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January 29, 2016

VIA ECFS

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Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

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

Dear Ms. Dortch:

This letter responds to the recent report submitted by INCOMPAS's economist, David S. Evans.[1] Although Dr. Evans's report is lengthy, the required response is short and simple.

First, Dr. Evans's arguments about programming price harms are incorrect. He claims that lower programming prices for New Charter are harmful price increases for programmers. But this argument is contradicted by the FCC's recent decision in the AT&T/DirecTV merger, which found that lower programming prices are in fact a merger benefit because they benefit consumers.[2] Dr. Evans presents absolutely no evidence that any change in programming prices is anticompetitive or harmful to programmers—in fact, he goes out of his way to say that he is

[1] Declaration of Dr. David S. Evans, Chairman of Global Economics Group, LLC (Jan. 15, 2016) (attached to Letter from Markham C. Erickson to Marlene H. Dortch, Secretary (Jan. 15, 2016)) ("Dr. Evans Decl.").

[2] *Applications of AT&T Inc. and DirecTV For Consent to Assign or Transfer Control of Licenses and Authorizations*, Memorandum Opinion and Order, 30 FCC Rcd 9131, 9243 ¶¶ 290-291 (2015).

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not asserting that the applicants have engaged in anticompetitive conduct "or would do so following the Transaction."[3]

He nonetheless tries to suggest competitive implications by discussing a *different* aspect (interconnection) of a *different* deal (the proposed Comcast-TWC merger). But whatever the merits of the regulators' view in that case, Comcast would have provided over 54% of broadband service over 25/3 Mbps.[4] Here, New Charter will represent only 17% of the relevant market: MVPD service.[5] No one can seriously contend this share is anticompetitive when the D.C. Circuit has twice rejected a 30% cap,[6] and New Charter will be smaller than other MVPD and broadband providers.

In any event, adding Charter to the current purchasing of Time Warner Cable/Bright House Networks represents a scant 4% of the MVPD marketplace.[7] While that additional volume will bring a modest benefit to New Charter, it is small compared to the 100 million MVPD home marketplace, which AT&T and Comcast will continue to dominate. Not surprisingly, no major programmers—which have enjoyed nearly double digit price increases for the past decade[8]—have submitted comments complaining about the effect of this transaction on programming prices.

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[3] *See* Dr. Evans Decl. ¶ 21 n.16.

[4] *See Applications of Comcast Corp., Time Warner Cable Inc., Charter Commc'ns, Inc., and SpinCo to Assign and Transfer Control of FCC Licenses and Other Authorizations*, Opposition to Petitions to Deny and Response to Comments, MB Docket No. 14-57, 147 n.454 (Sept. 23, 2014) (Comcast held 54.2% of nationwide 25/3 Mbps subscribers at the time of filing).

[5] *See Application of Charter Communications, Inc., Time Warner Cable Inc., and Advance/Newhouse Partnership For Consent to the Transfer of Control of Licenses and Authorizations*, Public Interest Statement, MB Docket No. 15-149, at 55-56 (July 25, 2015). New Charter will also serve only approximately 23% of 25/3 Mbps or above broadband subscribers.

[6] *See id.* at 56 (citing *Comcast Corp. v. FCC*, 579 F.3d 1 (D.C. Cir. 2009); *Time Warner Cable Entm't Co., L.P. v. FCC*, 240 F.3d 1126, 1136 (D.C. Cir. 2001)).

[7] *Application of Charter Communications, Inc., Time Warner Cable Inc., and Advance/Newhouse Partnership For Consent to the Transfer of Control of Licenses and Authorizations*, Opposition to Petitions to Deny and Reply to Comments, MB Docket No. 15-149, at 59 (Nov. 3, 2015).

[8] *Id.* at 58.

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Second, Dr. Evans is wrong about the implications of these modest price reductions for broadband competition. He argues that customers will not buy broadband without video, that New Charter's lower programming prices will make its prices lower than some other companies', and that this price gap will deter broadband investment. This argument, however, confuses creating a stronger competitor with harm to competition. Lower prices for consumers are a merger *benefit*, as the Commission just affirmed in *AT&T/DirecTV*.[9]

Dr. Evans also fails to demonstrate a central assumption of his theory—that broadband providers cannot be successful without also offering a video product. Indeed, he discusses clear cases in which broadband providers *are* successful without offering a video product.[10] This is consistent with Charter's experience—approximately **[BEGIN HIGHLY CONFIDENTIAL INFORMATION] [END HIGHLY CONFIDENTIAL INFORMATION]**of Charter's residential subscribers do not subscribe to video.

The attached report of Dr. Michael Katz provides additional detail regarding the economic aspects of some of these arguments.

Please contact me if you have any questions regarding these matters.

Sincerely,

/s/ John L. Flynn

John L. Flynn
Counsel for Charter Communications, Inc.

cc: Vanessa Lemmé

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[9] *See* n.2, *supra*.

[10] *See* Dr. Evans Decl. ¶ 78 & n.79 (discussing PenTeleData and Harbor Communications, two fiber providers who do not offer video).

