of the Comments Round in this Docket that reviews the proposed merger of Charter, Time Warner Cable (TWC), and Bright House Networks (BHN) to form New Charter concluded, *"To date, Charter's proposed acquisitions have received significantly less criticism than Comcast's deal for Time Warner Cable, which would have united the two largest cable operators in the country."*[5]

Nevertheless the case for rejecting the formation of New Charter is at least as strong as, although notably distinguishable from that which resulted in Comcast's abandoning its bid for TWC. New Charter will be operating with a toxic burden of a high debt in an, at best, weakly competitive market (fixed broadband access or distribution). The weakness of this competition is well established and widely known. Most tellingly it has been confirmed by statements and presentations aimed at the financial community by players in the cable sector itself. These presentations and comments are designed to convince investors of cable operators' ability to make money by whatever measures they choose to implement without having to contend with the constraints (the "invisible hand") of competitive market forces[6].

Therefore New Charter will be motivated to give the highest priority to financial engineering tactics and maneuvers to service its debt regardless of, and with consequences certain to be harmful to the public interest, customers and other constituencies. There will be no effective curbs on its ability or on the decisions it takes to implement these tactics. The formation of New Charter, whose franchise areas cover about 40% of the US population, would have a substantially negative impact on the future quality and pricing of broadband services in the US.
As the article in the New York Times implies, the diverse legitimate objections and concerns about New Charter raised in Comments and Petitions from public interest groups, other MVPDs (Multichannel Video Programming Distributors), and content developers and owners, have not yet been depicted comprehensively and convincingly. The issues behind these objections are strongly interconnected, and

[5] http://www.nytimes.com/2015/10/15/business/media/dish-network-seeks-rejection-of-2-deals-proposed-by-charter.html?_r=0
[6] Two examples: http://deadline.com/2011/05/liberty-medias-john-malone-says-cable-is-pretty-much-a-monopoly-in-broadband-129173/, and Altice's presentation to investors about its proposed acquisition of Suddenlink - slide 7: "High Quality Network with Unique Competitive Position," http://altice.net/wp-content/uploads/2015/05/2015-05-20-Suddenlink-IR-presentation-FV.pdf

the cumulative effects of their outcomes and the true extent of their inevitably harmful and foreseeable consequences have yet to be fully exposed.

One explanation for the relatively low breadth and intensity of opposition to New Charter, and a plausible (albeit unwise) justification for considering that it would pose a smaller threat to the public interest, customers and the future of broadband and video services markets in the US than a combination of Comcast and TWC is that at the outset New Charter would command smaller shares in broadband and video distribution markets. Moreover New Charter would not have as extensive a position in its own content as Comcast commands. Vertical integration between major sources of content and broadband distribution, such as Comcast's, which is more pronounced than New Charter's would be, gives a broadband operator the incentive and power to discriminate unreasonably against other content providers and/or to obtain significantly more favorable terms from them than are available to other broadband access channels, including small cable operators. The Commission has revealed that concerns about abuses of the market power of a vertically integrated operator weighed heavily in its deliberations about the merits and faults of the Comcast/TWC transaction.[7] This power may become more effective in future if a trend to impose data caps on broadband customers instead of allowing unlimited use for a fixed price becomes increasingly widespread (and Charter's commitment to not introducing data caps is limited to 3 years).[8]

However, a crucial and alarming difference between New Charter and the once proposed, now abandoned Comcast/TWC combination is that the former will be burdened with a huge debt load that it will be under pressure to service. In contrast, whatever one's opinion about its business practices Comcast's ability to meet its financial obligations was not in doubt. The consequences of this debt load have so far been most clearly and thoroughly delineated in the Petition To Deny submitted by Free Press[9], but were only lightly touched upon in the joint Petition To Deny from other public interest groups including Public Knowledge[10].

The foreseeable consequences of New Charter's operating with a high debt load are:

A. *Pursuit of actions to pay down the debt and avoid bankruptcy* that will reflect the priorities of financial engineering above all others, with the goal of increasing cash flow to meet the demands of New Charter's creditors. These actions will entail:

[7] http://www.fiercecable.com/story/fccs-sallet-comcast-twc-merger-would-have-thrown-sand-gears-online-video-di/2015-09-28
[8] "How Comcast wants to meter the Internet," http://hosted.ap.org/dynamic/stories/U/US_COMCAST_DATA_CAPS?SITE=NDBIS&SECTION=HOME&TEMPLATE=DEFAULT; "New Comcast plan charges $30 more for the Internet you already get," http://mashable.com/2015/11/07/comcast-data-caps/#rCeETwyAnuqN
[9] Free Press Petition to Deny, http://apps.fcc.gov/ecfs/document/view?id=60001329091
[10] Public Knowledge et al., http://apps.fcc.gov/ecfs/document/view?id=60001329043

- Failure or serious shortfalls to fulfill promises and commitments to invest to improve the quality, capacity and coverage of its networks and to meet its public interest obligations,
- Further deterioration in already unsatisfactory customer care and experiences, and
- Increases in the prices charged to customers that are greater than can be justified by increases in costs or improvements in the services provided.

The first of the consequences enumerated above - failure to meet commitments and public interest obligations - has been overlooked in the many expressions of support for New Charter (typically one page comments or less) from local officials, Chambers of Commerce, minority and public service organizations. They justify their support with language such as "*We trust that New Charter will bring back jobs from overseas call centers outsourced by Time Warner…. We would welcome one of these call centers in ____"* ; *"New Charter has a stated commitment to delivering superior broadband; broadband designed for online video and data-hungry apps,"; " We believe that New Charter's commitment to expanding broadband access would help our communities retail and attract businesses";* and *"I strongly believe that New Charter's pledge to spend at least 2.5 billion to improve telecommunication performance and support small business subscribers in rural areas is critical to low-income customers."*[11] Charter has reneged on past commitments[12] and is just as likely to renege on these ones if fulfilling them would cause trouble in generating enough cash to service its debt.

B. *Bankruptcy* if the preceding tactics to increase New Charter's cash flow prove to be insufficient and this outcome becomes the only path left open to reduce the debt load.

The claims and assertions being propagated by New Charter and its fellow travelers of the transaction-specific benefits that its formation will allegedly generate are the results of smoke and mirrors analyses that are designed to conceal the reality that New Charter will inevitably encounter and the risks inherent in its situation. The records of Charter, which went through bankruptcy in 2009, and of the largest shareholder in New Charter – John Malone – with respect to the relative priority assigned to investment and customer service compared to competing allocations of financial resources that do nothing for customers or other broad constituencies are further reasons for expecting that New Charter will act in accordance with the

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[11] The good faith intentions of these commenters are not in question here, however their ability and expertise or the level of effort they have devoted to assess independently the credibility of what they may be told by Charter (with respect to investment plans, operations etc.) and to grasp the full picture behind the New Charter transaction is dubious. For example, the number of locations where New Charter may operate additional or expanded customer service centers that provide jobs for local residents is limited. At best only a minority of the municipalities and counties weighing in on behalf of New Charter may become the beneficiaries in terms of any new employment opportunities.
[12] Public Knowledge et al., ibid; Alliance for Community Media et al,, Joint Petition to Deny, http://apps.fcc.gov/ecfs/document/view?id=60001328966

priorities delineated above. It will underperform with respect to its franchise obligations and fail to fulfill the expectations aroused by the promises or commitments it makes (even though characterized as "*enforceable*" or *"binding")* in order to secure approval of this transaction.

Since the fixed broadband access or distribution markets in the franchise areas it serves are at best only weakly competitive, which is a general characteristic of the environments of US cable operators, there will be no effective restraints on New Charter to inhibit it from following a course that is harmful to the public interest and to its customers and other stakeholders. Consummation of the proposed New Charter transaction will create a more powerful player than Charter is today with even less reason, motivation or incentive to act in the public interest and in a customer- driven and -responsive mode than Charter has traditionally exhibited.

