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February 12, 2016

BY ECFS

Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, DC 20554

Re: Notice of *Ex Parte* Letter, 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

Dear Ms. Dortch:

In accordance with the Protective Order in the above-captioned proceeding, INCOMPAS submits the attached redacted version of its *ex parte* letter and accompanying declaration of Dr. David S. Evans. In the enclosed *ex parte* and declaration, redacted Highly Confidential Information is denoted with “{{BEGIN HCI END HCI}}” and Confidential Information is denoted with “{BEGIN CI END CI}.” In the attached PowerPoint presentation, Highly Confidential Information is denoted with “{{HCI HCI}}” and Confidential Information is denoted with “{CI CI}.”

Please contact me with any questions.

Respectfully submitted,



Markham C. Erickson
Counsel for INCOMPAS

Enclosures

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445 Twelfth Street, SW
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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

Dear Ms. Dortch:

This letter responds to Charter’s letter of January 29, 2016, as well as Professor Michael Katz’s declaration of the same date. Attached, please find a declaration from Dr. David S. Evans, which responds in detail to Professor Katz. Attached to Dr. Evans’s declaration is a PowerPoint presentation that highlights elements of the declaration.

Professor Katz agrees, either explicitly or implicitly through silence, with key points we have raised:

- The transaction would significantly lower the net fees New Charter pays to programmers.¹ In particular, the transaction would increase the implicit access and

¹ Michael L. Katz, Charter-TWC-BHN: Efficiencies Analysis, MB Docket No. 15-149 ¶ 9 (Nov. 2, 2015); Michael L. Katz, Charter-TWC-BHN: A Response to Dr. Evans, MB Docket No. 15-149 ¶ 7 (Jan. 29, 2016) (“Katz Reply Declaration”).

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distribution fees charged by New Charter by {{HCI
HCI}}²

- New Charter’s ability to extract higher distribution fees from programmers results from control of a larger bottleneck to households. Larger multichannel video programming distributors (“MVPDs”) can credibly threaten to block access to a large number of households, which would impose a significant loss to video programmers that have high fixed costs and depend on wide distribution.³
- MVPDs are two-sided platforms. Professor Katz does not refute Dr. Evans’s analysis of MVPDs as two-sided platforms. Indeed, he treats them as such when he states that changes to the price structure following the merger would enhance consumer welfare.⁴
- Charter would not pass through to consumers the full amount of its price increase to programmers. While we dispute Professor Katz’s estimate of the consumer pass-through, even his inflated estimates mean that New Charter would keep 40% to 50% of its price increase to programmers.
- Changes in video programming cost delta significantly effects broadband entry and deployment.⁵

Further, there are several important points that are not controversial:

- Local broadband markets are dysfunctional due to numerous barriers to broadband infrastructure investment and deployment, as the Commission has found in its recent broadband competition reports.⁶

² David 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 (Jan. 15, 2016) (“Evans Declaration”).

³ *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, 9175 ¶ 113 (July 28, 2015) (“AT&T/DIRECTV Order”).

⁴ See Katz Reply Declaration ¶ 14.

⁵ *AT&T/DIRECTV Order*, 30 FCC Rcd. at 9179-80 ¶ 126; *id.* at 9182 ¶ 133.

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- When threatened with competition, an incumbent broadband provider will engage in targeted price discrimination.⁷

⁶ *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, as Amended by the Broadband Data Improvement Act, 2016 Broadband Progress Report*, GN Docket No. 15-191, FCC 16-6, ¶¶ 125-126 (2016) (“2016 Broadband Report”); *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, as Amended by the Broadband Data Improvement Act, 2015 Broadband Progress Report and Notice of Inquiry on Immediate Action to Accelerate Deployment*, 30 FCC Rcd. 1375, 1426-30 ¶¶ 141-152 (2015); *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, as Amended by the Broadband Data Improvement Act, Eighth Broadband Progress Report*, 27 FCC Rcd 10342, 10403-10 ¶¶ 139-54 (2012); *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, as Amended by the Broadband Data Improvement Act, Seventh Broadband Progress Report and Order on Reconsideration*, 26 FCC Rcd 8008, 8040 ¶ 65 (2011); FCC, *Connecting America: The National Broadband Plan*, at 167-90 (2010), <https://transition.fcc.gov/national-broadband-plan/national-broadband-plan.pdf>.

⁷ {{BEGIN HCI

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- Small, competitive broadband providers have lower incentives to compete against large, incumbent cable/broadband providers because of the significant cost-delta between these providers that result from the former's ability to impose price increases on programmers.⁸ The transaction would increase this cost delta.
- The proposed transaction would lead to harm to programmers similar to the harm imposed on merchants by American Express's anti-steering rules in the case of *United States v. American Express*, where Professor Katz was an expert for the government. If Professor Katz had followed the same approach to which he testified in the *American Express* case in 2014, he should have concluded that the New Charter transaction is anticompetitive. Professor Katz previously found that merchants would pay a higher price for network services and that American Express passed on to cardholders less than the full amount of those higher prices.⁹ This was sufficient for him to find an anticompetitive harm.¹⁰

The following items are still in controversy, but they should not be:

- Charter insists, against all evidence to the contrary, that broadband providers can be successful without also offering a video product.¹¹ Because consumers overwhelmingly demand to purchase broadband and video together, it generally does not make sense for small providers to offer standalone broadband (and such standalone offerings are rarely seen). In determining whether to enter a market, a broadband provider must offer linear video programming to compete against incumbent providers.¹²

⁸ See Evans Declaration ¶ 59.

⁹ *United States v. American Express Co.*, 1:10-CV-04496, Trial Transcript at 4039:23-25 (July 29, 2014) (“The merchants pay higher prices and that less than the full amount is passed on to cardholders.”).

¹⁰ *Id.* at 3821:8-10 (“My central conclusion is that the anti-steering rules harm competition and consumers, and consumers in this case means merchants and their customers.”).

¹¹ See Letter from John L. Flynn, Counsel to Charter Communications Inc., to Marlene H. Dortch, FCC, MB Docket No. 15-149, at 3 (Jan. 29, 2016).

¹² See Evans Declaration ¶¶ 43-48; Nancy Rose, Deputy Assistant Attorney General for Economic Analysis, Antitrust Division, Department of Justice, Remarks at ABA Economics Committee Brown Bag on Bargaining Leverage and Competitive Effects (June 25, 2015) (“[B]roadband investments are less attractive, at least at present, if you can't also get access to

(Continued...)

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- Professor Katz states that a video programming buying cooperative necessarily would fail because “inter-company differences make it extremely difficult for two large MVPDs to jointly bargain with a programmer effectively.”¹³ Yet Time Warner Cable negotiates programming contracts on behalf of Bright House Networks. This arrangement apparently works and is successful in providing BHN with more favorable terms than it

low cost video programming and put together a cable-like package (MVPD) to offer customers. And that’s in part because it’s a way that many consumers are buying a bundle of cable and broadband from their provider. And so it might even be that by discouraging online video, you’re also discouraging broadband buildout and competition in that market down the road.”); Tim Mullaney, *Cord-cutters: Why It’s Apple’s New Key Demographic*, CNBC (Mar. 17, 2015), <http://www.cnbc.com/2015/03/17/why-apples-newest-key-market-is-cord-cutters.html> (reporting only 7.3% of households have cut the cord); *See, e.g.*, Shalini Ramachandran, “Comcast Results Show Cable’s Comeback,” Wall Street Journal, February 3, 2016, <http://www.wsj.com/articles/comcast-profit-buoyed-by-growth-in-video-and-broadband-subscribers-1454500891> (reporting that Comcast added 89,000 video customers in Q4 2015 and is “forestalling the cord-cutting trend”). The FCC has long-recognized that a broadband provider must offer video programming to successfully enter the market. *See, e.g.*, *Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992, Report and Order and Further Notice of Proposed Rulemaking*, 22 FCC Rcd. 5101 ¶ 51 (2006); *id.* ¶ 62 (“The record here indicates that a provider’s ability to offer video service and to deploy broadband networks are linked intrinsically, and the federal goals of enhanced cable competition and rapid broadband deployment are interrelated.”); *Exclusive Service Contracts for Provision of Video Services in Multiple Dwelling Units and Other Real Estate Developments, Report and Order, Notice of Proposed Rulemaking*, 22 FCC Rcd. 20235 ¶ 20 (2007) (“[B]roadband deployment and entry into the MVPD business are ‘inextricably linked.’”); *Review of the Commission’s Program Access Rules and Examination of Programming Tying Arrangements, First Report and Order*, 25 FCC Rcd. 746 ¶ 36 (2010) (“[A] wireline firm’s decision to deploy broadband is linked to its ability to offer video.”).

¹³ Katz Reply Declaration ¶ 11.

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could obtain on its own.¹⁴ Today, moreover, there are at least two existing video programming purchasing cooperatives.¹⁵

The net price increase that would be created by this transaction is enough to block the merger. Professor Katz said essentially that (though in the context of an antitrust lawsuit under Section 1 of the Sherman Act) in his role as expert for the United States in the *American Express* case. If the transaction is nevertheless approved, the Commission should reject the consumer pass-through claimed by Professor Katz as a benefit sufficient to find the merger in the public interest. Indeed, the Commission found as much in its review of the AT&T/DirecTV transaction, when it found that Professor Katz's claimed consumer pass-through was insufficient to find the transaction in the public interest. In that transaction, the Commission imposed the further public interest benefit of requiring AT&T to deploy its fiber to the premises (FTTP) service to at least 12.5 million mass-market customer locations within four years.¹⁶ If the Commission were to approve the present transaction, it should require Charter to participate in a video programming purchasing cooperative to mitigate the transaction's effect on local broadband competition. A cooperative is superior to a regulatory requirement to build out, because it creates a market-based, structural remedy. Further, it incents broadband competition. Where AT&T's build out would position it to compete more effectively relative to incumbent cable companies, any build out requirement imposed on Charter (without the cooperative remedy) would not increase broadband completion.