CHARTER-TWC-BHN:
A RESPONSE TO DR. EVANS

Surreply Declaration of
Michael L. Katz

January 29, 2016

CONTENTS

I. INTRODUCTION AND OVERVIEW

1. Charter Communications, Inc. ("Charter"), Time Warner Cable Inc. ("TWC"), and Advance/Newhouse Partnership have requested the consent of the Federal Communications Commission ("Commission") to approve the transfer of licenses and authorizations in conjunction with the merger of Charter, TWC and Advance/Newhouse Partnership's subsidiary, Bright House Networks ("BHN"), to create "New Charter."[1]

2. At the request of counsel for Charter, I conducted a quantitative assessment of the consumer benefits that will result from programming cost savings that the proposed transactions will enable.[2] As part of that assessment, I reviewed various claims made by opponents to the proposed transactions with respect to the likelihood that programming cost savings would be realized and the degree to which consumers would benefit from these savings.[3,4] In an earlier declaration, I summarized the findings of my assessment.[5]

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1 *Application of Charter Communications, Inc., Time Warner Cable Inc., and Advance/Newhouse Partnership for Consent to Transfer Control of Licenses and Authorizations*, MB Docket No. 15-149, June 25, 2015.

2 Because BHN systems purchase most of their video programming through contracts negotiated with programmers by TWC, in what follows, I will generally refer to TWC and BHN systems collectively as TWC systems to streamline the exposition.

3 For a list of the filings on which I focused, see Reply Declaration of Michael L. Katz, November 2, 2015 (hereinafter *Katz Reply*), footnote 3.

4 I also reviewed the opponents' arguments regarding competitive effects of certain terms in Charter's and TWC's programming contracts (*i.e.*, most-favored nation ("MFN"), windowing, and alternative distribution means ("ADM") provisions).

5 *Katz Reply*, Exhibit B to Opposition to Petitions to Deny and Response to Comments, MB Docket No. 15-149, November 2, 2015.

3. I have subsequently been asked by counsel for Charter to review an economic report by Dr. David Evans and associated pleadings in order to determine whether these filings provide a basis for amending or reversing the conclusion that the proposed transactions will generate substantial consumer benefits as the result of programming cost savings.[6] In short, they do not.

4. Based on my review of these filings—as well as my review of earlier comments and petitions to condition or deny the proposed merger, my review of the relevant economic literature, application of relevant economic principles, and analysis of the empirical evidence—I continue to conclude that the proposed transactions will allow New Charter to realize lower marginal costs of video programming, particularly for legacy Charter systems,

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[6] Specifically, I address the following filings: Reply of INCOMPAS, *In the Matter of Applications of Charter Communications, Inc., Time Warner Cable Inc., and Advance/Newhouse Partnership for Consent to Transfer Control of Licenses and Authorizations,* MB Docket No. 15-149, November 12, 2015 (hereinafter *INCOMPAS Reply*); Letter from Markham C. Erickson, Counsel for INCOMPAS, to Marlene H. Dortch, Secretary, Federal Communications Commission, *Re: Notice of Ex Parte Presentation, 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, December 4, 2015 (hereinafter *INCOMPAS Notice of Ex Parte Letter*); and Letter from Markham C. Erickson, Counsel for INCOMPAS, to Marlene H. Dortch, Secretary, Federal Communications Commission, *Re: 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, January 15, 2016, including Dr. David S. Evans, "Economic Analysis of the Impact of the Proposed Merger of Charter, Time Warner Cable, and Bright House Networks on Video Programming Prices and Broadband Entry and Competition – Evans Declaration I," January 15, 2016 (hereinafter *Evans Report*).

These filings contain numerous opinions and statements. My present declaration is intended to cover all of the major categories of economic assertions in these filings relevant to assessing the consumer and efficiency benefits of programming cost savings. Any silence with respect to a particular empirical or theoretical claim stated should not be interpreted as agreement with that claim unless I specifically state such an agreement.

and that these merger-specific, marginal cost savings can be expected to benefit consumers by generating economic incentives for the combined firm, as well as rival service providers, to offer lower quality-adjusted prices[7] for their video services than they otherwise would.[8]

5. Specifically, I find that:

- *Dr. Evans agrees that the proposed transactions will give rise to merger-specific savings that will be passed through to consumers.*
    - — *The projected savings are merger specific.* As do I, Dr. Evans concludes that the proposed transactions will generate merger-specific reductions in programming licensing fees. By contrast, INCOMPAS (formerly COMPTEL) asserts that the programming cost savings are not merger specific because they allegedly could be achieved through a buyer cooperative. This conflict between INCOMPAS and its economic expert illustrates the incoherence of INCOMPAS's advocacy.
    - — *The projected programming cost savings will be substantially passed through to consumers.* Dr. Evans admits that pass through will occur but

7 It is important to consider quality-adjusted prices because price changes that are unadjusted for quality changes may not give an accurate picture of consumer-welfare effects. For example, even if the nominal price of a service rises, its quality-adjusted price will fall if consumers gain additional value from an expanded channel lineup or superior programming that exceeds the nominal price increase.

8 To be clear, the programming cost savings will be unlikely to reverse the tide of rising overall programming costs due to general industry trends. Nonetheless, consumers will benefit from the cost savings because quality-adjusted prices for video services will rise more slowly than they would in the absence of the proposed transactions.

expresses concerns about its degree. One of his main arguments appears to be that the world is complex and certainty is difficult to achieve, which does not contradict the fact that the degree of pass-through is very likely to be substantial. Another of his principal arguments appears to be the claim that New Charter will pass savings through to consumers only where it faces competition in the provision of broadband Internet access service ("BIAS"). If so, his claim is inconsistent with fundamental economic principles, and he offers no empirical evidence to support his claim.

- *Dr. Evans provides no valid basis for asserting that the programming cost savings will harm consumers or competition.*

  — *Dr. Evans provides no evidence that the projected programming cost savings will arise from harm to competition.* Dr. Evans offers no limiting principle for determining when a source of competitive advantage should be considered to be anticompetitive. Absent such a principle, one might well conclude that competition in BIAS provision is harmed by the fact that Google Fiber and Google's Internet search and YouTube services have the same corporate parent, Alphabet, Inc., because common ownership of these complementary services makes Google Fiber a more formidable BIAS competitor, which might dampen rivals' investment incentives.[9] But instead

9 For example, from Alphabet's perspective, it might even be profitable to price Google Fiber's BIAS offerings below cost in order to stimulate consumption of the complementary services.

of attacking this complementarity, a sounder approach is to recognize that cost savings generally promote competition unless they are obtained through anticompetitive means. Notably, there is no evidence that the proposed transactions' programming cost savings will arise from harm to competition.