In trying to establish New Charter, Charter Communications and its key ally John Malone are following a well- trodden path of expanding with takeovers and debt when interest rates are low. This strategy leads to trouble and potentially bankruptcy when markets change, revenues do not grow as optimistically forecast and may even decline, and interest rates rise. There are multiple examples of this outcome and the financial engineering maneuvers that companies resort to when they find themselves faced with this situation. Charter's dismissal of Free Press' reference to its 2009 bankruptcy as *"misleading and beside the point …as it arose from wholly different circumstances"* [13] is true with respect to the conditions in the markets in which Charter was operating six years ago compared to New Charter. Nevertheless Free Press' reference is highly relevant as an example of and specific precedent for the outcome when a network operator is managing its business while coping with a high debt load. Free Press reinforces this message in its references to John Malone's record[14] with the cable operator TCI in the 1990s which underinvested for years but eventually found an acquirer (AT&T, a naive investor in the cable business) that overpaid and then sold these cable properties at a huge loss after underestimating how much additional investment it would have to make in TCI's networks[15]. Free Press showed itself to be well aware of the *"wholly different circumstances"* of the cable sector over time, referring to its domination by video services and the growing competition it faced from satellite TV providers in the 1990s as compared to its now becoming a broadband play in a quasi-monopoly market. Free Press' warning about the consequences and risks of high debt is as valid today and would be for New Charter as it was for Charter leading up to its bankruptcy in 2009.

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[13] Charter Opposition to Petitions to Deny (Public Version), - Charter Opposition - footnote 316, http://apps.fcc.gov/ecfs/document/view?id=60001332667

[14] John Malone's financial brilliance is not in doubt, but his attention to the public interest and consumers is: http://www.denaliinvestors.com/letters_public/THE%20MALONE%20COMPLEX%20by%20DENALI%20INVESTORS.pdf; http://www.barrons.com/articles/SB110091006916379727

[15] http://usatoday30.usatoday.com/tech/techinvestor/2001/12/20/att-comcast.htm;

In markets that are truly competitive the demise or weakening of a company that has failed to anticipate its vulnerability as a result of high debt may not be harmful to the public interest. Its more conservative and wiser competitors will be able to step in and deliver products and services to the customers of the profligate provider that has been driven more by the imperatives of financial engineering than by other priorities such as customer service and investments in improvements and innovation in the products and services it is offering.. However New Charter's business is based on the deployment and operation of broadband access infrastructure and the delivery of broadband access services that are an essential facility and foundation for enabling economic and social progress in the 21st. century. The broadband market in the US is not competitive and customers in many locations have no or only one alternative to New Charter. Moreover New Charter will operate under franchises that include obligations to customers that do not apply to businesses in truly competitive markets, since they include privileged rights for access to and use of public resources. Hence New Charter's adoption of a risky, highly leveraged business model that will imperil the future quality and coverage of its networks and services poses a threat to the public interest that a similar model in a truly competitive market does not.

In 2014 Time Warner Cable under the same CEO as today asserted that its acquisition by Comcast would produce benefits from: *(a) Economies of scale, (b) Expanded geographic reach, and (c) Sharing of technologies and services.* TWC also asserted that cable operators are in a "*Dynamic, Expanding, and Highly Competitive Marketplace*[16]*.* The reviews of this transaction by the FCC and Department of Justice (DoJ) seemed to conclude – since Comcast and TWC decided to drop their merger application - that these benefits were either not credible or to the extent that they may have been plausible were decidedly outweighed by the harmful consequences of the increased market power that the resulting expanded cable business would have possessed. Furthermore the relevant marketplace is not sufficiently competitive to support the claim that market forces are strong enough to inhibit abuses of this market power.

Future abuses of their market power by cable operators may be stimulated further in future by their motivations to limit cord cutting to maintain their video services revenues.[17] Cord cutting involves customers choosing to cancel their video

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[16] Applicants Public Interest Statement (Public Version), http://apps.fcc.gov/ecfs/document/view?id=7521097357

[17] Interestingly a cable operator may decide to favor the opposite strategy, i.e. to encourage cord cutting (e.g. http://www.dslreports.com/shownews/Cablevision-CEO-Makes-It-Clear-Company-Is-Targeting-Cord-Cutters-134260). The cable operator provides the broadband channels that OVDs depend on, and the margins in this segment of their business are higher, because the operating costs are much lower than for their traditional pay TV business that incurs significant and rising content (programming) costs. This strategy would further increase the weight of broadband in the decisions taken by cable operators, in which market, depending on the location, they enjoy a monopoly or duopoly position. TWC generates the majority of its profits from the broadband and voice, not the video services it sells (based on the revenues and costs of its different services as reported in TWC's 2014 10-K, pp. 48-51, http://d1lge852tjjqow.cloudfront.net/CIK-0001377013/667ba850-28a8-

subscriptions and preferring to have video programs delivered over broadband access channels rather than via traditional cable video channels that share the same broadband infrastructure. Specifically, data caps applied to broadband access channels, thereby limiting the amount of video that can be viewed over broadband without incurring additional charges will make unlimited access to comparable and competitive VOD (video-on-demand) services delivered over pay TV channels more attractive, in effect discriminating anti-competitively against the former, and in particular OTT (over-the-top) video providers or OVDs.

Now TWC (and Charter) is invoking the same benefits and making similar assertions as in the Comcast/TWC transaction about the competitive intensity of its (and Charter's) marketplace to justify the value to customers and the benefits to the public interest of its acquisition by Charter[18]. TWC is also arguing that any potential anti-competitive harm of its combination with Charter will be smaller since New Charter will not have as powerful a position in vertical integration (content ownership) as Comcast. However as noted New Charter will confront a formidable challenge associated with the huge debt it is incurring that "New Comcast" would not have encountered. Moreover there is no more justification for giving credence in 2015 to TWC's (under the same CEO) and Charter's claims of benefits from their merger and assertions about the competitive intensity of the marketplace in which they operate than there was to accepting comparable assertions by TWC and Comcast in 2014 and earlier in 2015 in their earlier now withdrawn application.

The alleged benefits from the formation of New Charter are as unsupported and unbelievable as the same benefits were in the case of "New Comcast", while the foreseeable harm from allowing this transaction to proceed is as great, although the result of a different set of considerations and concerns regarding the implications and foreseeable consequences of its huge debt. The case against New Charter is as compelling as was the opposition to "New Comcast".

The only way that New Charter can credibly claim to be able to service its huge debt and meet its franchise obligations, as well as fulfill any additional commitments it may make to secure approval of the transactions involved in its creation is to achieve significant revenue growth and operating cost reductions to boost its cash flow[19]. These achievements will require increases in the prices New Charter

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48c5-a119-2cda58c82c2f.pdf). However a cable operator has to maintain a potentially tricky balance in considering how to respond to cord cutting, because if its video revenues fall too far, its net performance may suffer because its total costs (common plus service-dependent) may increase as a proportion of total revenues.

[18] According to this theory – in effect the assumption of a monotonic link between size and efficiency - the benefits of expansion or economies of scale must be lower than if Comcast had acquired TWC since the resulting entity (New Charter) will not be as large.

[19] Charter claims it will be able to achieve annual cost savings of $800 million. This amount, even if it is accepted as credible, is insufficient to cover the additional interest expense associated with the extra debt (perhaps $27 billion) that New Charter will be taking on.

charges its customers regardless of whether it delivers more services or a higher quality of service to them, and reductions in its operating costs to the point where they will cause a deterioration in its already unsatisfactory level of customer care. The weakness of competition in the US broadband market is what will enable New Charter to take actions designed to satisfy the investment community and its creditors, including ones that will adversely affect customers and harm the public interest.

This report provides evidence to support the findings just outlined and to demonstrate the misrepresentations being propagated by New Charter.

3.Transaction-Specific Benefits: Reality and Fiction

The benefits claimed to ensue from the formation of New Charter are a typical collection of items trotted out in favor of any merger in many sectors. These items include in particular the prospect of substantial synergies thanks to economies of scale that will result in significant cost savings and increased investment capacity to improve infrastructure, products and services and foster innovation. Sometimes benefits related to an increased range of offerings to win a larger share of each customer's wallet are also cited, as well as the opportunities for growth in revenues and profits thanks to expanded geographic coverage (a larger addressable customer base) and the acquisition of complementary skills.

