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July 18, 2002

BY HAND

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
236 Massachusetts Avenue, N.E.
Suite 110
Washington, DC 20002

Re: OPP Experimental Economics Study Examining Horizontal Concentration In The Cable Industry, CS Docket Nos. 98-82, 96-85, MM Docket Nos. 92-264, 94-150, 92-51, 97-154, and MB Docket No. 02-70

Dear Ms. Dortch:

Transmitted on behalf of SBC Communications Inc. are an original and 16 copies of Comments of SBC Communications Inc. in the above-referenced proceedings.

In the event there are any questions concerning this matter, please communicate with the undersigned.

Very truly yours,

Robert M. Halperin

Enclosures

cc: Qualex (by e-mail)
Linda Senecal (by e-mail)

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

In the Matter of	)	
	)	CS Docket Nos. 98-82, 96-85,
OPP Experimental Economics Study	)	MM Docket Nos. 92-264, 94-150,
Examining Horizontal Concentration	)	92-51, 97-154, MB Docket No.
In the Cable Industry	)	02-70

COMMENTS OF SBC COMMUNICATIONS INC. ON EXPERIMENTAL ECONOMICS STUDY

On June 3, 2002, the Federal Communications Commission issued a study report entitled "Horizontal Concentration in the Cable Television Industry: An Experimental Analysis" (released as Office of Plans and Policy (OPP) Working Paper No. 35) ("Working Paper" or "the experimental study").[1] That same date, the Commission issued a public notice seeking comment on that study in connection with both certain pending rulemakings and the pending proposed merger of AT&T Broadband and Comcast Corporation.

SBC Communications Inc. ("SBC") respectfully submits these brief comments to demonstrate that the Working Paper does not support the conclusion that the proposed transaction between AT&T and Comcast ("the Applicants") is in the public interest. Fundamentally, the Working Paper fails to reflect the real world and, as a result, is of no practical use, particularly as related to the proposed AT&T/Comcast transaction.

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1 A corrected version of this study was released on July 3, 2002.

THE WORKING PAPER DOES NOT REFLECT THE REAL WORLD AND THEREFORE IS OF NO PRACTICAL USE IN EVALUATING THE LIKELY COMPETITIVE EFFECTS OF THE MERGER.

A study such as this can be useful only if the model used in the study reflects the real world situation and the behavior of the experimental participants can reasonably be expected to mirror that of the real marketplace participants. Those conditions clearly are not satisfied here. As the authors of the Working Paper acknowledge, there are various aspects of the experimental study that do not reflect the real world in which program networks seek to sell their wares to multichannel video programming distributors ("MVPDs").[2] Many of these failings are attributable to the fact that the number of both buyers (MVPDs) and sellers (program networks) in the study ranges from 3 to 5, far less than the hundreds of buyers and sellers with very diverse relevant characteristics in the real world.[3] We highlight below four of the many significant ways the Working Paper fails to replicate the real-world it is seeking to study (beyond the obvious point that students reacting to hypothetical examples may well act differently than experienced businesspeople whose decisions have real economic consequences). Each of these points is either expressly recognized by the study's authors or cannot be disputed.

First, the study does not recognize important differences in programming. In the real world, all program networks are not interchangeable. While many program networks compete in the same programming niche (*e.g.*, program services that primarily run general entertainment programs or provide home shopping services), others face less competition within their niche. Moreover, some programming niches have more appeal than others. The experimental study

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2 Working Paper at 3, 51-52.

3 *Id.* at 3, n.6. "The experimental market includes far few[er] programming networks and MVPDs than there are in the actual market." *Id.* at 51.

fails to reflect the extent to which various program networks are (or are not) substitutes for each other. In the real world, the degree of program substitutability affects both the profitability of the programming and the bargaining power of the programmer *vis-à-vis* the MPVD. In the real world, the value placed by a MVPD on a particular program network also depends on how much, and what, other programming that MVPD is carrying. To a particular MVPD, a second news channel may be less valuable than a first shopping channel. The study admits the relevance of these factors and its failure to address them.[4] It therefore fails to provide meaningful information concerning the effects of increased horizontal concentration on program prices.

Second, the experimental study is static, while the real-world marketplace is dynamic. The study reports the results of a series of independent hypothetical transactions. The students participating in the study could negotiate only one transaction at a time.[5] A buyer, for example, could not negotiate with two (or more) different sellers of programming at the same time to determine which would provide it the "best deal." In the real world, of course, rational buyers and sellers consider alternative transactions. For example, a rational MVPD will consider alternatives to a given program network if there are multiple sellers of similar programming or if its channel capacity is limited (even if it is not full).