It is particularly critical that the Commission address the availability of competitive broadband given the state of the residential broadband marketplace. The Commission's 2016 *Broadband Progress Report* that was released just a few weeks ago confirms that 61 percent of Americans have no or only one option for a fixed broadband service that delivers 25 Mbps/3 Mbps.¹⁷ As Chairman Wheeler has stated: "[t]he underpinning of broadband policy today is that competition is the most effective tool for driving innovation, investment, and consumer and

¹⁴ See *Advance/Newhouse Partnership*, Response to Information and Data Request Issued on Sept. 21, 2015, MB Docket No. 15-149, Response to Request 56 (Oct. 13, 2015) (describing relationship between BHN and TWC).

¹⁵ See *About Us*, NCTC: National Cable Television Cooperative, Inc., <https://www.nctconline.org/> (last visited Feb. 12, 2016); *About NRTC*, NRTC: National Rural Telecommunications Cooperative, <http://www.nrtc.coop/pub/us/about/> (last visited Feb. 12, 2016).

¹⁶ *AT&T/DIRECTV Order*, 30 FCC Rcd. at Appendix B, Section III.

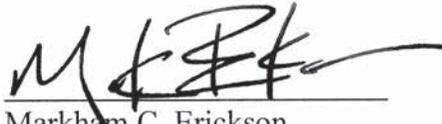
¹⁷ See 2016 Broadband Report ¶ 86, Table 6.

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economic benefits.”¹⁸ Indeed, consumers benefit by such competition whether they purchase service from an incumbent or a competitor as competition stimulates innovation and investment by incumbents and competitors alike. Here, without addressing the harm to local broadband competition, the merger would not be in the public interest.

Sincerely,



Markham C. Erickson
Counsel for INCOMPAS

Enclosure

CC: Jon Sallet
Owen Kendler
Elizabeth McIntyre

¹⁸ Prepared Remarks of FCC Chairman Tom Wheeler, The Facts and Future of Broadband Competition, 1776 Headquarters, Washington, D.C. (Sept. 4, 2014), <https://www.fcc.gov/document/chairman-remarks-facts-and-future-broadband-competition>.

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**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**

A RESPONSE TO PROFESSOR KATZ

EVANS DECLARATION II

David S. Evans

February 12, 2016

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I. Introduction and Summary

1. My name is David S. Evans and I am an economist. I submitted a declaration on the Transaction on January 15, 2016.¹ Professor Katz responded to my declaration on January 29, 2016.² This declaration responds to his reply declaration.

2. In my initial declaration, I showed that the Transaction would result in a significant increase in the implicit prices that the merging parties charge video programmers for access to their households. That would, in turn, enable the merging parties to engage in pricing strategies that would deter competition in local broadband markets and reduce investment in fiber. Professor Katz's reply declaration does not, for all intents and purposes, dispute those conclusions. He claims the results I have pointed to are efficient outcomes of the Transaction. Below I explain why, as a matter of economics, he is wrong.

3. I have reached three key findings based on my review of Professor Katz's reply declaration.

1. Professor Katz's declaration does not dispute my conclusion that the MVPDs are two-sided platforms that connect video programmers and households or that the Transaction would significantly raise the implicit prices that the merging parties would charge video programmers as a result of their increased control over access to households. The analysis I presented follows the approach that Professor Katz took in his testimony on behalf of the U.S. Department of Justice in *United States v. American Express*.³ In that case, he concluded that American Express had significant market power over merchants that wanted to access its cardholders. He also concluded that American Express's practices were anticompetitive because they would increase merchant prices and the increase in prices would be only partly offset by the pass-through of savings to

¹ Declaration of David S. Evans, "Economic Analysis of the Proposed Merger of Charter, Time Warner Cable, and Bright House Networks on Video Programming Prices and Broadband Entry and Competition" FCC, MB Docket No. 15-149 (Jan. 15, 2016) ("Evans Declaration").

² Surreply Declaration of Michael L. Katz, "Charter-TWC-BHN: A Response to Dr. Evans," FCC, MB Docket No. 15-149 (Jan. 29, 2016) ("Katz Reply").

³ *United States vs. Am. Express*, Trial Transcript, 10-CV-4496 (E.D.N.Y. July 29-30, 2014) ("Katz Amex Testimony"), 3815:7 – 4105:10, 4114:20 – 4288:18 ("Katz Amex Testimony").

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consumers. In *American Express*, Professor Katz focused on the price increase to the business side of the two-sided platform and considered pass-through to the consumer side as a partial offset. In this Transaction, Professor Katz focuses on the partial pass-through to the consumer side of the two-sided platform and discounts entirely the price increase to the business side of the two-sided platform.

2. Professor Katz has not responded to the empirical evidence I presented that an increased margin from lower video programming costs would result in greater selective price cuts that would reduce competition in local broadband and deter entry. I presented empirical evidence on market-based competition in paragraphs 97-103 of my declaration.⁴ He simply dismisses this evidence, which was based in part on data I collected and interviews I conducted with leading local broadband providers on the grounds that it is “unsubstantiated.”⁵ By contrast, Professor Katz’s initial and reply declarations do not engage in any fact-based inquiry of competition in local MVPD or broadband markets.
3. Professor Katz has put forward no credible empirical evidence to support his claim that Charter would pass-through 50-60 percent of costs savings to households in the form of lower quality-adjusted prices.⁶ Unlike economists who have conducted econometric studies of pass-through, he has presented no reliable fact-based analysis of how the merging parties change prices in response to shocks to cost. His claim that New Charter would pass on \$113 to \$140 million of benefits to consumers simply has no empirical foundation based on the actual behavior of the merging parties or the study of real-world markets.⁷ At the same time, he has conducted no empirical investigation of competition in local cable markets that would provide evidence on the extent to which the merging parties would pass-through cost savings to engage in selective price-cutting to deter entry and expansion of rivals.⁸

⁴ Evans Declaration, ¶¶ 97-103.

⁵ Katz Reply, ¶ 26

⁶ Reply Declaration of Michael L. Katz, Charter-TWC-BHN: Efficiencies Analysis, MB Docket No. 15-149, ¶ 10 (Nov. 2, 2015) (“Katz Declaration”).

⁷ Katz Declaration, ¶ 10. In some mergers the precise amount and nature of the pass through is not important and a simple back-of-the-envelope calculation suffices. First, the competition authority may find a small anticompetitive competitive effect from the merger. If there are significant cost savings, economists can reasonably conclude that some of those saving would be passed on to consumers. It may not matter whether the pass-through rate is 10 percent or 50 percent. In this case it does matter because the FCC needs to weigh harm to video programmers and harm to local broadband competition against the benefits of pass-through to households. Second, it usually does not matter how the cost savings are passed on to consumers, only that they are. In this Transaction, however, the extent to which the merging parties are likely to pass on cost savings in ways that could affect competition in local markets matters greatly. Professor Katz, unfortunately, does not contribute to our understanding of these issues because he has not considered the specifics of the merging parties, their competitive strategies, or even the MVPD and broadband industries more broadly. His declaration provided a slightly more complicated version of a basic textbook—i.e. fact-independent—result.

⁸ My initial declaration did not address the possibility of a buyer cooperative and in particular did not consider a counter-factual world in which New Charter would purchase programming through a buyer cooperative. As a

II. Professor Katz’s Analysis of the Impact of the Merger on Video Programmers Is Inconsistent with His and the Justice Department’s Analysis in *United States v. American Express*

4. If Professor Katz followed the same approach he testified to in the *American Express* case in 2014 he should conclude that this Transaction results in competitive harm.⁹ Part A shows that Professor Katz has not refuted my claim that MVPDs are two-sided platforms, that larger MVPDs can charge higher prices because of their ability to deny access to a larger portion of households, and that the Transaction would significantly increase the price for access and distribution. Part B summarizes Professor Katz’s testimony in *American Express* on behalf of the U.S. Department of Justice and shows that the approach he testified to is consistent with the approach I have taken for this Transaction. It also is and the polar opposite of the approach he has taken for this Transaction. Part C then shows that based on the approach Professor Katz testified to in *American Express* he should conclude that this Transaction causes competitive harm. Part C also responds to Professor Katz’s arguments as to why the FCC should not worry about a significant transfer of economic value from video programmers to the merging parties.

A. Professor Katz Does Not Refute the Finding that the Transaction Would Significantly Increase Access and Distribution Fees to Video Programmer Customers of the Merging Parties

5. Professor Katz and I agree that Transaction would enable New Charter to pay video programmers significantly less¹⁰ because the parties would have increased bargaining power over programmers.¹¹

result, there is no basis for Professor Katz’s claim that my findings and INCOMPAS arguments are inconsistent with each other. Katz Reply, ¶ 9.

⁹ Katz Amex Testimony, 4039:20–4040:4.

¹⁰ Katz Declaration, ¶¶ 13-36.