Nevertheless despite the promises forthcoming from Charter it is remarkable how many mergers fail and end up destroying, not creating value, not only for shareholders but also for customers of and other stakeholders in the merging companies.[20] The questions around why some mergers and acquisitions fail while others significantly deliver on their promise are complex, multiple and often specific (e.g. related to individual personalities). They may also involve the consequences of mistaken perceptions of market opportunities, the impact of unexpected exogenous events, cultural misunderstandings, or even (at least allegedly) serious misrepresentations of its position by one of the parties involved. Even if the strategic intent driving the merger is valid, it may fail because of errors in execution, e.g. the internal coordination and reshuffling of the companies' resources may consume so much time and attention and become entangled in internal corporate jockeying for position that customers are neglected and competitors gain substantial market share as a result.[21]

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[20] http://www.axial.net/forum/3-failed-mergers-and-what-they-reveal/, AT&T/TCI is another example of a failed acquisition, as is WorldCom/MCI. See also "Why large M&A deals destroy value," http://www.efinancialnews.com/story/2012-01-24/large-mergers-acquisitions-destroy-value-mckinsey, and "The Sources of Value Destruction in Acquisitions by Entrenched Managers", Journal of Financial Economics (JFE), Vol. 106, No. 2, 2012

[21] Loss of market share under these circumstances is dependent on there being effective competition in the market and in customers being able to switch readily from one provider to another, neither of which conditions is found in the broadband market.

A convincing exposition of the benefits of transactions such as those that will allegedly result from the formation of New Charter cannot simply present the case for them (that stripped of their quantitative details are generic as if they are valid for all mergers that result in a larger company), but must also make some effort to:

(i) Explain why these benefits will be realized specifically (for example increased scale does not lead to lower costs at all values of scale); and
(ii) Justify why and how the merged company will avoid the potentially value-destroying damage that may ensue and the deleterious impact of the costs that may be incurred and the disruptions that may be experienced in the process of merging.

The negative considerations just outlined in (ii) may or should be relatively less worrisome in the case of New Charter since it involves the merger of largely (but as discussed below not entirely) geographically distinctive businesses offering comparable services to customers within one country rather than, as in other cases, mergers that cover more than one country and/or include products and services from the merging parties that have been competing against each other for the same customers. Nevertheless there are possible sources of differences between the companies that would constitute New Charter in areas such as business and operational support systems and product portfolios (such as for customer premises equipment) as well as decisions about key roles in the new company that may prevent alleged synergies from being implemented as rapidly or as fully as forecast, or in the worst case may result in additional and not reduced costs, and lower not greater efficiencies.

There is insufficient publicly available information to perform a thorough due diligence of the proposed New Charter covering its potential pitfalls and sources of inefficiencies as well as the benefits claimed for it. It is regrettable that as far as can be seen the economists whose Declarations[22] support New Charter have apparently not been asked or have decided not to produce balanced analyses that reflect risks and potential negative consequences as well as potential benefits[23]. Charter is in effect asking reviewers to accept its findings and those of the experts it has hired on trust. However, trust is not justified in this instance since as will be shown Charter's claims and representations include several misleading and in the worst cases demonstrably false findings and assertions. Moreover as will also be shown the benefits claimed to be specifically associated with the formation of New Charter can be achieved at lower risk by rejecting the transaction (see Sections 6 and 7 below).

In addition to the claimed generic benefits of the merger that New Charter would generate (cost savings through economies of scale) two specific projected benefits

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[22] Charter Opposition to Petitions to Deny, Exhibits (Public Version) -Economists' Declarations- http://apps.fcc.gov/ecfs/document/view?id=60001332668

[23] One of the economists (Dr. Scott-Morton) states that she has reviewed documents and interviewed executives from Charter and TWC executives and relied on these sources to produce her findings.

based on its role as a network operator have been delineated: (a) Expansion of Wi-Fi Access Points, and (b) Improvements and Enhanced Competition in the Provision of Services to Enterprise Customers.

On the Wi-Fi front Charter says that New Charter will deploy an additional 300,000 Wi-Fi Access Points because of the capital investment enabled by its formation and the synergistic sharing of expertise in Wi-Fi deployments between the three Applicants that would not otherwise have the incentive to implement this deployment. Moreover this additional deployment will enhance the possibility that New Charter would seek to acquire licensed spectrum or become a partner in a license-seeking venture, eventually to the benefit of competition in the mobile market.

Implicit in these statements is that the formation of New Charter will release additional funds for investment over and above the sum of what the three Applicants would otherwise have available, and moreover that New Charter will be able to commit funds to bidding for spectrum licenses (presumably in the upcoming 600 MHz auctions) that are likely to be very expensive. However as demonstrated below (see Section 8) a debt-burdened New Charter will have less not more money to commit to these investments than the total available to the three Applicants as separate companies. The value of Wi-Fi Access Points to cable operators (and mobile operators) is well established and the incentive for individual operators to give their customers as much Wi-Fi coverage as possible, including through reciprocal partnerships, is strong. The claim that New Charter will be more likely to expand the number of Wi-Fi Access Points beyond what its constituent companies would otherwise deploy is not plausible given both its financial situation and the incentives of the companies separately to follow the same path. The Wi-Fi benefit is therefore not transaction-specific.

Great stress is laid in favor of the New Charter proposal that its constituent companies do not operate in geographically overlapping markets hence their combination will allegedly have no impact on competition. Yet access to Wi-Fi Access Points by customers of a cable operator includes access to Wi-Fi outside the franchise areas of that operator thanks to agreements with other providers of Wi-Fi hot spots. Moreover Charter is dropping hints or making suggestions that New Charter may decide to enter the mobile communications market, in which in order to be competitive services must offer national (and even international) coverage. In other words, and to take the forward looking dynamic perspective that Charter recommends[24], the combination of the Applicants in a single company will have a foreseeable impact on the future competitive landscape of the broadband market in the US as cable operators expand the geographic coverage (and portfolios) of the services offered to their subscribers. The assertion that because the Applicants' cable franchise areas do not overlap therefore their merger will have no future competitive consequences is false.

[24] Charter Opposition, p.39, ibid.

The claim of a benefit related to greater competition in the Enterprise Services market from the formation of New Charter is more plausible, especially given the many concerns expressed about the allegedly weak state of competition in this market (vigorously denied by AT&T and Verizon), as documented in the long-running Special Access Proceeding (FCC Docket 05-25). To support this claim Charter refers to a "*$2.5 billion enterprise build-out*". Moreover in its June, 2015 Public Interest Statement the Applicants denigrated (including references to TWC's own experiences) the effectiveness and competitiveness of partnerships to achieve the same geographic coverage and pricing and efficiency for offering and delivering enterprise services as New Charter will allegedly be capable of as one company.

Several questions and observations come to mind in reviewing this claim. First, it is unclear as in the Wi-Fi case whether and if so how the $2.5 billion investment in enterprise build-out would be an additional investment over and above what the three Applicants might or will invest anyway. Enterprise revenues, while still small as a proportion are nevertheless growing and becoming recognized as a material and attractive additional source of revenues for cable operators that they can address with relatively moderate investments.[25] Moreover as noted New Charter is likely to have fewer financial resources than the three Applicants in total as separate businesses to invest over the next few years as it tries to service its debt. Second, the problems encountered in partnering relationships as reported by TWC could just as well be a consequence of a poorly formulated and/or executed cooperation as of an intrinsic or inevitable deficiency in the choice of a partnership as compared to a merger[26]. The difficulties of executing a successful merger, while different, are not any less formidable than for a partnership. The superior value or benefit of a merger over a partnership is neither borne out by many experiences in multiple sectors of the economy including technologically dynamic ones, nor proven in the context of New Charter. Moreover notably Charter and TWC have recently entered into a partnership with Comcast to provide enterprise services.[27] Therefore the validity of a potential transaction-specific benefit related to the formation of New Charter for the provision of enterprise services in the US is dubious because of the implications of New Charter's debt on its investment capacity and the prospects for alternative arrangements such as partnerships. In the best case even if everything goes according to New Charter's optimistic forecasts with no stumbles along the way this benefit will be marginal, assuming that an additional investment is actually forthcoming over and above what TWC and Charter (and BHN) should be

[25] http://www.fiercetelecom.com/story/cable-operators-taking-greater-share-large-businesses-says-analyst-firm/2015-09-21

[26] Ericsson and Cisco have agreed on a partnership (http://www.marketwatch.com/story/ericsson-cisco-seal-strategic-network-partnership-2015-11-09), whereas their direct competitors Nokia and Alcatel-Lucent decided to merge (http://www.cnet.com/news/nokia-to-buy-alcatel-lucent-for-16-billion-as-it-eyes-global-market/)

[27] http://www.fiercetelecom.com/story/comcast-business-threatens-verizon-att-enterprise-unit-vpn-mobility-and-sca/2015-09-24

incentivized to do as separate companies in order to pursue their own enterprise revenue opportunities.