— *Dr. Evans provides no evidence that the pass through of projected programming cost savings will substantially reduce BIAS provider entry and investment.* Although INCOMPAS's members presumably possess relevant data and documents, neither Dr. Evans nor INCOMPAS provide or cite data, profitability analyses, or any other relevant business documents in support of their claims regarding the effects of the proposed transactions on other firms' decisions to invest in BIAS provision.

— *Although Dr. Evans invokes the terminology of two-sided markets, he fails to recognize one of the most fundamental principles of two-sided markets.* Dr. Evans fails to recognize that, in two-sided markets, the *structure* of prices—as well as their overall level—matters for consumer welfare and efficiency. Given the nature of contracting institutions in the video programming marketplace, the marginal cost savings (and the associated change in the structure of the two-sided prices associated with MVPD platforms) can be expected to *increase* the consumption of video services, all else equal. In the light of the fact that the social marginal cost of another viewer's receiving video content is near zero, this increase in output corresponds to both a consumer benefit and an efficiency gain.

— *Dr. Evans is doing no more than asserting that increased competitive pressures constitute harm to competition.* In summary, the core of Dr. Evans's and INCOMPAS's objection to the proposed transactions is that New Charter will be a stronger competitor and offer more attractive services to consumers. It is not surprising that those members of INCOMPAS competing with New Charter would prefer that it have less—rather than more—attractive offerings even though the more-attractive offerings will benefit consumers.

6. The remainder of this declaration explains these findings in greater depth and describes the facts and analyses that led me to reach them.

II. CONSUMERS WILL BENEFIT FROM MERGER-SPECIFIC PROGRAMMING COST SAVINGS.

7. In my earlier declaration, I calculated that New Charter's subscribers can be expected to realize initial savings of **[BEGIN HIGHLY CONFIDENTIAL INFORMATION]{{**[redacted]}}**[END HIGHLY CONFIDENTIAL INFORMATION]** per year as a result of the proposed transactions' programming cost savings alone.[10] Dr. Evans also concludes that the proposed transactions will generate merger-specific reductions in programming licensing fees, but he questions the magnitude of the pass-through rate and argues that New Charter would engage primarily in targeted price reductions to limit local

10 *Katz Reply*, ¶ 65 as corrected in "Programming Costs Savings – Updated – DOJ PRODUCTION.xlsx."

competition.[11] By contrast, Dr. Evans's client, INCOMPAS, argues that the programming cost savings are not merger-specific.[12] In this section, I show that, in addition to contradicting one another, Dr. Evans and INCOMPAS make arguments that lack logical and/or factual bases.

A. THE PROPOSED TRANSACTIONS WILL GIVE RISE TO MERGER-SPECIFIC PROGRAMMING COST SAVINGS.

8. In my earlier declaration, I demonstrated that the proposed transactions will reduce the merging parties' marginal costs by generating programming cost savings that could not be realized absent the proposed transactions.[13]

9. Dr. Evans agrees that the proposed transactions will lead to significant programming cost savings,[14] but INCOMPAS attempts to deny that the programming cost savings are merger specific.[15] In doing so, INCOMPAS contradicts itself—in addition to Dr. Evans. It does so by making two incompatible arguments, each of which is critically flawed. Although it asserts that New Charter's obtaining lower programming prices is *not merger specific,* INCOMPAS (as does Dr. Evans) also asserts that the proposed transactions are harmful precisely because they will give rise to *merger-specific* reductions in the programming prices

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11 *Evans Report,* ¶¶ 107 and 129. At times, it is difficult to discern whether Dr. Evans is objecting that pass through will be too high or too low.

12 See, *e.g., INCOMPAS Reply* at 5.

13 *Katz Reply,* § II.A

14 *Evans Report,* § III.C.

15 See, *e.g., INCOMPAS Reply* at 5.

paid by New Charter.[16] This contradiction demonstrates the incoherence of these arguments.[17] In fact, the programming price reductions are merger specific and—because they generate marginal cost savings—will be significantly passed through to consumers.[18]

10. Falsely claiming that I agree with its argument, INCOMPAS asserts that the programming cost savings are not merger specific because "a video programming purchasing cooperative could achieve similar programming costs savings."[19] This is incorrect. It is highly unlikely that Charter could achieve similar programming cost savings through participation in a joint-purchasing arrangement, such as a buying cooperative. As I explained in my earlier declaration, although buying cooperatives may achieve cost savings when buyers are seeking similar products under similar terms, large MVPDs such as Charter and

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16 See, *e.g., INCOMPAS Reply* at 7-8; *Evans Report*, ¶ 11.

17 INCOMPAS also contradicts several other opponents of the proposed transactions that explicitly or implicitly conclude that the programming cost savings are merger specific. For example, Cincinnati Bell calls the programming cost savings "as merger-specific as it gets." (Reply of Cincinnati Bell Extended Territories LLC, *In the Matter of Applications of Charter Communications, Inc., Time Warner Cable Inc., and Advance/Newhouse Partnership for Consent to Transfer Control of Licenses and Authorizations,* MB Docket No. 15-149, November 12, 2015 (hereinafter *Cincinnati Bell Reply*) at 3.)