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6. In his initial declaration, Professor Katz did not meaningfully explain why New Charter would have greater bargaining power.¹² In AT&T-DIRECTV, however, Professor Katz was explicit that the ability to obtain lower prices from video programmers results from the fact that: the “*loss of a large buyer is more than proportionately disruptive to the content owner’s business model*”¹³ (emphasis added) and being able to offer greater advertising reach.¹⁴ His reply declaration does not dispute my finding that the reason larger MVPDs can secure lower video programming prices is because they can deny access to a greater number of households and impose devastating harm on the video programmer. Nor does he dispute my observation that the larger MVPDs can charge higher implicit distribution fees to video programmers.

7. In addition, Professor Katz has not disagreed with my characterization of the relationship between MVPDs, video programmers, and households. MVPDs are intermediaries between video programmers and households. Video programmers use MVPDs to obtain access and distribution to households. In this Transaction, however, Professor Katz’s analysis of competitive effects for a two-sided platform is inconsistent (and is, indeed, opposite) of his analysis, and testimony, in *United States v. American Express* on behalf of the U.S. Department of Justice in 2014.

¹¹ *Id.* ¶¶ 14-15.

¹² There is a brief discussion of the mechanisms by which the merger could reduce programming fees. Katz Declaration, ¶¶ 13-17. But this is less detailed than the corresponding discussion in Professor Katz’s declaration in the AT&T-DIRECTV transaction.

¹³ Michael L. Katz, An Economic Assessment of AT&T’s Proposed Acquisition of DIRECTV, MB Docket No. 14-90, ¶ 113 (June 11, 2014) (“Katz AT&T-DIRECTV Declaration”).

¹⁴ Improved advertising revenue for video programming suppliers cannot explain the sizeable difference between the per-subscriber prices paid by large cable systems. Video programmer advertising accounts for about {CI CI} of the combined video programmer revenue from advertising and fees to MVPDs. {CI CI}

B. Evans’ Analysis of This Transaction Corresponds to Katz’s Analysis in *United States v. American Express*

8. American Express (“Amex”) is a two-sided platform that serves merchants and cardholders.¹⁵ Amex signs up cardholders. To gain access to these cardholders, merchants have to agree to pay a fee per transaction; to gain access to these merchants that accept Amex cards, cardholders have to enter into an agreement with Amex that usually involves their paying an annual fee but getting rewards for paying with the card. Amex acts as an intermediary between cardholders and merchants. It is a classic two-sided platform.¹⁶

9. When a cardholder uses their card to buy something for \$100, Amex pays the merchant approximately \$97. Amex keeps the roughly \$3 as its fee for providing access to the cardholders and services.¹⁷ The flow of payments for Amex is therefore similar to the flow of payments for video programmers. In both cases the platform pays the business side of the platform and charges the consumer side of the platform.

10. Professor Katz testified for the U.S. Department of Justice in *United States v. American Express* in the 2014. He defined a market that consisted of network services to merchants that took general-purpose credit and charge cards based on a SSNIP test that a hypothetical monopolist of credit and charge cards could raise the merchant discount by 5 percent or more.¹⁸ He concluded that Amex had market power because merchants needed access to the Amex

¹⁵ Decision, *United States vs. Am. Express*, 10-CV-4496, at 5, 10-14 (E.D.N.Y., Feb. 19, 2015) (“Amex Decision”); Katz Amex Testimony, 3827:15-20, 3828:23-3829:20; David S. Evans and Richard Schmalensee (2005), *Paying with Plastic: The Digital Revolution in Buying and Borrowing*, 2nd Ed., Cambridge, MA: MIT Press, 3-8.

¹⁶ Jean-Charles Rochet and Jean Tirole (2003), “Platform Competition in Two-Sided Markets,” *Journal of the European Economic Association*, 1(4): 990-1029.

¹⁷ Amex Decision, 15-16.

¹⁸ Katz Amex Testimony, 3903:15-3922:8. Professor Katz considered SSNIP analyses using both the network fees and the merchant discount as the base price.

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cardholders¹⁹ and because it was able to charge merchants a higher price than other card networks.²⁰ Amex cardholders accounted for 26.4 percent of general-purpose credit and charge card purchase volume in the United States.²¹

11. Professor Katz then analyzed the competitive effects of the practices at issue. These concerned certain rules that prohibited merchants from steering cardholders to other payment methods. He concluded that:

The result of the anti-steering rules is to reduce the sensitivity of demand on the merchant side of the platform, and, as a result of that, the merchant[s] pay higher prices and that less than the full amount is passed on to cardholders, and that some of that is captured by the networks.²²

He did not provide evidence that the practices would reduce the net output of card transactions.²³

12. Professor Katz’s analysis in *American Express* is roughly similar to the approach I have taken.²⁴ I have shown that the business side of the platform—video programmers—would incur

¹⁹ Katz Amex Testimony, 3968:7-3876:3, 3938:12-3939:2, 3956:18-3957:10 .

²⁰ Katz Amex Testimony, 3947:2-10.

²¹ Amex Decision, 67.

²² Katz Amex Testimony, 4039:20-40440:4.

²³ In *American Express*, the DOJ appeal brief noted that, “Amex does not challenge as clearly erroneous the court’s broader finding that its NDPs enabled all four networks to raise merchant fees. Rather, Amex argues that this proof does not satisfy Plaintiffs’ initial burden as a matter of law because ‘the trial evidence indisputably showed that output has *increased*,’ so that rising merchant fees ‘are equally consistent with growing product demand.’ Redacted Final Form Brief of Plaintiffs-Appellees, *United States v. Am. Express*, at 64-65 (citing Amex Br. at 42-44 (internal citations omitted)) (Amex’s emphasis). This Court, however, has never required proof of both increased prices and reduced output to meet the plaintiff’s initial burden. See *Virgin Atlantic Airways Ltd. v. British Airways PLC*, 257 F.3d 256, 264 (2d Cir. 2001); *Capital Imaging Assocs., P.C. v. Mohawk Valley Med. Assocs., Inc.*, 996 F.2d 537, 547 (2d Cir. 1993); cf. *Gordon v. Lewistown Hosp.*, 423 F.3d 184, 210 (3d Cir. 2005) (the plaintiff can discharge its “initial burden of showing that the alleged contract produced an adverse, anticompetitive effect” by demonstrating “that its enforcement reduced output, raised prices or reduced quality.”).

²⁴ To be clear, I am not endorsing the Justice Department’s case against American Express or Professor Katz’s testimony in that case, with which I disagree. Rather, I am agreeing that it is correct as an economic matter to

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significantly higher prices as a result of the Transaction, and that the pass-through to the consumer side—cable subscribers—would offset that price increase only partly.

13. Professor Katz’s analysis for this Transaction is the polar opposite of Professor Katz’s analysis in *American Express*.

- He finds that the Transaction would reduce the net amount of money received by the video programmers;²⁵ that is analogous to Amex’s practices reducing the net amount of money received by the merchants (recall that Amex pays the merchants less the higher the merchant fee it charges).
- In AT&T-DIRECTV he claimed that the ability to pay video programmers a lower amount of money was in part because of control over distribution to more households;²⁶ that is analogous to Amex having market power because it controls access to cardholders.
- In both this Transaction and Amex market power results from control over a relatively small fraction of consumers on a national basis; an increase to {BEGIN CI END CI} percent of MVPD households versus a total of 26.4 percent in *American Express*.²⁷
- In this Transaction, however, Professor Katz claims that there is nothing anticompetitive about the agglomeration of control over access to households reducing the net price paid to video programmers;²⁸ in *American Express*, he found that the practices at issue were anticompetitive because they limited the ability of merchants to counter the market power Amex possessed from its agglomeration of cardholders.²⁹
- In this Transaction, he claims the entire consumer pass-through counts as a net efficiency the FCC should consider for its public interest test;³⁰ in *American Express* he compared the

consider the impact of a platform’s business practices on both sides of the platform, to consider the impact on the total price charge to those two sides, and to consider both the merchants and the cardholders as “consumers” of the services provided by the platform.

²⁵ Katz Declaration, ¶¶ 13-36.

²⁶ Katz AT&T-DIRECTV Declaration, ¶ 113.

²⁷ See {BEGIN CI
Amex Decision, at 67.

END CI};

²⁸ Katz Reply, ¶¶ 21-33.

²⁹ Katz Amex Testimony, 3968:7-3876:3, 3938:12-3939:2, 3956:18-3957:10.

³⁰ Katz Declaration, ¶ 10.

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price increase to merchants with the benefits passed-through to cardholders, and concluded that the practices were anticompetitive because the former were larger than the latter.³¹

- In this Transaction, he insists that a significant increase in price to video programmers is not enough to show anticompetitive effects;³² in *American Express* Professor Katz found an anticompetitive effect based on an increase in the combined merchant and cardholder price.³³

Table 1 compares the approach taken by Professor Katz in the *American Express* case against his approach to this Transaction.

Table 1: Comparison of Transaction with *United States v. American Express*

Analysis of	<i>United States v. American Express</i>	Charter-TWC Merger
Business and products	Platform that provides merchants access to cardholders	Platform that provides video programmers access to households
Market definition	Merchant services for credit and charge cards in the US	Video programming distribution (scope open but needs to account for fact that merger has large price increase and therefore limited constraints)
Market power source	Ability to deny merchants access to cardholder spend; note typical consumer has multiple cards on person at checkout	Ability to deny video programmers access to households; note typical consumer has limited alternatives with high switching costs
Competitive effects	Ability to maintain “high” merchant discount by reducing merchant bargaining power; no significant examination of output by Katz or DOJ	Direct significant horizontal impact of merger on video programming distribution fees based on evidence sponsored by merging parties
Analysis of consumer side	Katz argues that merchant increase not offset by consumer pass-through. ³⁴ Consumer pass-through treated under pro-competitive justification prong of rule of reason by DOJ	{BEGIN CI [REDACTED] END CI} increase ignoring consumer side and {BEGIN CI [REDACTED] END CI} counting pass-through to get to total price change or as efficiency offset

³¹ Katz Amex Testimony, 4039:20-40440:4.