4. The Economics of Size, the Role of Incentives, and the Implications of Debt[28]

Charter's Opposition is a "doubling down" of its initial claims regarding the future benefits that will be generated by and the absence of any harm ensuing from the formation of New Charter. These claims are supported by a number of Declarations by economists from academia, Compass Lexecon and Charles River Associates[29]. The details of their calculation cannot be rebutted in this report since many of them are redacted (CONFIDENTIAL and HIGHLY CONFIDENTIAL). However there is one unexceptional theme that is repeatedly emphasized by these economists, namely that New Charter's behavior and actions will be driven by the financial incentives it perceives. The economists find that financial incentives to increase profits will ensure that New Charter will not act "badly," for example in ways that foreclose OVDs or more broadly constitute abuses of its market power, such as to raise prices without justification for consumers.

A premise for this finding, which these economists accept, is the claim that the markets in which New Charter operates are competitive, and consumers can readily switch to alternative providers if they feel they are being treated badly by New Charter. So the validity of the economists' arguments in support of New Charter's claims as of the credibility of the claims themselves boils down to the answer to the question of whether New Charter is indeed operating in competitive or in non- or only weakly competitive markets. In the latter scenario New Charter will experience significant temptations and financial incentives, and will have the freedom, to behave "badly" or harmfully. If New Charter's markets are not effectively competitive, then the economists' own logic should oblige them to reconsider and change their conclusions about the future behavior of New Charter to align them with the different set of incentives or priorities and means available to maximize financial rewards that are present in an effectively uncompetitive, in contrast to a truly competitive market.

The economists also do not consider New Charter's large debt load to be a concern. However, this load, although dismissed as a problem by Charter itself, will create pressure, i.e. financial incentives, or rather disincentives, that will adversely affect the desirable allocation of resources to investment and operational improvements as projected and committed to by New Charter, and encourage increases in the prices it charges to customers in order to increase cash flow. The implications of New Charter's debt load are discussed further below (Section 8).

The economists also predictably present the usual positive benefits flowing from increased size, i.e. economies of scale. Their discussions are one-sided and

[28] Charter Opposition, ibid.
[29] Economists Declarations, ibid.

unbalanced, disqualifying them as credible objective analyses and eroding the validity and calling into question the objectivity and basis of their findings. They give no or little thought to the well-documented instances and circumstances where increased size and mergers have led to dysfunctional and less efficient outcomes. For example, smaller companies are often more adept at and capable of implementing or commercializing innovations than larger organizations.[30]

There are no laws or hard and fast rules that uniquely determine what size is "best" for a firm in any particular business, since the quality of its management as well as various endogenous and exogenous factors in addition to size *per se* affect its efficiency and effectiveness. But the impression given by these economists and those that have supported other mergers before the FCC is that increased size and scale are always beneficial and never harmful. The conclusion from their logic is that small firms have no place in the market. This conclusion not only violates public policy as embedded in the Communications Act but belies experience with the records of innovative services introduced by small players, a few of which then become the next generation's major providers. It also ignores the ability of smaller, focused niche companies to address the needs of specific customer segments more responsively and efficiently than much larger companies that may become entangled in bureaucratic sluggishness that impedes their flexibility and adaptability.

The economists' Declarations would be more credible if they acknowledged factors and examples that demonstrate the complexity of the economic and business issues they are asked to tackle, instead of delivering one-sided and uncritical opinions on behalf the companies that ask them to assess the value of what they are proposing to do, without considering alternative scenarios for achieving the benefits they endorse. In this instance of Charter/TWC/BHN one obvious alternative would include the scenario of an independent TWC. An independent TWC would not concentrate on making itself as attractive as possible for an acquisition, but could direct more of its resources than it has in recent years towards improving its services for customers and potential customers without, as in the New Charter scenario, having to service a high debt load (its debt-to-EBITDA ratio has been reported as 2.82[31], compared to Charter's of almost 4.7, and New Charter's of as much as about 5). This scenario is explored in more detail in Section 6 below.

5.The State of Competition in the US Fixed Broadband Market

A reader of Section II.A (pp. 32-39) in Charter's Opposition to Petitions to Deny covering conditions and trends in the broadband market might get the impression

[30] See for example, http://www.forbes.com/sites/osmancanozcanli/2011/01/08/innovation-in-large-companies/; http://www.entrepreneur.com/article/239936
[31] http://www.forbes.com/sites/greatspeculations/2015/06/26/watch-out-for-twc-charter-combos-post-deal-debt-levels/

from the discussion and representations it contains that New Charter confronts and will face intense and growing competition from a diverse set of current and emerging sources. This competition is allegedly being fueled by wireless operators, telephone companies aggressively building out fiber-based networks, and new entrants, notably Google from the private sector, as well as municipal fiber providers. The impression given by Charter's depiction of the broadband market is misleading and counterfactual for two reasons:

1. Wireless broadband is not a substitute for or a competitor to fixed broadband, but is primarily a complementary service within the context of customers' needs and demands for connectivity;
2. The coverage of all-fiber access networks that can compete with cable broadband, while growing is still and is likely to remain far short of the coverage that the cable industry has already achieved, and in any case in many locations would still only offer two choices to consumers for speeds above DSL levels.

This section of Charter's Opposition also contains the implausible finding, "Charter *estimates that it takes only six to twelve months for telcos and mobile operators to upgrade their networks to deliver higher speeds and twelve to twenty four months for new entrants like Google and municipal broadband operators."* While there are situations in which a current competitor to New Charter that has already installed fiber infrastructure can boost the speeds it can deliver rapidly, as cable operators upgrading to DOCSIS 3.0 and 3.1 on their existing HFC (hybrid fiber cable networks) have been able to, and can do once new standards and equipment meeting them becomes available, it is nonsense to suggest or estimate that deploying a fiber access network on any substantial scale (new or to replace or add to an existing copper telephone wire infrastructure) can be completed in such a short period. For different and often spectrum- and site-related reasons (and although as discussed below this is not otherwise relevant to an analysis of cable operators' markets since they are not and cannot be direct competitors to cable broadband services in most demographic circumstances) the significant network capacity upgrade programs of mobile operators also typically involve multi-year programs.

Charter is reiterating the same tired and discredited myth that as a fixed broadband provider it faces competition from wireless or mobile broadband services among other choices that customers can make[32], or switch to if dissatisfied with their cable broadband provider[33]. It lumps in a fixed wireless newcomer – Vivint Wireless – with mobile LTE networks. It provides no evidence or analysis of whether or to what extent a fixed wireless service such as Vivint will be able to serve substantial

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[32] Martyn Roetter, "The Top Ten Myths Major Broadband Providers Use Against Net Neutrality," July 30, 2014, Bloomberg BNA Daily Report for Executives; relevant discussions of the role and limitations of wireless networks can also be found in Andrew Odlyzko's paper, "Will smart pricing finally take off?" p.25-26, available at http://oai.dtic.mil/oai/oai?verb=getRecord&metadataPrefix=html&identifier=ADA613589

[33] Charter Opposition, p. 37-38, ibid.

numbers of customers competitively especially in denser urban and suburban areas, based on the frequencies, their propagation characteristics and economics and total capacity at its disposal and its network economics. In the context of mobile networks New Charter makes no reference to the (for its purpose inconvenient) fact that most traffic involving mobile devices does not go over RANs (radio access networks) but over links that are connected to fixed broadband facilities and do not traverse the mobile networks that would otherwise be hopelessly congested[34]. Nor does it mention that the use by consumers of mobile networks for real-time access to video services such as Netflix is economically prohibitive as well experientially undesirable given the costs per GB they would incur compared to the prices charged for fixed broadband access and the inherently greater fluctuations during a session in the capacity of a wireless connection compared to a fixed link[35]. According to Cisco[36] in 2014 mobile data traffic accounted for only 4% of total global IP traffic and although growing more rapidly than traffic over fixed facilities it will still only amount to 12% in 2019.