18 In the present section, I discuss INCOMPAS's argument that lower programming costs are not merger specific. In Section III below, I discuss INCOMPAS's contradictory argument that the proposed transactions are harmful because they will give rise to merger-specific reductions in programming costs, which allegedly will harm competition and consumers.

19 *INCOMPAS Reply* at 5. According to INCOMPAS (citing *Katz Reply,* ¶ 39), "In his declaration, Charter's economist suggests that participation in a video programming purchasing cooperative could achieve similar programming cost savings." In truth, I said the opposite. The lead sentence of the cited paragraph in my reply declaration is "Charter's experience with an attempt to create a cooperative purchasing group demonstrates the serious limitations of such groups." The remainder of the paragraph describes the problems that led to Charter's abandoning the effort without ever having made any joint purchases of carriage rights, including diverging objectives and strategies, concerns regarding member commitment, and the absence of retransmission fees from the cooperative's ambit.

TWC negotiate complex distribution rights, license content for different programming lineups, and have different licensing priorities.[20] Inter-company differences make it extremely difficult for two large MVPDs to jointly bargain with a programmer effectively.[21]

11. The errors in INCOMPAS's position can perhaps best be seen by recognizing that its view of the world cannot be reconciled with several important facts. If the cost savings were as readily attainable through a cooperative as INCOMPAS claims, then Charter's attempt to create a cooperative purchasing group under the auspices of the National Cable Television Cooperative ("NCTC") would not have failed,[22] and TWC's experience with joint purchasing would not have been limited to its unique arrangement with BHN.

12. INCOMPAS also asserts that the use of MFNs is incompatible with my argument that the complexity and diversity of programming contracts is a barrier to buyer cooperatives for large MVPDs.[23] However, as I explained in my initial declaration, while valuable, MFN clauses are also difficult to enforce because it can be difficult to make comparisons across

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20 *Katz Reply*, ¶ 37.

21 *Katz Reply*, ¶ 38.

22 *Katz Reply*, ¶ 39. NCTC operates a buying cooperative that reinforces the point that this type of arrangement is of limited value to large MVPDs. Over 850 cable operators license national cable networks through the NCTC but many of those operators serve very small numbers of subscribers (*e.g.,* fewer than a thousand). Notably, NCTC's four largest members "do not currently license substantial amounts of programming through the buying group." (National Cable Television Cooperative, "About Us," *available at* https://www.nctconline.org/index.php/about-us, site visited January 7, 2016; American Cable Association, "Smaller Cable Companies, Larger Programmers Have Long Benefited from Buying Groups Like NCTC," March 24, 2014, *available at* http://www.americancable.org/node/4718, site visited December 15, 2015.)

23 *INCOMPAS Reply* at 10-11.

contracts,[24] and MFN clauses typically have provisions limiting the exercise of the clause to situations where materially related provisions are comparable.[25] Although I stated that "a significant component of programming value is common to all MVPDs," as INCOMPAS correctly observes, this statement does not in any way change the fact that there are many non-price dimensions to the agreements between programmers and distributors, and that different distributors may choose to make different tradeoffs among these terms.[26]

13. In short, Dr. Evans is correct that the programming cost savings are merger specific, and INCOMPAS's claim has no basis in fact.

B. THE PROGRAMMING COST SAVINGS CAN BE EXPECTED TO BE PASSED THROUGH TO CONSUMERS.

14. In my initial declaration I demonstrated that, although several petitioners argued that the cost savings will not be passed through to consumers in the form of lower quality-adjusted prices than would otherwise be charged, their arguments have no basis in sound economic analysis or marketplace facts.[27]

15. It is well-established that, conditional on a supplier's remaining in business, its profit-maximizing prices depend on marginal costs. Hence, marginal cost savings are the savings relevant for projecting pass through. I took specific steps to ensure that the projected cost savings reported in my reply declaration are marginal cost savings. Specifically, in both the

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24 *Katz Reply*, ¶ 123.

25 *Id.*

26 *INCOMPAS Reply* at 11, citing *Katz Reply*, ¶ 112.

27 *Katz Reply*, § II.B.3.

top-down and bottom-up analyses, I assumed that there will be no marginal cost savings for any network for which Charter **[BEGIN HIGHLY CONFIDENTIAL INFORMATION]{{**[redacted]**}}[END HIGHLY CONFIDENTIAL INFORMATION].**[28] I did so even though it is possible that New Charter could realize cost savings for such networks.[29]

16. Economic principles clearly indicate that New Charter will have incentives to pass through to consumers some or all of the marginal cost reductions enabled by the proposed transactions in the form of lower quality-adjusted prices.[30] Moreover, both econometric studies of the MVPD industry and Charter's own experience indicate that a substantial share of the programming cost savings will be passed through to consumers.[31] None of this is news to the Commission; one of the studies that I cited was conducted by Commission staff,[32] and

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28 *Katz Reply*, ¶¶ 23 and 31.

29 Although Dr. Evans mischaracterized my reply declaration, he appears to agree that the proposed transactions could **[BEGIN HIGHLY CONFIDENTIAL INFORMATION]{{**[redacted]**}}[END HIGLY CONFIDENTIAL INFORMATION]**. (*Evans Report,* ¶ 107, citing *Katz Reply* at 19.)

30 For a discussion, see *Katz Reply*, ¶ 40.

31 *Katz Reply*, ¶ 49. As I noted in my initial declaration, MVPD petitioners' concerns that programming cost savings will make New Charter a stronger competitor should also be taken as evidence that these petitioners expect significant pass through to occur and that consumers will benefit. (*Katz Reply,* ¶ 61.)