³² Katz Reply, ¶ 29-31. I discuss these points further below.

³³ Katz Amex Testimony, 4039:20-40440:4.

³⁴ *Id.* at 4039:20 – 4040:4.

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14. There is no economic rationale for Professor Katz focusing on the business side of an intermediary and largely dismissing the consumer side in *American Express*, and in this Transaction, focusing on the consumer side of an intermediary and largely dismissing the business side. I have argued elsewhere that the antitrust analysis of intermediaries should take both sides into account. However, under the Department of Justice’s approach in *American Express*, an increase in price to the business side of a platform would be anticompetitive under a rule of reason analysis with pass-through to the consumer side treated as a possibly pro-competitive offset.

15. In previous proceedings, the FCC did not analyze MVPDs as intermediaries. That is not surprising given that the economic literature on multi-sided platforms is just making its way into decisions by courts and regulators. At this point, the FCC can rely on the extensive economic literature on multi-sided platforms,³⁵ the emerging legal scholarship and case law that applies it to antitrust and regulatory matters,³⁶ and antitrust and merger analysis of diverse intermediaries including those in payment cards and advertising.³⁷

³⁵ For a discussion of the literature, *see* Amex Decision, at 10-13, 44-45, 52-53.

³⁶ Memorandum and Order Approving Settlement, *In Re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, No. 1:05-md-01720 (E.D.N.Y. December 13, 2013); Alan O. Sykes, Economic Issues Pertaining to the Proposed Final Settlement, *In Re Payment Card Interchange Fee and Merchant Discount Litigation*, No. 1:05-md-01720 (E.D.N.Y. August 28, 2013); Amex Decision; *Qihoo 360 v. Tencent*, *Supreme People’s Court, People’s Republic of China*, Case C-67/13 P (Mar. 28, 2013), *Groupement des cartes bancaires v European Commission*, EU:C:2014:2204 (Sept. 11, 2014).

³⁷ *United States v. First Data Corp. and Concord EFS, Inc.*, No. 03-CV-02169 (D.D.C.2003); Complaint, *United States v. Daily Gazette Co., and MediaNews Group, Inc.*, No. 2:07-0329, ¶ 26 (May 22, 2007) (“Accordingly, the sale of local daily newspapers to readers, and the sale of access to those readers to advertisers in those newspapers, each constitutes a line of commerce and a relevant product market within the meaning of Section 7 of the Clayton Act and for purposes of Sections 1 and 2 of the Sherman Act.”); Complaint, *United States v. NAT, L.C. and D.R. Partners d/b/a Donrey Media Group*, No. 95:5048, ¶ 8 (Mar. 28, 1995) (“Local daily newspapers sell two products (services) to two sets of customers. To readers, they sell daily newspapers. To advertisers, they sell access to their readers. Each of these products constitutes a line of commerce and a relevant product market within the meaning of Section 7 of the Clayton Act.”).

C. Katz Has Not Rebutted My Finding that the Transaction Would Have Anticompetitive Effects as a Result of Agglomeration of Control of Access to Households

16. My analysis concluded that the Transaction would increase the distribution fees paid by video programmers by {BEGIN CI END CI} percent.³⁸ That is a significant anticompetitive effect from the merger. The Transaction would increase the net fees paid by video programmers and households by {BEGIN CI END CI} if we assume, following Professor Katz, that New Charter passes on 50 percent of the gains to consumers.

17. Professor Katz has not presented any meaningful rebuttal of these figures.³⁹ Table 2 summarizes the results. This result is different from the situation in *United States v. American Express*. In that case, Amex disputed that the rules helped maintain price. In this Transaction, the merging parties have themselves claimed that the merger would result in an increase in bargaining power that would impose significant economic harm on the business side of the platform.

³⁸ Evans Declaration, ¶¶ 65-66.

³⁹ Professor Katz does claim, incorrectly, that I have not shown that the merger has any anticompetitive effect on video programmers. *See* Katz Reply ¶ 29. The Transaction increases the distribution price to video programmers as noted above by {BEGIN CI END CI} percent. In a standard merger inquiry, and consistent with Professor Katz’s approach in *American Express*, that is sufficient to establish an anticompetitive effect. He claims incorrectly that “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 Charter pays to programmers and the retail prices that New Charter charges MVPD consumers must be anticompetitive.” Katz Reply ¶ 30. That is not true. I explained in my declaration why larger MVPDs could demand higher access fees as a result on their ability to block access to a larger portion of households and I provided empirical evidence on that ability. Evans Declaration, ¶¶ 53-67. As noted above, Professor Katz argued in AT&T-DIRECTV that the size premium results in part from the ability of larger MVPDs to disrupt the video programmers’ business model. *See supra*, ¶ 6. Aside from citing some general theoretical papers Professor Katz has offered no further evidence on this point in his reply declaration.

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Table 2: Effect of Merger on Video Programmer “Distribution Fee”

{BEGIN CI

END CI}

18. Unlike his testimony in *American Express*, Professor Katz insists that a significant price increase to businesses that use an intermediary is acceptable because (a) they are just “rent transfers”⁴⁰ and (b) will increase output.⁴¹

19. I would encourage competition authorities to be careful about starting down the slippery slope of “it’s just rent transfers” based on Nash bargaining theory.⁴² Most B2B transactions involve bargaining between the parties. Permitting significant agglomerations of bargaining power because they just involve “rent transfers” would allow precisely the sorts of concentrations the Clayton Act was designed to deter. There is no economic basis for doing so. Rent transfers between businesses ultimately have real effects because they influence entry and investment decisions even if they do not affect short-run production. Transferring “rents” from

⁴⁰ Katz Reply, ¶ 31.

⁴¹ *Id.* ¶ 33.

⁴² The standard Nash bargaining framework used by economists does not consider the impact of the “bargain” on other long-run investment decisions or competition. It is quite narrowly focused on the economics of splitting today’s pie.

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video programmers to New Charter would likely have real adverse effects on video programmers in the long run. It would affect future decisions to offer channels and produce content.⁴³

20. Professor Katz claims that the lower prices paid for video programming will increase “the consumption of video services.”⁴⁴ Professor Katz does not provide any evidence that is particular to this merger, or even this industry, that the output effect from lower video programming costs would be significant. New Charter might add some additional marginal channels at the lower prices. That could provide households with more choices of video programming. But it is not clear that it would significantly increase how much video programming they consume since they may just substitute the new channels for existing ones.⁴⁵

21. Finally, there is no public policy reason for increasing the bargaining power of the merging parties at the expense of video programmers. The video programming industry is relatively competitive. It has an HHI of {**BEGIN CI** **END CI**}, which puts it in the competitive range based on typical merger standards.⁴⁶ Content providers and video

⁴³ Professor Katz claimed that the Transaction could not have much of an effect because New Charter is such a small part of the total demand for video programming. *See* Katz Declaration, ¶ 88. He has not demonstrated that the relevant antitrust market for evaluating this Transaction consists of the national market for video programming. Any definition of the relevant market must be consistent with the evidence submitted by Charter that the Transaction would result in a significant increase in bargaining power that would significantly reduce the prices paid by the merging parties to video programmers (and therefore increase the access and distribution fees charged as I have pointed out). Under Professor Katz’s approach, any merger of regional distributors that resulted in a significant increase in the price of accessing consumers in that region should be approved, so long as the number of customers in that region was a small portion of the overall national market.

⁴⁴ Katz Reply, ¶ 33.

⁴⁵ From an economic standpoint, Professor Katz is simply saying that in addition to the first-order pass-through benefits, which he has claimed, he also wants to claim credit for the second-order effect of the lower prices on output. Directionally, the lower video programming costs have both of these effects. But Professor Katz has provided no fact-based, merger-specific evidence to support these claims.

⁴⁶ I obtained data on 2015 net operating revenue and ownership for US cable and regional sports networks from SNL Kagan. For networks with more than one owner, I assigned net operating revenue to each owner based on

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programming providers ultimately compete intensely for viewership by cable households. That competition determines how much they can charge for channels and how much they can charge for advertising. There are no significant entry barriers into producing content or for multi-channel or single-channel providers to add more channels. There are some situations in which video programmers that have purchased exclusive rights over “must-have” content like sporting events have bargaining power. Most video programming content, however, is not must-have. The local dominant cable system is the major bottleneck between content creators that want to reach households and households that want to consume content.⁴⁷ There is no apparent public policy reason, and Professor Katz has offered none, for giving those bottlenecks even greater power through control over access to more households.⁴⁸

their ownership share of the network. Then, I aggregated net operating revenue by owner and calculated the industry HHI using the resulting shares of net operating revenue.

⁴⁷ See, e.g., Jonathan A. Knee, Bruce C. Greenwald, and Ava Seave, *The Curse of the Mogul: What's Wrong with the World's Leading Media Companies* (New York: Penguin, 2009).