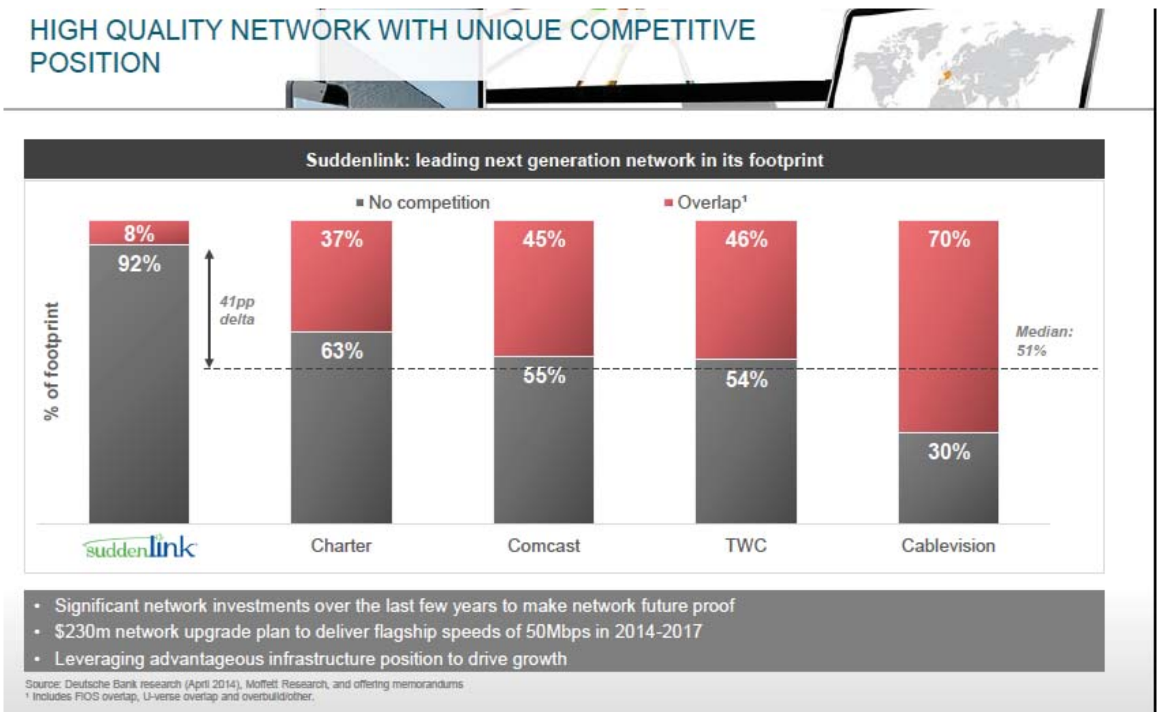
It is regrettable that while the Applicants make use of economists to support their case they do not apparently refer to sources of wireless and network engineering expertise who would be able to explain to them why mobile broadband services are not effective or even reasonable substitutes for modern fiber-intensive fixed broadband services in an era of increasingly bandwidth-intensive video and other services and applications. Customers desire and need both fixed and mobile broadband services to satisfy all their requirements and expectations wherever and whenever they want online connectivity. **Fixed and mobile services are therefore more complementary to each other than substitutable or competitive.**

Many locations and hence customers face a choice today that is limited to only one or at most two providers of fixed broadband services at speeds that are in the 20-25 Mbps range and above, and hence capable of handling increasingly bandwidth-intensive video and other services and applications. As Charter says correctly the situation is very dynamic, so today's advanced capabilities rapidly become tomorrow's standard or even minimum acceptable speed. The number of such providers accessible in any location is not going to increase as incumbent telephone companies upgrade or replace their traditional access infrastructure with all-fiber or more fiber-intensive connections, although it will establish a duopoly in place of a cable monopoly in some locations. Only new entrants such as Google, which has not given any indication that it will come close to matching the coverage of cable networks in the foreseeable future and/or municipal fiber networks that are also for

[34] The CTIA reports that in 2014 57% of mobile data traffic in the US was offloaded, up from only 8% in 2010 - http://www.ctia.org/docs/default-source/default-document-library/062115mobile-data-demands-white-paper.pdf
[35] Many contracts for mobile services include overage charges once a prescribed volume of data usage is exceeded.
[36] http://www.cisco.com/c/en/us/solutions/collateral/service-provider/ip-ngn-ip-next-generation-network/white_paper_c11-481360.html

the foreseeable future likely to be very limited in number, may increase the number of fixed broadband alternatives for a consumer in a location from two to three.

Evidence to support the contention that the US broadband market in which cable operators collectively have the largest market share (and Comcast the largest individual share) is found in the presentations by the Netherlands-based Altice (whose current major properties are in France) about its proposed acquisitions of the cable operators Suddenlink and Cablevision that are also pending. Both the content and tone of these presentations to the investment community demonstrate that Altice perceives this market in the US as uncompetitive and lightly regulated compared to the other countries where it operates, and hence as ripe for its exploitation with ruthless cost cutting and pricing practices that are not consistent with the public interest and will be harmful to consumers. One chart is particularly revealing in this regard, as reproduced here:



Source: Altice presentation "Altice enters US Market with acquisition of Suddenlink," page 7, http://altice.net/wp-content/uploads/2015/05/2015-05-20-Suddenlink-IR-presentation-FV.pdf

As Free Press has pointed out[37] , in 2011 John Malone acknowledged that the US broadband market is uncompetitive (in many places a "cable monopoly") and pointed to the limitations of wireless broadband as a substitute for fixed broadband. This acknowledgment provides further confirmation from a key player in the proposed New Charter of the validity of the findings of the preceding discussion. Circumstances in this regard have not changed materially since that time, even if John Malone has somewhat changed his tune to paint a picture of a more competitive broadband market by suggesting that cable does compete with DSL and not just with fiber-based access networks[38].

The critical importance of basing the answer to the question of whether the fixed broadband market is competitive or not on evidence instead of misleading analyses of the capacity of allegedly competitive wireless services and unsupported implications of the foreseeable coverage of and prospects for new entrants is starkly illustrated in the Free State Foundation's (FSF) filing on the New Charter transaction[39]. The FSF filing begs this fundamental question, although it neither recommends approval or rejection of New Charter, but nevertheless primarily presents reasons in favor of the former outcome. It does so by making an assertion and building its case on a premise that is unsupported and in fact untrue, on which the validity of its insights into the way this merger should be evaluated is entirely dependent. Unless this premise is valid and accepted the FSF'S insights have no value. FSF's premise is that all the market places in which New Charter would or might be involved and Charter already is – "digital, IP-enabled, cross-platform services such as wireline and wireless broadband Internet access services as well as multichannel video program distributor (MVPD) services" – are dynamic and competitive, and customers have ample competitive choices of provider.

This premise is demonstrably false where fixed broadband access services are concerned. To reiterate, many customers or households have access to one or only two providers of adequate fixed broadband services, particularly at speeds of 20-25 Mbps and above, and wireless broadband is not an adequate or effective substitute for fixed broadband. Hence the FSF's conclusion that, "---*any Commission intervention be based on a compelling evidentiary showing that competition will somehow fail to protect consumers*," is meaningless because there is insufficient competition already to protect consumers, let alone if in future a more powerful New Charter is created.