32 Federal Communications Commission, Report on Cable Industry Prices, *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992; Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, MM Docket No. 92-266, January 16, 2009, *available at* https://apps.fcc.gov/edocs_public/attachmatch/DA-09-53A1.pdf, site visited October 9, 2015, Appendix B, ¶ 9 as cited by *Katz Reply,* ¶ 50.

the Commission has recognized—most recently in its AT&T-DIRECTV Order—that reductions in the marginal cost of programming will be substantially passed through to consumers in the form of lower service prices and are cognizable efficiencies.[33]

17. Dr. Evans admits that New Charter would engage in pass through and that this would be the case even if it were a monopolist (which it is not).[34] However, he argues that New Charter would engage primarily in targeted price reductions to limit local competition.[35] Dr. Evans offers no economic reasoning to support his claim regarding targeting. In fact, contrary to Dr. Evans's claim, basic economic theory demonstrates that New Charter would have incentives to pass marginal cost savings through to consumers in any local market, whether or not it faces strong competition in that market. Indeed, economic analysis clearly demonstrates that there are conditions under which a supplier operating in multiple local markets will rationally choose to pass through a *smaller* percentage of its cost savings in those markets in which it faces more competition—the opposite of Dr. Evans's claim.[36] Further, Dr. Evans

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33 Federal Communications Commission, Memorandum Opinion and Order, *In the Matter of Applications of AT&T Inc. and DIRECTV For Consent to Assign or Transfer Control of Licenses and Authorizations,* MB Docket No. 14-90, rel. July 28, 2015 (hereinafter *AT&T-DIRECTV Order*), ¶¶ 287 and 290.

34 *Evans Report,* ¶¶ 107 and 129.

35 *Evans Report,* ¶ 129.

36 See *Katz Reply,* Technical Appendix, § B.4.

provides no evidence that the largest MVPDs, which generally pay lower programming costs than smaller MVPDs, have used those savings to limit local competition.[37]

18. Dr. Evans criticizes my earlier analysis of pass through for not being complicated enough. For example, Dr. Evans criticizes me for not providing a model of bundling.[38] Yet he fails to provide any meaningful analysis of how bundling matters.[39] Dr. Evans and I are in agreement that pricing is complex, and that one should not expect an exact linear relationship between programming cost increases and retail price increases. The purpose of the analysis I offered was to assist the Commission in its assessment of the proposed transactions by identifying likely ranges of effects, not precise estimates. Dr. Evans also asserts that there is no evidence that the logit demand specification and Bertrand pricing model fit the MPVD industry.[40] The Commission, however, recently concluded that such a nested logit demand structure and Bertrand pricing model was appropriate for analyzing the industry.[41]

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37 See, also, paragraph 27 below, which notes that Google Fiber's pattern of entry clearly does not support Dr. Evans's hypothesis that entrants will be deterred from investing in markets where larger MVPDs, with lower programming costs, are present.

38 *Evans Report,* ¶¶ 120-121.

39 Dr. Evans's discussion of first-degree price discrimination (*Evans Report,* ¶ 119 and footnote 118) clearly is irrelevant as it is an unrealistic, polar case and is one of the very few instances in which marginal costs are almost irrelevant to the seller's pricing decisions for the vast majority of its customers. A more appropriate discussion would have focused on second-degree price discrimination, under which a fall in marginal costs typically leads to a fall in prices.

40 *Evans Report,* ¶¶ 121-122.

41 *AT&T-DIRECTV Order,* Appendix C, § II. Logit demand is a simplified form of the nested logit model used in the assessment of the AT&T-DIRECTV transaction. (*AT&T-DIRECTV Order,* Appendix C, ¶ 25.)

19. Finally, INCOMPAS complains that Charter has not made a formal commitment to pass through cost savings.[42] As discussed above, New Charter will have incentives to pass through marginal cost savings, whether or not a formal commitment is made. Moreover, it would be extremely difficult or even impossible to make an enforceable and binding specific commitment because programming costs are constantly changing (generally rising) and product characteristics and packaging also shift over time. It would thus be very hard to establish precise formal benchmarks against which to measure pass through.

III. DR. EVANS PROVIDES NO VALID BASIS FOR ASSERTING THAT THE PROGRAMMING COST SAVINGS WILL HARM COMPETITION OR CONSUMERS.

20. Dr. Evans attempts to characterize the merger-specific programming cost savings as a public-interest harm, rather than benefit. In doing so, he joins INCOMPAS in confusing the interests of specific competitors with the public interest.

A. DR. EVANS DOES NO MORE THAN ASSERT THAT INCREASED COMPETITION CONSTITUTES HARM TO COMPETITION.

21. In my initial declaration, I demonstrated that several petitioners unsuccessfully argue that actions that increase the degree of competition that they face actually constitute harm to competition.[43] Petitioners' attempt to characterize the increased competitive pressures generated by programming cost savings as a public-interest harm is a classic example of confusing harm to competitors (*i.e.,* harm to petitioners' self-interests) with harm to

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42 *INCOMPAS Reply* at 7.