⁴⁸ Professor Katz claims my earlier declaration presented a “straw-man argument asserting that I would assess a merger to monopoly solely by examining pass through to consumers.” Katz Reply ¶ 32. My statement referred to a merger to monopoly of intermediaries and did not specifically address a merger to monopoly of cable systems; had I addressed cable systems particularly, I would have referred to a merger to monopoly of non-overlapping cable systems. See Evans ¶ 20. Having read his reply declaration, I continue to believe that the analytical framework he has put forward would not obviously condemn the effect of a merger to monopoly of non-overlapping MVPDs on the prices paid by MVPDs for video programming (and therefore in my terminology the prices charged by MVPDs for access and distribution to households) to the extent that was related to the price-size relationship we both agree exists. The analytical framework he has used for this Transaction, unlike the analytical framework he used in *American Express*, would begin by looking at the pass-through to consumers, ignore the direct impact of the price increase to video programmers, and then inquire whether there is a reduction in output of video programming. A standard merger analysis would examine the impact of the concentration on prices to the video programmers and then consider whether there are offsetting efficiencies. See U.S. DOJ and the FTC, Horizontal Merger Guidelines (2010), <http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf>. Merger analysis generally assumes that a significant increase in price resulting from increased market power is sufficient to cause concern.

III. Professor Katz Has Not Examined the Effect of the Transaction on Long-Run Consumer Welfare in Local Broadband and Video Programming Markets or Provided Substantive Responses to the Evans Declaration

22. Professor Katz has presented no meaningful economic evidence or argument in response to my analysis of the relationship between higher MVPD margins for the merging parties and competition in local broadband in the footprint of the merging parties. In my initial declaration:

1. I showed that the Transaction resulted in an anticompetitive increase in prices to video programmers. New Charter is not benefitting from a scale economy or other economic efficiency. It is securing lower video programming prices by being able to deny video programmers access to a larger group of households.⁴⁹
2. I showed that there is a significant market failure in the provision of local broadband in the areas served by the merging parties and that the lower video programming prices that large MVPDs are able to demand tend to perpetuate that market failure and discourage new entry.⁵⁰
3. I showed that the decline in video programming prices resulting from this Transaction would exacerbate this market failure and further deter local broadband competition.⁵¹

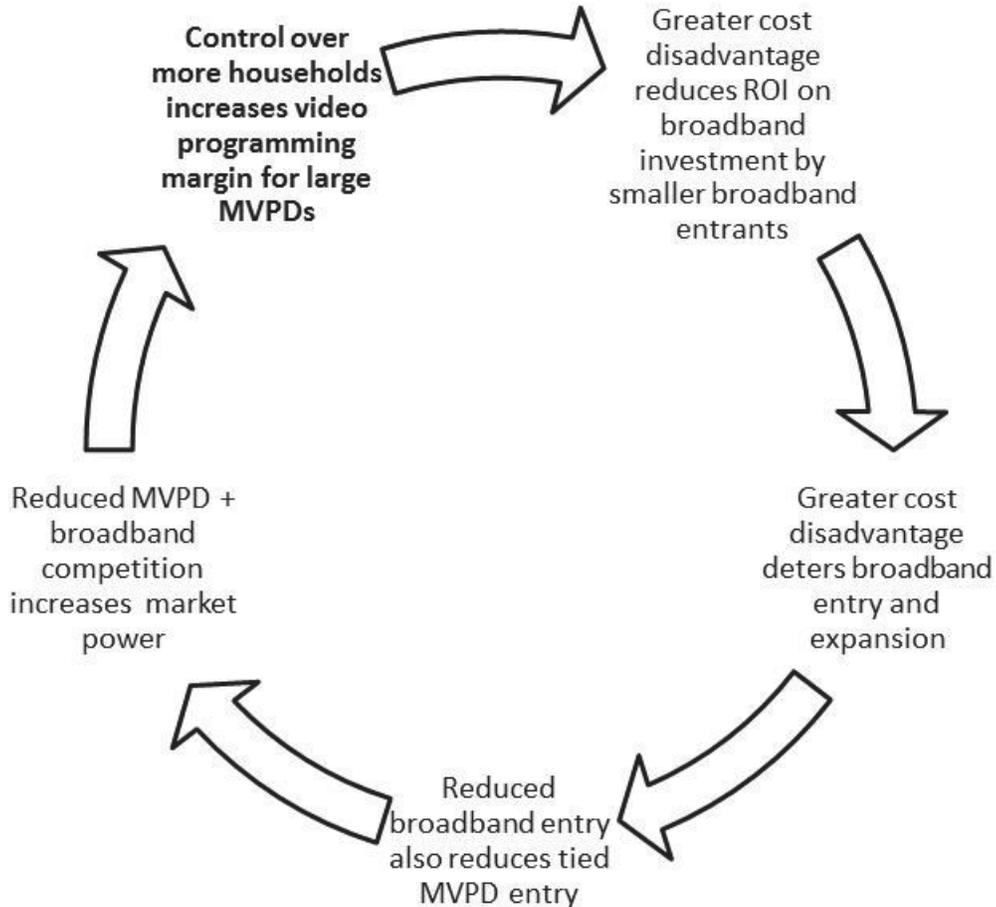
23. As a result, there is a vicious cycle between large MVPDs securing additional bargaining leverage to demand lower video programming prices and barriers to entry to local broadband competition:

⁴⁹ Evans Declaration, ¶¶ 35-68.

⁵⁰ *Id.* ¶¶ 72-85.

⁵¹ *Id.* ¶¶ 96-106.

Figure 1: Vicious Cycle between Large MVPD Market Power over Video Programmers and Local Broadband Competition



24. These findings were based on an extensive empirical analysis that examined the specific facts about competition for the firms and industries relevant to this Transaction.

1. I showed there are significant market failures in the areas served by the merging parties that are reflected in the limited broadband choices available to households and the low customer service ratings of the merging parties.⁵² This analysis was based in part on an empirical analysis of competitive broadband choices at the census tract level combined with U.S. Census of population data on households.

⁵² *Id.* ¶¶ 72-85.

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2. I conducted an empirical analysis of the relationship between the cost of video programming and the rate-of-return on investment in extending fiber to new areas based on in-depth interviews and examination of data from local broadband providers.⁵³ Four of the providers made available detailed and highly confidential company data.
 3. Based on a combination of in-depth interviews with local broadband providers and review of third-party sources I collected empirical evidence concerning how large MVPDs, including Time Warner Cable and Charter, engage in selective price-cutting in local markets when those MVPDs face incipient competition.⁵⁴
 4. I engaged in empirical examination of data from third party sources concerning how competitive entry changes prices and the quality of service offerings from large MVPDs such as Time Warner Cable.⁵⁵
25. Professor Katz does not dispute the empirical evidence I submitted except to claim I did not do enough to establish that there is a relationship between video programming cost savings and entry.⁵⁶ His criticism is hard to take seriously. Professor Katz conducted no market research at all on how cost savings would affect pricing generally or in local markets. He simply pulled a demand function off the shelf and plugged in market shares as discussed in the next section.
26. Professor Katz's criticism on the lack of evidence on entry decisions also seems beside the point, because the observation that there is a close connection between video programming

⁵³ *Id.* ¶¶ 86-95.

⁵⁴ My research team and I spent considerable effort over the space of six weeks collecting data from local broadband providers and interviewing executives at those companies. Professor Katz's assertion that I "paraphrase[d] unsubstantiated claims" is simply wrong. Katz Reply, ¶ 26. It is true that that the entities I interviewed desired to remain anonymous and did not wish to submit confidential business documents.

⁵⁵ See Evans Declaration, ¶¶ 86-95, 96-103.

⁵⁶ Katz Reply, ¶ 26. Professor Katz also criticizes me for citing 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." See Katz Reply, ¶ 26. In fact, I discussed the article because Professor Katz had relied on it as claimed support for his pass-through findings, in arguing that lower video programming costs for larger distributors increases consumer welfare. I pointed out that the conclusion in that article was that programming cost reductions from the merger could *decrease* consumer welfare because the benefits from the partial pass-through of cost savings are outweighed by the costs of reduced competition resulting from the heightened barrier to entry.

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costs and investment is not controversial. Professor Katz claimed that there was a significant relationship in the AT&T-DIRECTV Transaction:

The proposed transaction can be expected to increase AT&T's incentive to expand its FTTP footprint because the merger will increase the profitability of the services offered using the expanded facilities. Specifically, the merger will increase profitability by lowering AT&T's video services costs (especially its content acquisition costs) and increasing the quality of both its video offering and its bundles containing AT&T video services (which will result in higher penetration and less churn).⁵⁷

The basic economics are no different for the local broadband providers.

27. Professor Katz claims that entry is deterred in local markets only when consumers are getting price cuts that benefit them.⁵⁸ The empirical evidence shows that large MVPDs lower prices selectively, but above cost, in response to incipient competition. This is the mechanism by which entry is deterred and expansion discouraged. There is nothing unlawful about this. But it has the predictable effect that an expansion in the margins of the large cable systems will tend to perpetuate and exacerbate market failures in local broadband. Consumers get the temporary benefit of selective price cuts but they lose the more permanent benefit of increased competition. Professor Katz asserts that I lack empirical evidence to support this. This is not the case, as noted above.

28. Professor Katz claims my analysis lacks a “critical limiting principle” and that I “would have to show that the cost reductions are the result of anticompetitive behavior.”⁵⁹ That, in fact, *is* one of my limiting principles and is precisely what I showed: that by increasing the size of

⁵⁷ Katz AT&T-DIRECTV Declaration, ¶ 126.

⁵⁸ Katz Reply, ¶ 25.

⁵⁹ *Id.* ¶ 24.

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the bottleneck held by the merging parties the Transaction would result in a significant increase of the distribution cost to video programmers. The “cost reduction” secured by New Charter is the result of being able to deny video programmers access to a larger group of customers. It is an anticompetitive effect of the merger based on precisely the same reasoning Professor Katz testified to in *American Express*.