Charters' and its supporters' contentions about the competitive dynamics of the broadband market are founded on several incorrect assertions and misleading discussions whose significance is easily misinterpreted. In particular Charter refers

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[37] Free Press Petition to Deny, Comments of John C. Malone, Chairman, Liberty Media Corp. Capital, Q1 2011 Earnings Call (May 6, 2011), footnote 21, ibid.
[38] Comments of John C. Malone, Chairman, Liberty Media Corporation, at the Liberty Media Corporation Annual Shareholder Meeting (June 2, 2015).
[39] Randolph May, http://apps.fcc.gov/ecfs/document/view?id=60001328975

to a forecast that the majority of video viewed on the Internet will be delivered on mobile devices. Even if this forecast turns out to be true (it is not the case today) it does not mean that the majority of videos viewed on these devices will be delivered over mobile or wireless networks, for the reasons given above. Mobile devices are dual-mode, e.g. they include built-in Wi-Fi that connects directly to a fixed broadband connection as well as having cellular connectivity. Mobile customers are increasingly encouraged to use the non-cellular or non-mobile connection when available, not only because it will usually offer a more reliable channel, but also because its use does not contribute to the volume of traffic that counts towards a mobile customer's data cap which triggers additional charges once it is exceeded. Charter's failure to explain the distinction between a mobile device, or the content that may be viewed on it, and the channels over which this content may be delivered – both fixed and mobile – is not helpful to the reader who is not necessarily familiar with these devices, their capabilities and the networks they connect to and is trying to evaluate the merits of the evidence and competing arguments being presented by proponents and opponents of New Charter[40].

6. An Independent Time Warner Cable: A Better Scenario than in New Charter

Among the points raised by Charter to indicate the benefits from its proposed acquisition of TWC for the areas and customers served by TWC are that New Charter will[41]:

- Bring TWC's outsourced customer call center jobs back to the US (TWC having no plans to do so);
- Increase the size and speed of investments to transition TWC systems to all-digital networks, and deliver higher speeds and expand coverage, including for enterprise customers;
- Exploit economies of scale benefits that will be passed on to customers through more competitive fees;
- Introduce innovations (e.g. "Internet of Things" Services) that TWC alone is too small to undertake on its own;
- Extend Charter's commitments regarding interconnections and adherence to Open Internet rules to TWC franchises.

[40] It is unclear whether New Charter is genuinely confused about the difference between a device on which content is viewed and the network over which content is delivered to the device which, even if characterized as "mobile", can also access (dual-mode) a fixed service. A harsh assessment of this omission by New Charter is that by using this language it may be hoping that many readers will automatically and incorrectly assume that anything viewed on a mobile device must have been transmitted to it on a mobile or wireless network, and hence majority viewing is the same as majority networking, i.e. it is expected that mobile networks will in future carry more traffic than fixed access facilities and hence Charter's claim that they are becoming substantial competitors to fixed cable broadband services is justified.

[41] Applicants Public Interest Statement, ibid; Charter Opposition, ibid. and Economists Declarations, ibid.

However this picture of unalloyed transaction-specific benefits for TWC's franchise areas ignores the capabilities and resources of a TWC that remains independent from Charter and could – and should – apply its efforts differently than in the recent past without having to cope with the risks inherent in the large debt load that will limit what New Charter will be able or decide to do in its acquired TWC properties. All the benefits listed above are achievable without the merger and hence are not transaction-specific. They may even be greater in some instances in the context of an independent TWC that is not focused on maximizing the price a buyer will have to pay in order to acquire it.

Most notably TWC has a recent history of substantial share buybacks[42]. These buybacks totaled $7.7 billion between 2010 and February 2014[43] at which time the repurchase program was suspended when TWC entered into a Merger Agreement with Comcast. In 2013 TWC's share repurchases amounted to 100.5% of its free cash flow in that year.[44] TWC has been trying to be acquired and share buybacks are one means to maximize the acquisition price.

Charter's claim that TWC's lack of scale has therefore limited its investments and ability to innovate is nonsense. TWC's management has consciously chosen not to make additional investments to transition more rapidly to an all-digital network and offer higher speeds, and not to devote resources to the pursuit of innovations that will create value for customers. Instead TWC's management decided to devote billions of dollars to share buybacks that contribute nothing to these goals. Alleged restraints from a lack of scale are not a plausible explanation for TWC's decisions in recent years. There is no reason why an independent TWC not pursuing a goal to be acquired for the highest possible price should not be able to do at least as much if not more as New Charter is saying it will do, and moreover without the risks inherent in the much larger debt load that the latter would be carrying.

There are also no reasons why TWC should not decide to close its outsourced customer care centers and bring the jobs back to the US. If this is a good idea, as Charter argues, then it makes sense for an independent TWC to do the same. While if reducing or eliminating outsourcing is a bad idea (because it will entail higher costs with no or insufficient increase in quality) then New Charter will only be creating more trouble for itself and an independent TWC with its customer care centers in their current configurations will be better off than if it is merged with Charter. Furthermore there is nothing stopping TWC from making comparable and potentially even greater commitments on matters such as interconnection agreements and adherence to Open Internet rules as Charter has announced.

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[42] http://www.fool.com/investing/dividends-income/2014/10/22/why-time-warner-cables-share-buybacks-are-so-smart.aspx;

[43] TWC Annual Report for 2014, http://d1lge852tjjqow.cloudfront.net/CIK-0001377013/3fbb7bdd-36be-4b72-9c97-7ac051c702f9.pdf

[44] http://ir.timewarnercable.com/files/2015/3Q15/TWC-Trending-Schedules-Q3-2015-FINAL.PDF

The subtext behind much of this discussion is Charter's implication that in multiple respects the problem or obstacle preventing TWC from becoming a better, more customer-responsive and socially responsible corporation (in addition to unjustifiably blaming a lack of scale) is its current management that will no longer be in place post-merger.

Interestingly in January 2014, shortly after its current CEO assumed this position after a 16 year long career at the company, most recently as its COO and President, TWC published a presentation comparing itself favorably to Charter[45]. TWC described itself as follows: *"TWC is Better Positioned than Charter, reflecting years of Innovation and Investment."* A reasonable question to ask is whether TWC still holds this opinion. If its assessment is valid then TWC's own leadership (key members of which will be handsomely compensated if the New Charter transaction is consummated), does not believe in the claim, and the justification for its acquisition, that Charter's management will deliver benefits to its customers that TWC itself has been unable to provide.

If there have been shortfalls in what TWC might have accomplished to date, then as just shown it is its goal or ambition to be acquired that has significantly and harmfully distorted TWC's priorities so that it has been paying insufficient attention to customers and stakeholders other than shareholders. If the hope for an acquisition were to be laid to rest by rejection on solid grounds of an acquisition by Charter following the abandonment of the earlier merger agreement with Comcast, the priorities of TWC's management should become rebalanced along lines that are more beneficial for customers and the public interest.

In other words not only are the benefits claimed for the New Charter merger dubious, risky and definitively not transaction-specific, but these benefits are realistically more achievable and hence properly viewed as being *specific to rejection of the transaction*.

7. Bright House Networks (BHN) – Not Broken or Needing a New Charter Fix

The smallest component of the proposed New Charter – BHN – has a long history with TWC, which has a long-standing deal to handle Bright House's cable programming and technology purchases. Publicly available information about BHN, a private company, is limited. Nevertheless, reportedly[46] BHN is a *"flagship asset,"* that is characterized within the context of New Charter as:

- Largest cable operator in Tampa and Orlando – attractive, growing areas; both top 20 DMAs
- Best in class infrastructure – highly standardized, converged metro,

[45] http://ir.timewarnercable.com/files/4Q13/TWC_and_Charter_Comparison_vFINAL.pdf
[46] http://ir.timewarnercable.com/files/doc_presentations/2015/Charter-BHN-and-TWC-Public-Presentation-FINAL_v001_j73c9t.PDF

regional and backbone IP networks

• 99.5% of network ≥ 750MHz; first provider of all fiber Gigabit communities in Florida

• BHN customer satisfaction scores among the highest in the industry[47]

• 54% total customer relationship penetration and 39% residential triple-play penetration contributes to attractive cash flow profile.