43 *Katz Reply*, ¶ 62.

competition (which would affect consumer welfare).[44] I explained that it is not surprising that competitors are concerned about the prospect that Charter will enjoy lower programming costs when the proposed transactions are consummated: any reduction in Charter's marginal costs will increase the competitive pressures faced by rival MVPDs, which will benefit consumers even if the rivals would prefer to face less competition.[45]

22. Dr. Evans and INCOMPAS repeat the latter's objection to the proposed transactions' programming cost savings on the grounds that these savings will make the merging parties stronger competitors in the provision of broadband/video bundles and, thus, allegedly harm competition in the provision of BIAS.[46] However, even if the claim that a firm can succeed as a BIAS provider only if it also is a low-cost MVPD were true, it would not change the fact that INCOMPAS is repeating the mistake of confusing harm to its commercial interests with harm to competition.[47] To see why, suppose *arguendo,* that "the high cost of providing video service is a principal barrier to broadband investment and deployment, particularly for small

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44 *Id.*

45 Indeed, in its reply comments, Cincinnati Bell explicitly objects to the proposed transactions on the grounds that they will lead to increased competition from New Charter. (*Cincinnati Bell Reply* at 3 ("[T]he reality is that [reducing New Charter's video programming costs] strengthens New Charter and will make it that much more formidable as a competitor.").) See also, Comments of Cincinnati Bell Extended Territories LLC, *In the Matter of Applications of Charter Communications, Inc., Time Warner Cable Inc., and Advance/Newhouse Partnership for Consent to the Transfer Control of Licenses and Authorizations*, MB Docket No. 15-149, October 13, 2015, at 13.

46 *COMPTEL Petition* at 12-13; *INCOMPAS Reply* at 3-4, 8, and 12-13; *Evans Report,* ¶¶ 13-14.

47 *INCOMPAS Notice of Ex Parte Letter.*

and medium service providers."[48] The proposed transactions will not raise small and medium service providers' programming costs.[49] But the transactions will reduce Charter's programming costs relative to what they otherwise would be—generating more-vigorous competition in the form of New Charter.

23. Although consumers would benefit from reductions in Charter's programming costs and the resulting lower retail prices of video services, Dr. Evans asserts that lowering Charter's costs may deter entry and investment by rival BIAS providers in a way that leaves consumers worse off.[50] His assertion is fatally flawed in several important respects.

24. First, it lacks a critical limiting principle. As a matter of antitrust economics and common sense, Dr. Evans would have to show that the cost reductions are the result of *anticompetitive* behavior because, absent such a screen, his line of reasoning would seek to block a successful firm from taking any actions that increased the competitive pressures faced by rivals. Dr. Evans provides no evidence of anticompetitive behavior.

25. Second, under Dr. Evans's theory, consumers are harmed when the reduction in Charter's programming costs leads competing firms that are integrated MVPDs and BIAS providers to invest less. However, under Dr. Evans's theory, these effects arise only if Charter is offering consumers more-attractive offerings (some combination of lower prices

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48 *Id.* at 2.

49 *Katz Reply,* § II.D.3.

50 *Evans Report*, §§ IV.C and D.

and more-desirable service attributes) than it would absent the proposed transactions. But if that were the case, then consumers would manifestly be *benefiting* from the transactions.

26. Dr. Evans might attempt to sidestep this inconvenient fact by arguing that entry will be deterred entirely, allowing Charter to charge high prices. But then the possibility of harm to consumers arises under Dr. Evans's theory only if other firms' entry decisions hinge on the incumbent's cost level. The members of INCOMPAS (*e.g.*, Google Fiber) could have chosen to provide Dr. Evans with relevant business documents and analyses of the profitability of entry to submit in this proceeding to demonstrate how entry decisions would or would not be affected by Charter's cost savings. Instead, Dr. Evans paraphrases unsubstantiated claims made by anonymous parties in interviews and unidentified documents, and he provides no evidence that these few companies are representative of potential entrants broadly.[51] He also cites a journal article that raises the theoretical possibility of reduced entry *by MVPDs*. That article neither attempts to estimate *actual* effects on MVPD entry nor even mentions entry by BIAS providers.[52]

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[51] *Evans Report*, ¶¶ 98-102. Moreover, even Dr. Evans's anecdotes illustrate the weakness of his theory. He describes a situation in which TWC lowered the prices it charges to consumers, which led "ISP1" to lower its prices as well. (*Evans Report*, ¶ 98.) Dr. Evans asserts that these price reductions led ISP1 to reduce its fiber buildout. (*Id.*) However, Dr. Evans never assesses the effects of the price reductions on consumer welfare. Presumably, the fact that both TWC and ISP1 lowered their prices was *beneficial* to consumers in this unidentified market.

[52] George Ford and John Jackson (1997), "Horizontal Concentration and Vertical Integration in the Cable Television Industry," *Review of Industrial Organization*, **12**: 501-518.

Dr. Evans criticized my citing Ford and Jackson's estimate of the pass-through rate on the grounds that the article is old and out of date. (*Evans Report*, ¶ 124.) I cited the article as corroboration of the point that it is reasonable to use a pass-through rate in the neighborhood

27. Moreover, Dr. Evans does address the fact that, of the first three cities in which Google Fiber has chosen to enter, TWC is an incumbent cable provider in two (Austin, Texas and Kansas City, Missouri) and Comcast is an incumbent cable provider in the third (Provo, Utah).[53] The six additional cities for which Google Fiber has announced entry plans are also all served by either TWC or Comcast.[54] This pattern of entry clearly does not support Dr. Evans's hypothesis that entrants will be deterred from investing in markets where larger MVPDs, with lower programming costs, are present.

28. In summary, Dr. Evans and INCOMPAS are asking the Commission to risk harming consumers based on a purely hypothetical and vaguely defined possibility for which they have provided no meaningful evidence. Moreover, as described above, Dr. Evans provides no evidence that the programming cost savings are the result of anticompetitive conduct. And

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of 50 percent in this industry when calculating consumer benefits. (*Katz Reply*, ¶ 50.) The passage of time is of greater consequence for Dr. Evans's attempt to use the article to argue that entry will be deterred by programming price differentials: he fails to acknowledge that, although the article raised a theoretical possibility regarding MVPD entry, there has been considerable actual entry and growth by competing MVPDs since the time of the article. (Federal Communications Commission, Fifteenth Report, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 12-203, July 22, 2013, *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-13-99A1.pdf, site visited January 21, 2016, ¶ 23.)