29. My analysis is based on a second limiting principle: whether there is a significant market failure in the related market, which would be exacerbated by the exercise of market power. I showed that in my initial declaration.⁶⁰ I do not believe that this proposition is really a matter of much dispute, and in any event, Professor Katz has not disagreed with that finding or the empirical evidence I cite.

30. I do not have any reason to believe that the situation analyzed in my initial declaration is common. With regard to my first limiting principle, most proposed mergers do not have significant anticompetitive effects. It is also uncommon for the merging parties to submit evidence that the merger will increase prices significantly, as a result of increased bargaining power, and tout that that as an efficiency. With regard to my second limiting principle, it is hard to think of many consumer markets that work as poorly as local broadband or have the sort of vicious cycle that I have identified. I do not believe there is much risk that adopting the approach I have taken for this transaction will risk a raft of inefficient government intervention.

⁶⁰ See Evans Declaration, ¶¶ 72-85.

IV. Professor Katz Has No Empirical Evidence for His Claimed Consumer Benefits

31. Professor Katz does not have any reliable or credible economic evidence to support his claim that Charter would “pass through” 50 to 60 percent of the cost savings from video programmers to consumers in the form of lower quality-adjusted prices. Economists examine the rate of pass-through by studying how firms or industries change prices in response to cost shocks. They use time-series or cross-sectional data—or both—to conduct such empirical inquiries.⁶¹ Professor Katz has done none of this.⁶²

⁶¹ See Kusum L. Ailawadi and Bari A. Harlam (2009), “Retailer Promotion Pass-Through: A Measure, Its Magnitude, and Its Determinants,” *Marketing Science*, 28(4): 782-791; Lian An and Jian Wang, “Exchange Rate Pass-Through: Evidence Based on Vector Autoregression with Sign Restrictions,” *Open Economics Review*, 23(2): 359-380; John Beirne and Martin Bijsterbosch (2011), “Exchange Rate Pass-Through in Central and Eastern European Member States,” *Journal of Policy Modeling*, 33(2): 241-254; David Besanko, Jean-Pierre Dubé, and Sachin Gupta, “Own-Brand and Cross-Brand Retail Pass-Through,” *Marketing Science*, 24(1): 123-137; Mārtiņš Bitāns (2004) “Pass-Through of Exchange Rates to Domestic Prices in East European Countries and the Role of Economic Environment,” Bank of Latvia Working Paper 4/2004; Celine Bonnet, Pierre Dubois, and Sofia B. Vilas-Boas (2013), “Empirical Evidence on the Role of Non-Linear Wholesale Pricing and Vertical Restraints on Cost Pass-Through,” *Review of Economics and Statistics*, 95(2): 500-515; Matthieu Bussière (2013), “Exchange Rate Pass-Through to Trade Prices: The Role of Non-Linearities and Asymmetries,” *Oxford Bulletin of Economics and Statistics*, 75(5): 731-758; Matthieu Bussière, Simona Delle Chiaie, and Tomas A. Peltonen (2014), “Exchange Rate Pass-Through in the Global Economy: The Role of Emerging Market Economies,” *IMF Economic Review*, 62(1): 146-178; José Manuel Campa and Linda S. Goldberg (2005), “Exchange Rate Pass-Through into Import Prices,” *Review of Economics and Statistics*, 87(4): 679-690; Mikael Carlsson and Oskar Nodström Skans (2012), “Evaluating Microfoundations for Aggregate Price Rigidities: Evidence from Matched Firm-Level Data on Product Prices and Unit Labor Cost,” *American Economic Review*, 102(4): 1571-1595; Michele Ca’Zori, Elke Hahn, and Marcelo Sanchez (2007), “Exchange Rate Pass-Through in Emerging Markets,” *European Central Bank Working Paper No. 739*; Ehsan U. Choudhri, Hamid Faruquee, and Dalia S. Hakura (2005), “Explaining the Exchange Rate Pass-Through in Different Prices,” *Journal of International Economics*, 65: 349-374; Zsolt Darvas (2001), “Exchange Rate Pass-Through and Real Exchange Rate in EU Candidate Countries,” *Deutsches Bundesbank Economic Research Centre Discussion Paper 10/01*; Jean-Pierre Dubé and Sachin Gupta (2008), “Cross-Brand Pass-Through in Supermarket Pricing,” *Marketing Science*, 27(3): 324-333; David Evans, Howard Chang, and Steven Joyce (2015), “The Impact of the U.S. Debit-Card Interchange Fee Regulation on Consumer Welfare,” *Journal of Competition Law and Economics*, 11(1): 23-67; Natalia Fabra and Mar Reguant (2013), “Pass-Through of Emissions Costs in Electricity Markets,” *NBER Working Paper No. 19613*; Pinelopi Koujianou Goldberg and Michael M. Knetter (1997), “Goods Prices and Exchange Rates: What Have We Learned?” *Journal of Economic Literature*, 35: 1243-1272; Gita Gopinath and Roberto Rigobon (2008), “Sticky Borders,” *Quarterly Journal of Economics* 123(2): 531-575; Rebecca Hellerstein (2008), “Who Bears the Cost of a Change in the Exchange Rate? The Case of Imported Beer,” *Journal of International Economics*, 76(1): 14-32; Takatoshi Ito and Kiyotaka Sato (2007), “Exchange Rate Pass-Through and Domestic Inflation: A Comparison between East Asia and Latin American Countries,” *RIETI Discussion Paper Series 07-E-040*; Ramona Jimborean (2013), “The Exchange Rate Pass-Through in the New EU Member States,” *Economic Systems*, 37(2): 302-329; Ramón

32. His primary economic “evidence” of pass-through is based on a hypothesized demand schedule that yields exactly the same “estimate” of pass through for every firm in the economy, regardless of industry or any other specifics, except for its market share.⁶³ That model does not even apply to Charter because the model assumes, contrary to the facts, that Charter offers a

Maria-Dolores (2010), “Exchange Rate Pass-Through in New Member States and Candidate Countries of the EU,” *International Review of Economics and Finance* 19(1): 23-35; Sergio Meza and K. Sudhir (2006), “Pass-Through Timing,” *Quantitative Marketing Economics*, 4(4): 351-382; Dubravko Mihajjek and Marc Klau (2001), “A Note on the Pass-Through from Exchange Rate and Foreign Price Changes to Inflation in Selected Emerging Market Economies,” *BIS Papers No. 8*; Dubravko Mihajjek and Marc Klau (2008), “Exchange Rate Pass-Through in Emerging Market Economies: What Has Changed and Why?” *BIS Papers No. 35*; Rajmund Mirdala (2009), “Exchange Rate Pass-Through to Domestic Prices in the Central European Countries,” *Journal of Applied Economic Science*, 4(3): 408-424; Rajmund Mirdala (2014), “Exchange Rate Pass-Through to Consumer Prices in the European Transition Economies,” *Procedia Economics and Finance* 12: 428-436; Emi Nakamura and Dawit Zerom (2009), “Accounting for Incomplete Pass-Through,” *Review of Economic Studies*, 77(3): 1192-1230; Vincent Nijs, Kanishka Misra, Eric T. Anderson, Karsten Hansen, and Lakshman Krishnamurthi (2010), “Channel Pass-Through of Trade Promotions,” *Marketing Science*, 29(2): 250-267; Koen Pauwels (2007), “How Retailer and Competitor Decisions Drive the Long-Term Effectiveness of Manufacturer Promotions for Fast Moving Consumer Goods,” *Journal of Retailing*, 83(3): 297-308; Yuri Ponomarev, Pavel Trunin, and Alexei Uluykaev (2014), “Exchange Rate Pass-Through in Russia,” Working Paper; Timothy J. Richards, Miguel I. Gómez and Jun Lee (2014), “Pass-Through and Consumer Search: An Empirical Analysis,” *American Journal of Agricultural Economics*, 96(4): 1049-1069.

⁶² Professor Katz claims incorrectly that one of my “main arguments is that the world is complex and certainty is difficult to achieve” and then goes on to say that fact “does not contradict the fact that the degree of pass-through is likely to be substantial.” See Katz Reply, ¶ 5; see also *id.* ¶ 18. My main argument is that the analysis of pass-through by the merging parties needs to be based on empirical examination of the merging parties and not by using a simple textbook formula that could apply equally to any firm or industry. Moreover, while Professor Katz keeps repeating variants of the “pass-through is very likely to be substantial” claim, and here says that it is even a “fact,” he has no credible fact-based evidence that is particular to the merging parties to support that conclusion. Katz Reply, ¶ 5.

⁶³ Professor Katz points to the FCC’s consideration of a related economic model in its ATT-DIRECTV transaction order. But the FCC’s consideration was in the context of evaluating a merger simulation model rather than an attempt to estimate pass-through. The FCC explicitly said that the extent of pass-through under that theoretical model may be too high but considered that model for reasons unrelated to pass-through: “Finally, we acknowledge that the ‘nested logit’ structure used in the BH Simulation is known to pass through a higher percent of transaction efficiencies relative to other merger simulation structures. The BH Simulation pass-through rate – the percent of the programming payment reductions that would be passed on to consumers through lower prices – is [BEGIN HIGHLY CONF. INFO.] [END HIGHLY CONF. INFO.] percent. It is not possible to alter the pass-through rate without adopting a different merger simulation structure that may not capture the significant benefits of the nested logit structure in determining the substitution between products and/or the discrete choices made by subscribers.” *Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations, Memorandum Opinion and Order*, MB Docket No. 14-90 ¶103 (2015) (internal citations omitted).

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The foregoing declaration has been prepared using facts of which I have personal knowledge or based upon information provided to me. I declare under penalty of perjury that the foregoing is true and correct to the best of my information, knowledge, and belief.