BHN had revenues of $3.8 billion in 2014 (compared to $22.8 and $9.1 billion for TWC and Charter respectively) and its capital expenditures amounted to $600 million (compared to $4.1 and $2.2 billion for the other two components of New Charter). Notably whether or not GAAP or non-GAAP metrics are used, BHN's 2014 free cash flow was about 80% or more of Charter's despite the latter's substantially larger size in revenues and in customer base (6.2 versus 2.5 million).

Hence BHN along with its relationship with TWC would seem to be in a stronger position to continue to enhance its services and strengthen its business than if it is absorbed into a debt-burdened New Charter.

8. Two More Mergers and Deeper in Debt – The Soul of New Charter

As noted earlier the most comprehensive and compelling analysis so far of the specious nature of the benefits claimed for the formation of New Charter and of the absence of harm that will ensue for the public interest and consumers has been provided by Free Press.[48] This analysis places great emphasis on the consequences of the substantial increase in debt ($27 billion) that New Charter will incur to finance the transaction. The impact of the need to service this debt will strain and likely overwhelm the ability of New Charter to make the investments and improvements it touts, and fulfill the public interest obligations it is under, meet the commitments it has announced, and maintain the pricing levels and practices it refers to, i.e. to deliver the benefits it is asserting will ensue and avoid the harmful consequences it claims will not be experienced.

In its Opposition[49], Charter dismisses in less than two pages towards the end of this almost 100 page document the fundamental and far-reaching concern about the consequences of New Charter's huge debt load, under "Other Unrelated Conditions and Concerns." Yet the issue of debt leverage and its consequences is **the source** of justified skepticism or even alarm about the credibility of Charter's claims regarding the benefits and absence of harm associated with the formation of New Charter.

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[47] BHN ranks higher in Customer Satisfaction Indices than both Charter and TWC, with TWC most recently scoring the lowest among cable operators – more details on the Customer Satisfaction ratings of the Applicants and their implications are discussed in Section 9 and the Appendix

[48] Free Press Petition to Deny, ibid.

[49] Charter Opposition, p.81-82, ibid.

Charter *"expects"* that the great majority of its debt post-merger will be at a fixed rate insulating it from future rises in interest rates. However it is not clear exactly how much of its total debt may be vulnerable to such increases as a result both of a generally anticipated rise in financing costs over the next few years compared to the historic low levels that have prevailed over the past 7 to 8 years, and a possible downgrade of some portion of the debt New Charter would be carrying.[50]

Charter is "generous" in stating that New Charter's debt load will be $61.5 billion and its debt-to-EBITDA ratio as 4.5 whereas other independent sources project a debt that may reach around $65 billion or even higher, and that New Charter will be saddled with a debt-to-EBITDA ratio of just over 5. New Charter states that its pro forma interest payments will be $3.3 billion but it is unclear whether these payments could be higher and if so by how much, making it very difficult if not impossible for New Charter to meet all its promised commitments and obligations, *"enforceable"* and "*binding*" or not.

Charter is also being disingenuous in comparing New Charter's leverage measured as the debt-to-EBITDA ratio with that of Charter pre-transaction (it would on their calculation be only be about 10% higher – an increase of up to 25% might be the result of this calculation depending on final details of the debt), whereas a more significant comparison would be with TWC's leverage today since TWC is the largest component of the merged entity, with revenues about 2.5 times Charter's. As noted in Section 4 above TWC's debt-to-EBITDA ratio of below 3 is much lower than New Charter's would be.

In their annual reports or 10-K filings corporations list a number of risk factors that may adversely affect the future performance of their business. Companies in the same sector typically use very similar language in these warnings. The risk factors cover competition, financing issues, changes in customer demand etc. In the case of New Charter the risk factors related to financing warrant careful attention and should be ringing alarm bells. In its 2014 Annual Report Charter stated[51]:

"We have a significant amount of debt and may (subject to applicable restrictions in our debt instruments) incur additional debt in the future. As of December 31, 2014, our total principal amount of debt was approximately $21.1 billion, including $7.0 billion of debt for which proceeds are held in escrow pending consummation of the Transactions.

[50] https://www.moodys.com/research/Moodys-places-Time-Warner-Cables-Baa2-senior-unsecured-and-Prime--PR_326169

[51] Charter Communications 2014 10-K filing, February 24, 2015, p18, http://phx.corporate-ir.net/phoenix.zhtml?c=112298&p=irol-SECText&TEXT=aHR0cDovL2FwaS50ZW5rd2l6YXJkLmNvbS9maWxpbmcueG1sP2lwYWdlPTEwMDk1NTY5JkRTRVE9MSZTRVE9MjImU1FERVNDPVNFQ1RJT05fUEFHRSZleHA9JnN1YnNpZD01Nw%3d%3d

Our significant amount of debt could have consequences, such as:

- impact our ability to raise additional capital at reasonable rates, or at all;
- make us vulnerable to interest rate increases, because approximately 28% of our borrowings are, and may continue to be, subject to variable rates of interest;
- expose us to increased interest expense to the extent we refinance existing debt with higher cost debt;
- require us to dedicate a significant portion of our cash flow from operating activities to make payments on our debt, reducing our funds available for working capital, capital expenditures, and other general corporate expenses;
- limit our flexibility in planning for, or reacting to, changes in our business, the cable and telecommunications industries, and the economy at large;
- place us at a disadvantage compared to our competitors that have proportionately less debt; and
- adversely affect our relationship with customers and suppliers.

If current debt amounts increase, the related risks that we now face will intensify."

The vulnerability of the implementation of New Charter's plans[52], including the fulfillment of its commitments, to changes in the financing climate (interest rates have only one way to go – up) and to ongoing trends in the markets it serves is a critical issue. Charter's own forecasts and estimates cannot be taken on faith or blind trust. Charter has included multiple misrepresentations and distortions of the truth as well as omitted significant relevant facts in its advocacy for New Charter that have been identified in this report and in other critiques of New Charter.

The stakes and risks associated with New Charter, especially for the future development of a healthy broadband market in the US are enormous, since its combined franchise areas would cover about 40% of locations in the country. The substantial risk associated with New Charter is that its priorities will have to be skewed towards meeting its debt-related obligations at the expense of its other promises and commitments (*"enforceable"* and *"binding"* or not) to customers and to serve the public interest.

Moreover as also demonstrated in this report, the prospects for broadband in an alternative scenario with an independent TWC (and BHN with which TWC has a longstanding relationship) are more promising and less risky than the prospects for New Charter. The burden of proof that New Charter will deliver transaction-specific benefits and not cause harm that outweighs any plausible benefits rests with Charter. It has failed to make this case by a wide margin.

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[52] The commitments Charter has announced are described as "binding" and "enforceable." But there are no mechanisms in place to monitor how well New Charter will actually respect these commitments, or to enforce them in the event that New Charter does neglect or renege on its promises, and apply specified penalties sufficiently large to act as deterrents against such behavior.

9. Implications of Cable Operators' Record of Customer Satisfaction

There is ample evidence (see Appendix) that broadband operators as a category have over many years been rated lower than other sectors of the economy in terms of customer satisfaction. Moreover, within this category cable operators achieve lower scores than telephone companies, and their scores have tended to decrease in recent years.

The persistently poor records of cable operators in the results of customer satisfaction surveys, compared to other network operators and to companies in other sectors of the economy, are consistent with the characterization of the broadband market they are serving as uncompetitive. The lack of competition in this market is particularly worrisome because it is delivering a service that has become an indispensable underpinning for customers in their daily lives and long-term aspirations - economically, socially and personally. Many of them have no choice but to put up with whatever their monopoly or duopoly provider chooses to offer under whatever terms and conditions are applied at the provider's discretion.