53 Data on cable providers are available from SNL Kagan, "US Multichannel Operator Comparison by Market," 2015, *available at* https://www.snl.com/interactivex/OperatorComparisonByMarket.aspx, site visited October 19, 2015; information on cable providers in Provo, UT *available at* http://www.provo.org/about-us/current-issues/google-fiber/isp-s-in-provo, sited visited January 20, 2016; data on Google Fiber *available at* https://fiber.google.com/about/, site visited January 21, 2016.

54 *Id.*

Dr. Evans himself explicitly states that: (a) he is *not* asserting that New Charter is or will engage in anticompetitive pricing and product strategies in MVPD or BIAS markets, and (b) the behavior about which he is raising concern "would not obviously violate antitrust laws."[55]

B. DR. EVANS'S CLAIMS REGARDING EFFECTS ON PROGRAMMERS HAVE NO BASIS IN SOUND ECONOMIC REASONING.

29. In writing about the effects of a merger on the programming market, Dr. Evans states that, in a traditional antitrust analysis, "[i]t would be sufficient to show an anticompetitive effect on one side of the intermediary and no consideration would be given to the other side."[56] However, Dr. Evans provides no theory or evidence of an anticompetitive effect in any programming market.

30. His attempt to recast the discussion in the terminology of two-sided markets does nothing to remedy this infirmity of his argument. Whatever language he chooses, Dr. Evans implicitly *assumes* that any change in firm size that leads to an increase in the difference between the fees that New Charter pays to programmers and the retail prices that New Charter charges MVPD consumers must be anticompetitive. Dr. Evans's reasoning is faulty.[57] Many

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55 *Evans Report,* footnote 16 ("I am not asserting that Charter or TWC are currently engaging in anticompetitive strategies or would do so following the Transaction.").

56 *Evans Report,* ¶ 113.

57 Dr. Evans also fails to acknowledge that the programmers accounting for the great majority of programming license fees paid by MVPDs have very strong bargaining positions because of the economic harm an MVPD would suffer if it did not carry their programming. (*Evans Report,* ¶ 53.) The Commission concluded in its Comcast-NBCUniversal Order that Comcast and NBCU would own a collection of programming that was essential to the commercial success of an MVPD, both jointly and in some cases individually. (See Federal Communications Commission, Memorandum Opinion and Order, *In the Matter of Applications of Comcast Corporation, General Electric Company and NBC Universal, Inc.*

explanations of why larger buyers receive lower prices demonstrate that the price reductions arise precisely because the increased buyer size generates *increased competition*.[58] Yet, under Dr. Evans's approach, one apparently would conclude that competition is harmed in such situations. This nonsensical conclusion illustrates the consequences of the lack of a limiting principle in Dr. Evans's arguments.[59]

For Consent to Assign or Transfer Control of Licenses and Authorizations, MM Docket No. 10-56, rel. January 20, 2011, ¶¶ 36, 44, 57, 139; see also, *id.*, Appendix B, ¶ 46 ("[T]he overall bundle of NBCU cable networks is critical programming that MVPDs need to offer a competitive service that is attractive to consumers even if no individual network in the bundle were considered 'marquee' programming.").) Several other programmers, including Disney and A&E, also own important collections of programming.

As the Commission has observed, "[c]ollectively, Comcast, Discovery, News Corp., Disney, Viacom, and Time Warner earned more than 69 percent of total basic cable subscriber fees in 2010, and 84 percent of basic cable network advertising revenues." (Federal Communications Commission, Fourteenth Report, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 07-269, rel. July 2, 2012, *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-12-81A1.pdf, site visited January 22, 2016, ¶ 367.)

58 For example, Professor Christopher Snyder has published a paper explaining that the existence of a large buyer could undermine tacit collusion among sellers. (Christopher M. Snyder (1998) "Why do larger buyers pay lower prices? Intense supplier competition," *Economic Letters,* **58**: 205-209.) In my own academic work, I showed that a larger buyer might be able to obtain lower prices by having a more credible threat to switch suppliers because it is better able to amortize the fixed costs associated with switching, particularly if switching consists of engaging in self supply through vertical integration. Here, too, prices fall because the competitive pressures in the market have increased. (Michael L. Katz (1987) "The Welfare Effects of Third-Degree Price Discrimination in Intermediate Goods Markets," *American Economic Review,* 77(2): 154-167.) For example, because of its size, Netflix has a more credible threat of producing its own programming, which may allow it to extract price concessions from third-party program creators and earn greater margins as an OVD.

59 As far as I can discern, Dr. Evans does not offer a sound theory of why larger MVPDs are able to negotiate lower programming license fees. He appears to rely on the existence of fixed costs incurred by programmers. (*Evans Report,* ¶ 53.) But it is well established in the literature that, if the presence of high fixed costs is driving fee differences, then a larger MVPD may end up paying *higher* programming fees than smaller MVPDs. (See Alexander

31. The Commission has reached the correct conclusion on this issue in the past: with respect to the effects on programmers as sellers and MVPDs as buyers, the proper treatment of changes in programming prices that arise due to increases in buyer size is to consider them to be rent transfers.[60] Unless rent transfers arise for anticompetitive reasons, they are neither a public interest harm nor benefit.[61] This conclusion holds with equal force if one applies the

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Raskovich (2003) "Pivotal Buyers and Bargaining Position," *Journal of Industrial Economics*, **51**(4): 405-426.)