Executed on February 12, 2016.

A handwritten signature in black ink, appearing to read 'DSE', with a stylized flourish at the end.

David S. Evans
Chairman
Global Economics Group, LLC



**ECONOMIC ANALYSIS OF CHARTER/TIME
WARNER CABLE TRANSACTION ON VIDEO
PROGRAMMING DISTRIBUTION AND LOCAL
BROADBAND COMPETITION**

David S. Evans
Global Economics Group, University of
Chicago, and University College London

February 9, 2016
Presentation to U.S. Department of Justice



DIRECT EFFECTS OF MERGER ON PRICES FOR VIDEO PROGRAMMING ACCESS AND DISTRIBUTION

12-Feb-
16

Video programmers use MVPDs for access and distribution to households



- MVPD distributes programming as part of bundles or a la carte (Katz ¶ 10)*
- MVPD usually pays video programmer fee per subscriber based on collected revenue, with kickers based on tiers and channel placement (Katz ¶ 29)
- Video programmers insert ads into programming and get paid directly by advertisers (Katz ¶ 87)
- Video programmers bear risk of subscribers choosing packages with their content (determines subscriber revenue) and advertising (based on viewership)
- Usually, channels and consumers have “direct relationship” in the sense that people watch “CNN,” they don’t watch “Charter”
- Video programming is a reasonably competitive industry with many players; although there are some “must-have channels” (sports, local news), most are not

* Cites to “Katz” refer to Professor Katz’s 11/2/2015 Declaration. Cites to “Katz Reply” refer to Professor Katz’s 1/29/2016 Declaration

The following slide contains
highly confidential information

Charter says merger will result in significant reduction in video programming prices they pay



- Merger combines TWC/BHN {CI} and Charter {CI} to create an MVPD with {CI} of MVPD households
- Merger would result in significant reduction in average price to subscriber paid to video programmers according to Charter/Katz
 - {{HCI HCI}} percent reduction in prices from Charter stepping into *existing TWC contracts*. (Katz ¶ 32)
 - {CI CI} percent reduction in prices after contract renewal for Charter, {CI CI} percent for TWC, and {CI CI} percent overall based on simple regression. (Evans ¶ 58)*
 - Katz agrees larger reduction than {{HCI HCI}} percent in longer term as contracts get renegotiated. (Katz ¶ 21)

CI}

* Cites to “Evans” refers to Evans Declaration, 1/15/16. Based on simple linear regression of price against size.

Merger results in lower video programming prices from control of larger bottleneck, not efficiencies



- “Such scale effects may arise because the *loss of a large buyer is more than proportionately disruptive to the content owner’s business model*” (Katz, AT&T-DirectTV ¶ 113)* (emphasis added)
 - Larger MVPDs can credibly threaten to block access to households thereby imposing significant loss on video programmers who have high fixed/low variable cost businesses and whose returns depend on wide distribution
 - Larger MVPDs have greater bargaining power than smaller MVPDs (Katz ¶ 16 n.11 (citing evidence))
- No economic evidence of efficiencies that could account for significant price-size relationship and Charter/Katz have not offered any. In AT&T-DirectTV ¶ 113 advertising reach only other “efficiency” identified
 - Advertising reach economies can’t account for difference; and advertising-size effect likely from enhanced ability to deny access to large groups of customers and therefore not economic efficiency

MVPDs are intermediaries just like newspapers, card networks, and other two-sided platforms



- MVPDs are intermediaries between video programmers and households
 - MVPD enables video programmers to access households
 - MVPD pays video programmers and households pay MVPD
 - Advertisers pay video programmers to deliver ads to households
- Card networks are intermediaries between merchants and cardholders
 - Card network enables merchants to access cardholders
 - Card network pays merchant (e.g. \$100) minus “merchant discount” (e.g. \$2) (for payment of e.g. \$98) when cardholder charges; cardholders may get rewards for charging and may pay annual fee.
- ISPs are intermediaries between Internet content providers and households
 - ISP enables content providers to access households
 - ISP charges household and very large ISPs may charge some content providers
 - Advertisers pay content providers to deliver ads to households and content provider may charge households directly
- Newspapers are intermediaries between advertisers and readers
 - Newspapers enable advertisers to access readers
 - Advertisers pay newspapers to deliver ads to readers and some readers pay for paper

In these and many other cases the “business side” is “paying” to get access to the “consumer side”. Katz has not disputed MVPDs are two-sided platforms. (See Katz Reply Declaration ¶¶ 5, 30).

The following slide contains
highly confidential and
confidential information

A large, light-colored, stylized circular graphic composed of several overlapping curved segments, resembling a partial circle or a decorative element, positioned behind the main text.

Merger would result in significant increase in price paid by “business side” of platform



- Merger reduces price per subscriber paid to video programmers by {CI} CI} percent overall (Evans Reply ¶ 58)
 - Consistent with Katz’s estimates for Charter walking into TWC contracts and his declaration (Katz estimates Charter will save {{HCI} HCI}} by stepping into TWC contracts (See Katz ¶ 32))
- The fact that merger affects price “paid” to video programmers does not mean that it is not a “price increase” to video programmers for access and distribution services
 - Decrease in price paid to video programmers reflects ability of New Charter to charge more for access to its larger base of households as part of “disruptive strategy”
 - Suppose two card networks merged resulting in increase in merchant discount from 2% to 3%. The amount *paid* by the card network to the merchants for \$100 cardholder charge would decrease from \$98 to \$97 – but merchants are paying \$1 more for distribution for a 50% increase in price for accessing cardholders (\$3-\$2)/\$2 = 50%)
 - The fact that the MVPD distribution fee is implicit in transaction and not explicit is not relevant to economic analysis.
- Merger increases total price even if Katz’s claims about 50-60% pass through were correct
 - Katz provides no fact-based merger-specific analysis for assessing extent of pass through in this merger and therefore his pass-through estimates should have little weight; no dispute that it is positive though, just that magnitude hasn’t been estimated empirically
 - Even assuming his claimed level of pass through, merger still increases the total price paid by both sides

Merger would increase “distribution fee” by around {CI [REDACTED] CI}



{CI

CI}

{CI

CI}

Katz does not directly dispute this analysis in his Reply Declaration; only says contrary to Katz in AT&T-DirectTV that there are many reasons for volume discounts. (Katz Reply ¶ 30).

Comparison with U.S. v. Amex



Analysis of	<i>U.S. v. American Express</i>	<i>Charter TWC Merger</i>
Business and products	Platform that provides merchants access to cardholders	Platform that provides video programmers access to households
Market definition	Merchant services for credit and charge cards in the US	Video programming distribution (scope open but needs to account for fact that merger has large price increase and therefore limited constraints)
Market power source	Ability to deny merchants access to cardholder spend; note typical consumer has multiple cards on person at checkout.	Ability to deny video programmers access to households; note typical consumer has limited alternatives with high switching costs
Competitive effects	Ability to maintain “high” merchant discount by reducing merchant bargaining power; no significant examination of output by Katz or DOJ	Direct significant horizontal impact of merger on video programming distribution fees based on evidence sponsored by merging parties
Analysis of consumer side	Katz argues merchant increase not offset by consumer pass through. (See <i>U.S. vs. Amex</i> , Trial Transcript, July 29, 2014, at 4039-40.) Consumer pass-through treated under pro-competitive justification prong of rule of reason by DOJ	{CI [redacted] CI} increase ignoring consumer side and {CI [redacted] CI} counting pass-through to get to total price change or as efficiency offset

Katz Initial and Reply Declarations do not provide credible economic response



- No harm, just transfer of rents (Katz Reply ¶ 31)
 - Reduced “rents” to video programmers reduces incentives to invest in programming
 - Bargaining models do not account for economic impacts of bargain on upstream or downstream markets
 - Slippery slope to accept “transfer of rents” as justification for increase in market power from mergers
 - Inconsistent with standard merger analysis as well as American Express where key alleged effect of anti-steering provisions was reducing merchant bargaining power and thus the split of rents between Amex and merchants
- Lower video programming prices will increase “consumption of video services” (Katz Reply ¶ 33)
 - Like his pass-through analysis there is no fact-based merger-specific analysis of this assertion, which directionally is true
 - Lower prices result in MVPDs adding marginal channels but not clear the extent to which that results in substitution between channels as consumers reallocate viewing time versus increase in viewing time and consumption
 - In *U.S. vs. Amex*, Katz found that merchants paid a higher price, and American Express passed less than the full amount on to consumers, and that this was sufficient to find an anticompetitive harm, as did DOJ (*U.S. vs. Amex*, Trial Transcript, July 29, 2014, at 3821, 4039-40)
 - Katz provides no basis for concluding that first-order pass-through effect or second-order output effect completely offsets, or even significantly offsets, increase in implicit access and distribution fees to video programmers
- No public policy reason to for increasing bargaining power of merging parties at expense of video programmers
 - HHI for video programmers is {CI CI} and video programmers compete intensely for viewers which ultimately determines per-subscriber prices and advertising revenue
 - Bottleneck in movement of programming from content creators to video programmers to MVPDs to households is at the cable system level (See e.g. *The Curse of the Mogul: What's Wrong with the World's Leading Media Companies*, p. 62)