If the broadband market were competitive then it would have been expected that one or more of the cable operators would have invested to improve their customer care and service substantially – an "uncable" strategy – in order to differentiate themselves positively from competitors and thereby gain market share at the latter's expense. Instead the two largest cable operators – Comcast and TWC – have preferred to spend billions of dollars on share repurchases,[53] despite their appalling reputations which they obviously believe does not have a material negative impact on their bottom line[54]. Even among cable operators these two largest companies score relatively poorly (among the worse of the worst), indicating that greater scale, despite what Charter implicitly claims, does not guarantee improved performance.

One condition related to customer satisfaction with cable companies is their use of arbitration clauses in the contracts their customers are offered, which many consumers most likely do not appreciate until and unless they have a dispute with their cable provider that they try to resolve. The attitudes and behavior of cable (and telephone) operators (among other companies) towards their customers is a cause for significant and growing concern, as these services providers have been trying to severely limit the latter's rights, e.g. through the imposition in their customer contracts of the compulsory use of arbitration[55] in the event of disputes

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[53] As already noted TWC's share repurchases have amounted to $7.7 billion since 2010, while Comcast spent over $21 billion on share buybacks from 2006 through 2014 (source: Comcast financial reports and analysis by MFRConsulting)

[54] BHN typically scores higher than Charter and TWC in customer satisfaction while in the latest surveys TWC has achieved the distinction of tying for last place among the cable operators covered in the survey.

[55] "Arbitration Everywhere, Stacking the Deck of Justice," http://www.nytimes.com/2015/11/01/business/dealbook/arbitration-everywhere-stacking-the-deck-of-justice.html?ref=business; Time Warner Cable is one example referred to in this article. An

between the services provider and their customers. Limitations of consumers' rights are particularly troublesome in markets such as broadband access where consumers have no or few alternative suppliers to turn to. The practice of compulsory arbitration is a sector-wide and not a company-specific phenomenon. Individual consumers other than multimillionaires and billionaires have no effective negotiating power or resources to sustain claims against multibillion dollar corporations determined to prevent the establishment of any precedents to limit or reject whatever steps they may wish to take at their sole discretion.

Clauses in customer contracts should be scrutinized and addressed as a matter of regulatory policy by the FCC in cooperation with the FTC (Federal Trade Commission), and in particular in the course of reviews of transactions that these services providers present for approval, where the regulators may have more leverage to influence their future behavior. These clauses, while they may not be illegal are indicators of how cable and other operators treat customers, particularly individual consumers who inevitably have few resources to marshal against multibillion corporations on their own without strong countervailing influences that they can count on, such as from regulation.

Admittedly it can and no doubt will be argued that the question of arbitration clauses is irrelevant in a review of the New Charter proposal. All the cable operators involved already use them so the formation of New Charter will change nothing in this respect. However their use is relevant as an indicator of the credibility of, or justifiable lack of confidence in the promises and commitments proclaimed by Charter on behalf of a future New Charter, namely that it will operate and be obliged to act in the interests of consumers by "market forces" and their financial incentives. These proclamations are belied by the use of procedures such as arbitration that deprive consumers of substantial rights in the event of disputes.

Moreover, the widespread use of an arbitration clause in cable operators' consumer contracts is an example (an "industry practice") of tacit collusion that requires no inter-company mechanism in order to be established and remain effective. In an uncompetitive market such as broadband it is easy for companies to end up in the same place in many (not all) respects simply by monitoring and observing each other's practices. As long as for example two fixed broadband providers in an area are doing well, and there are no realistic prospects for disruptive entrants, then they have an incentive not to rock the boat, or to limit the intensity of their rocking, by avoiding the introduction of differentiating or disruptive innovative initiatives that may benefit customers, but may also put pressure on their margins.

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arbitration clause is included in all the consumer contracts of the Applicants (Charter, TWC and BHN, see (all accessed on Nov. 2nd, 2015): http://help.twcable.com/twc_sub_agreement.html; https://www.charter.com/browse/content/services#terms; http://brighthouse.com/policies/policies/residential-agreement.html

10. Other Issues

10.1 PEG Programming Claims

Charter dismisses concerns about alleged failures to live up to its PEG commitments by stating (Charter Opposition, p. 87-88) that, "*If petitioners believe that Charter has not met its PEG obligations under those agreements they have adequate recourse through local franchise negotiations and enforcement of franchise agreements.*"

This statement cries out for answers to the following questions:

- What financial incentives are there for a regionally concentrated New Charter to employ "whipsaw" tactics in negotiations with individual local franchises in a region and how will its actions be influenced by these incentives?

- Is it possible for example that the extent and/or timing of investments within a region or the location of a new customer care center (job creation) within one franchise area rather than another might be influenced by differences in the costs to New Charter of the obligations that are negotiated in these franchises?

- Is it likely that vast asymmetries in the resources and relevant information available to New Charter as compared to many local franchise authorities will play a role in the outcome of these negotiations?

- What do economists and experience tell us about the risks and potential market failures associated with asymmetric negotiations?

10.2 Low-Income Households

Charter says it is making an "*enforceable commitment*" to provide a broadband offering that will be attractive and affordably priced throughout its footprint within three years of closing. The words are fine, but the descriptor "*enforceable*" raises several questions about its meaning in practice:

- Will evidence be provided from independent sources that this commitment has been and is being fulfilled?
- What procedures will be used for investigating whether New Charter has failed to meet this commitment during and then after the three years?
- What incentives to encourage New Charter to over deliver with respect to, and what penalties to discourage neglect of this commitment are or will be in place and how will they be applied?

11. Conclusion

The case against New Charter is robust. Its claims of transaction-specific benefits are at best unsupported and at worst demonstrably false. Its dismissal of concerns about the harm that will ensue requires a suspension of disbelief about its narrative that downplays any risks or foreseeable adverse consequences of the huge debt it will be carrying. Moreover Charter's and its supporters' statements are tarnished with several misleading and demonstrably incorrect assertions. In addition there are large gaps or holes in their depiction of a broadband future with New Charter because they ignore a substantial body of evidence that contradicts their findings and points to an alternative scenario with a better foreseeable outcome for the public interest and consumers.

The proponents of New Charter have failed to produce solid evidence and credible objective analyses to meet the requirements for approval of its formation. Furthermore this report has explained how an alternative scenario in which TWC and BHN will remain independent from Charter will produce superior outcomes for customers and for the purposes of public policy, in particular for the future health of critical broadband infrastructure and services. The transaction-specific benefits associated with New Charter are paradoxically dependent upon its rejection, not its approval, in order to stimulate the leadership of TWC (and BHN) to concentrate on customers and other stakeholders instead of lopsidedly focusing on maximizing the price they can obtain from a buyer.

Appendix: Customer Dissatisfaction

The following two charts are the extracts from the American Customer Satisfaction Survey, 2014, reproduced at *http://arstechnica.com/business/2014/05/comcast-time-warner-cable-still-have-the-angriest-customers-survey-finds/* . The maximum score is 100.

Source: American Customer Service Satisfaction Index, 2014, reproduced at http://arstechnica.com/business/2014/05/comcast-time-warner-cable-still-have-the-angriest-customers-survey-finds/

Internet Service Providers ACSI Scores			
Company	**2013**	**2014**	**% Change**
Internet Service Providers	**65**	**63**	**-3.1%**
Verizon Communications (FiOS)	71	71	0%
AT&T (U-verse)	65	65	0%
CenturyLink	64	65	2%
All Others	71	65	-8%
Cox Communications	68	64	-6%
Charter Communications	65	61	-6%
Comcast	62	57	-8%
Time Warner Cable	63	54	-14%

Even more recent information confirming the continuing poor (and even deteriorating) performance of US cable operators in satisfying customers can be found at:

http://cabletv.com/blog/2015-tv-customer-satisfaction-industry-survey/;

http://bits.blogs.nytimes.com/2015/06/02/customer-satisfaction-with-tv-internet-and-phone-service-at-7-year-low-study-finds/?em_pos=large&emc=edit_nn_20150602&nl=nytnow&nlid=70137876&_r=1;

http://www.theacsi.org/news-and-resources/press-releases/press-2015/press-release-telecommunications-and-information-2015