60 *AT&T-DIRECTV Order*, ¶¶ 290-291; Federal Communications Commission, Hearing Designation Order, *In the Matter of Applications EchoStar Communications Corporation, (a Nevada Corporation), General Motors Corporation, and Hughes Electronics Corporation (Delaware Corporations) (Transferors) and EchoStar Communications Corporation (a Delaware Corporation) (Transferee),* CS Docket No. 01-348, rel. October 18, 2002, ¶ 211 ("[A]ny savings in programming costs that result from a change in bargaining power represent a shift in surplus between programming providers and DBS operators, but not necessarily an increase in total surplus.").

61 As I showed in my initial declaration, a wide range of measures indicate that the video content creation and programming industries are healthy and there is no basis for concern that the programming cost reductions enabled by the proposed transactions will harm consumers. (*Katz Reply*, § II.D.2.a.) The estimated annual programming cost savings associated with legacy Charter systems constitute less than **[BEGIN HIGHLY CONFIDENTIAL INFORMATION]**{{[redacted]}}**[END HIGHLY CONFIDENTIAL INFORMATION]** of the annual U.S. operating revenues of cable and broadcast networks. (*Katz Reply*, ¶ 88.) Such a small change is unlikely to materially affect the investment incentives of programmers, whose revenues have grown rapidly.

In a report filed in this proceeding, Professor Kwoka appears to suggest that programmer revenues have grown strongly over time largely—or even only—because of ESPN. (Reply Comments by Professor John Kwoka, "Economic Analysis of the Effects of the Proposed Merger of Charter Communications, Time Warner Cable, and Advance/Newhouse Partnership on Program Providers Serving the Latino Market," Appendix 1 to Reply Brief of Entravision Communications Corporation, *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, November 12, 2015, ¶ 15 ("It [the increase in programmer revenue] is widely understood to result largely from sports programming and, perhaps, almost uniquely from ESPN.").)

However, of the $38.7 billion in growth of cable networks' licensing fees between 1995 and 2014, substantially less than half ($16.5 billion) was for basic sports networks and RSNs, and language of two-sided markets and considers programmers to be purchasers of MVPD platform services.[62]

32. Dr. Evans presents a straw-man argument asserting that I would assess a merger to monopoly solely by examining pass through to consumers.[63] That is false: the analytical framework that I have applied—and the one that the Commission appears to have applied in the past—would consider whether there were anticompetitive effects on programming prices. An industry-wide merger to monopoly would give rise to very different competitive effects than will the proposed transactions (among other differences, it would involve MVPDs serving the same geographic markets as one another). I am unaware of any evidence that the proposed transactions in this proceeding will harm competition in the programming market; certainly Dr. Evans has presented none.

33. Lastly, although Dr. Evans invokes the terminology of two-sided markets, he fails to recognize one of the most fundamental principles of two-sided markets—the structure of

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ESPN itself accounted for less than a fifth ($7.5 billion). (SNL Kagan, "U.S. TV Network Industry Benchmarks," *available at* https://www.snl.com/interactivex/tv_IndustryBenchmarks.aspx, site visited October 13, 2015; SNL Kagan, "TV Network Advanced Search," *available at* https://www.snl.com/interactivex/bbsearch.aspx?activeTabIndex=9, site visited December 11, 2015; U.S. Bureau of Labor Statistics, "Consumer Price Index - All Urban Consumers," *available at* https://research.stlouisfed.org/fred2/series/CPIAUCSL, site visited October 23, 2015.) The SNL Kagan data were adjusted for inflation using the U.S. Bureau of Labor Statistics data.

62 Of course, as discussed elsewhere in my earlier declaration and the present one, to the extent they are marginal cost reductions and do not undermine investment in programming, the price reductions give rise to consumer benefits.

63 *Evans Report*, ¶¶ 111-114.

prices, as well as their overall level—matters for consumer welfare and efficiency.[64] Given the nature of contracting institutions in the video programming marketplace (*i.e.,* the parties negotiate a per-subscriber price and the buyer then effectively chooses a quantity), the marginal cost savings (and the associated change in the structure of the two-sided prices associated with MVPD platforms) can be expected to *increase* the consumption of video services, all else equal.[65] In the language of two-sided markets, MVPD platforms will facilitate additional transactions (*e.g.*, a greater numbers of video subscribers) as a result of these price changes. Given that the social marginal cost of another viewer's receiving video content is near zero, this increase in output corresponds to both a consumer benefit and an efficiency gain.

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64 Indeed, the most prominent definition of two-sided markets builds explicitly on the notion that examining the net, two-sided price alone is insufficient to understand market behavior and participants' economic welfare. For example, Jean-Charles Rochet and Jean Tirole, two leading scholars examining two-sided markets, state that:

> Payment systems are inherently two-sided markets, namely markets in which platforms must court two sides who want to interact with each other, and in which the price structure, that is the allocation of charges between the two sides of the market, matters.

(Jean-Charles Rochet and Jean Tirole (2006) "Externalities and Regulation in Card Payment Systems," *Review of Network Economics,* **5**(1): 1-14, at 2.)

65 Because the programming cost savings resulting from the proposed transactions are marginal cost savings, the creation of New Charter will create incentives for the firm to purchase additional programming in the form of: (a) additional networks per subscriber, and/or (b) additional subscribers to existing networks as these new subscribers are attracted by the lower service prices that will result from the pass through of programming cost savings. The latter effect will also arise as competing video distributors lower their quality-adjusted prices.

IV. CONCLUSION

34. Based on my analysis of the relevant facts and economic principles, and for the reasons described above, I continue to find that consummation of the proposed transactions can be expected to generate consumer benefits due to the pass through of programming cost savings.

Executed on Friday, January 29, 2016.

Michael L. Katz