**EFFECTS OF INCREASED HORIZONTAL
PRICE INCREASE TO VIDEO PROGRAMMERS
ON COMPETITION IN LOCAL BROADBAND**

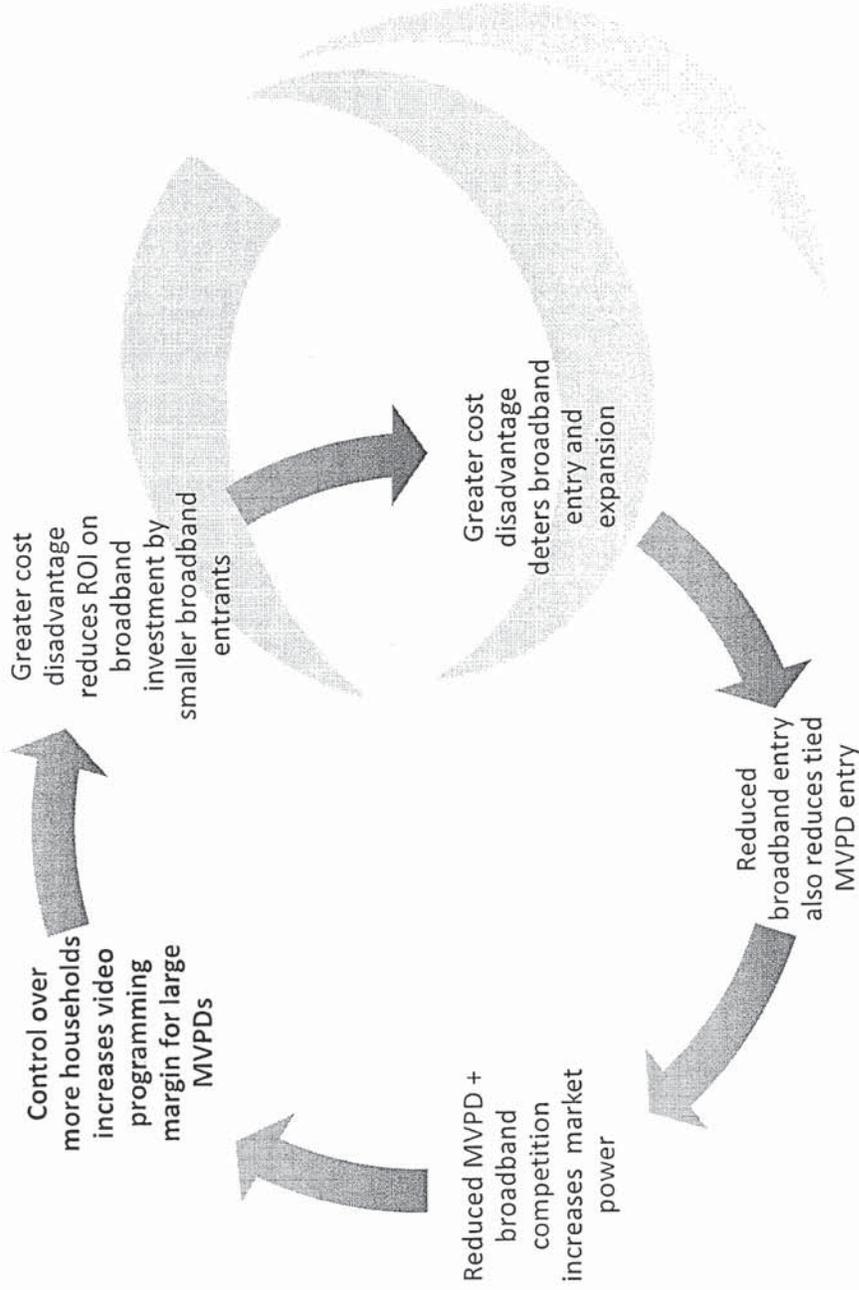
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Local markets for broadband highly dysfunctional

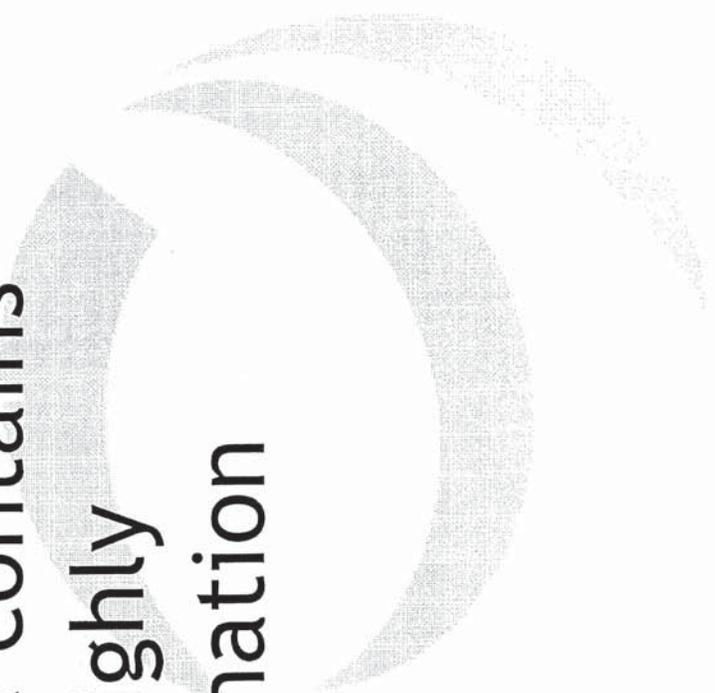


- Consumers lack good alternatives
 - Average household has <1 alternative ISP in New Charter footprint.
 - 86% of households do not have alternative to merging parties with equal or better broadband speed in New Charter footprint.
- Consumer satisfaction low and consumer complaints high for local broadband and cable
 - Charter and TWC like other large cable systems have very lower consumer ratings.
 - Complaints are widespread and well known.
- High barriers to entry:
 - New players face serious video programming cost disadvantage relative to large incumbents
 - Political barriers reinforced by lobbying by large players
 - High sunk capital costs of entry
 - Two-market entry into ISP and MVPD required
 - High switching costs for incumbents

Vicious cycle between large MVPD market power over video programmers and local broadband competition



The following slide contains
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Large MVPDs have market power over video programmers which results in cost/margin advantage



- Large MVPDs integrated into ISP and MVPD
 - All larger MVPDs, including the merging parties, operate as ISPs and MVPDs
 - Bundle broadband and video programming and engage in extensive price discrimination involving these bundles
- Large MVPDs including the merging parties have significant market power over video programmers
 - Use power to extract lower video programming prices/higher distribution and access fees
 - These lower prices/higher fees are *not the result of superior efficiency; result of exercising market power over access to households*
- Transaction would increase market power significantly
 - Significant increase in access fees (around {CI CI} percent before pass-through).
 - The lower prices paid by New Charter would result from greater control over access to households not from superior efficiency
- Selective above-cost price cuts from higher margin would make offering video programming uneconomic or more uneconomic from smaller broadband providers
 - {{HCI
 - HCI}}

Large MVPD market power results in significant cost-delta for small MVPDs



- Cablevision, a relatively small MVPD with {CI} subscribers, currently has a programming cost disadvantage compared to the merging parties
 - Charter pays {CI} percent less than Cablevision
 - TWC pays {CI} percent less than Cablevision
 - On average the merging parties pay {CI} percent less than Cablevision
- Post merger programming cost disadvantage
 - Cablevision's programming cost disadvantage will grow as a result of the merger. Based on a simple regression of programming costs and subscriber counts, New Charter's average video programming cost per subscriber/month will be {CI} compared to the merging parties' current subscriber-weighted average costs of {CI}
 - The merging parties will pay {CI} percent less than Cablevision post-merger compared to {CI} percent pre-merger

The following slide contains
highly confidential information



Large MVPDs use margin advantage for targeted above-cost price cuts



- Large MVPDs including the merging parties use margin advantages to engage in targeted above-cost price cuts to deter broadband entry and expansion
 - Selective above-cost price cuts used to deter incipient competition and to limit actual competition
 - {{HCI
 - HCI}}
 - For example, Comcast launched a new competitive offering in response to Google Fiber's entry in Provo: "Competition is good, and Comcast is just now proving it. I spoke with one of their sales guys who confirmed that Comcast will be offering a package of 250Mbps/50Mbps for \$70 starting in September, but only in Provo. (Sorry, everywhere else.) This is in direct response to Google Fiber coming to town[.]" (See [http://www.muninetworks.org/content/comcast-reacts-google-fiber-provo.](http://www.muninetworks.org/content/comcast-reacts-google-fiber-provo))

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highly confidential information

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Changes in video-programming cost delta significantly affects broadband deployment



- “The proposed transaction can be expected to increase AT&T’s incentive to expand its FTTP footprint because the merger will increase the profitability of the services offered using the expanded facilities... [My] analysis indicates that the proposed merger would lead to substantial increases in the incentives to deploy FTTP.” (Katz, AT&T-DirectTV, ¶¶ 126, 133).
- Higher programming cost delta results in lower investment in broadband from the merging parties’ competitors
 - A competitive ISP suggested that when faced with aggressive pricing practices and targeted retention efforts by TWC, the competitive ISP incurred a {{HCI HCI}} percent decline in their internal rate of return (IRR), measured over a ten-year forward-looking period, and caused the competitive ISP to reduce its fiber build investment plans for the 2015, which included several thousand homes, representing approximately {{HCI HCI}} percent of the competitive ISP’s existing footprint. (Evans ¶ 98).
 - An executive at another competitive ISP noted to my staff “This disparity between the cost paid by large incumbents and smaller competitive broadband providers naturally creates markets in which new deployments simply do not make commercial sense. In other words, a large delta like the one Charter seeks here makes it less likely those competitive broadband providers will be willing or even able to deploy into New Charter’s territory—delaying or even foregoing opportunities for meaningful competition in those markets.” (Evans ¶ 102).