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4 *E.g., id.* at 52-53 ("[T]he experiments impose the restriction that the value a particular MVPD places on a given programming network is independent of the types of programming networks the MVPD decides to carry. In the actual market, MVPDs have an incentive to carry a package of programming networks that maximizes their subscription and local advertising revenues. Under such packaging, the value MVPDs place on a given programming network depends, in part, on the types of programming networks they decide to carry."); *id.* at 16 ("most cable operators have diminishing marginal utility (i.e., profitability) from signing additional affiliate agreements with cable networks").

5 *Id.* at 18 ("Participants could only submit a bid to buy or offer to sell to one individual at a time.").

Similarly, a rational programmer generally knows what fixed costs must be covered by all of its sales, and the marginal costs of dealing with a particular MVPD. If it receives a price from a given MVPD that does not cover both its marginal costs and a proportionate share of its fixed costs, then it will need to recover a disproportionately high share of those fixed costs (as well as the relevant marginal costs) from other MVPDs. Unless these costs can be covered, the programming in issue will either not be launched at all (if the program service would be new) or will ultimately fail (if the program service already exists).

The study authors recognize that the actions of one major MVPD can affect the quality of programming made available to other MVPDs.[6] The same logic leads to the conclusion that the actions of one major MVPD can also change the prices other MVPDs pay for, or even the existence of, some programming. Indeed, this point is the essence of an expert economic statement SBC submitted with its comments on this merger.[7] The experimental study ignores this critical real-world dynamic, and this fact alone makes this study virtually useless as applied to this merger.

Third, although the study recognizes the importance of vertical integration between program networks and MVPDs, that factor is also not considered. "While the issue of vertical integration is a potentially significant institutional feature that subsequent analyses may be able

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6 "The experiments impose the restriction that the value of a particular buyer (e.g., cable operator) places on a particular programming network is independent of the carriage decisions made by another MVPD (e.g., DBS). In the actual market, a large buyer's decision not to carry a programming network may affect the quality of the programming offered by the programming network." *Id.* at 52.

7 Declaration of Robert H. Gertner at ¶¶ 18-29.

to consider, we chose not to account for it because of the already complex nature of the experimental design."[8]

Fourth, and of particular relevance to the proposed merger, the utility of the experimental study is limited because none of the scenarios comes close to reflecting the market structure that exists either with or without the merger. This point, of course, is beyond dispute. The limited number of MVPDs hypothesized in the study leads to MVPDs that have much greater market shares than currently exist. In one scenario (the scenario with the least concentration), the largest cable system has a market share of approximately 27%, followed by another with a share of approximately 24%. In contrast, according to the Applicants, the largest cable firm today (AT&T) serves about 21% of MVPD households.[9] The second largest cable system operator today (AOL-Time Warner) currently serves approximately 14%.[10] Thus, this scenario does not reflect either the current (pre-merger) or alternative (post-merger) market structure.

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8 Working Paper at 51. The Commission has found that approximately 35% of satellite delivered national cable program networks are vertically integrated with cable systems. Eighth Annual Report, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* FCC 01-389 at ¶ 157 (rel. Jan. 14, 2002) ("*Eighth Annual Report*").

The model also assumed that the price of cable television advertising is independent of the size of the cable operator and that advertising purchasing practices would not change if MVPD market concentration increased. Working Paper at 51. Because larger cable systems may be more viable sellers of advertising than smaller cable systems, these static assumptions may understate the economic effects of increased horizontal cable concentration on cable programmers. *Id.* at 52.

9 *See* Applicants' Public Interest Statement at 50. All market shares are calculated based on the 91.33 million MVPD subscriber number used by the Applicants.

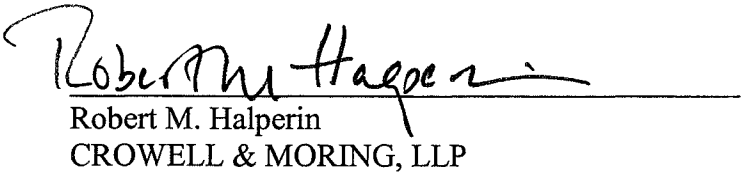
10 S. Sutel, "*AOL Time Warner Loses Subscribers,*" Associated Press, June 25, 2002 (AOL-Time Warner provides service to 12.9 million households with the Newhouse partnership systems included; with the Newhouse partnership services excluded, AOL-Time Warner will manage systems providing service to 10.8 million households).

The other scenarios in the study are even less reflective of today's marketplace. In one case, the largest and second largest MVPDs have 51% and 17% shares.[11] The remaining scenario envisions a cable duopoly with one firm having a 44% share and the other having a 39% share (with the remaining 17% share going to the only DBS firm providing service). Given the unrealistic nature of the different scenarios, the experimental study does not provide much, if any, guidance on the likely competitive impact of this proposed merger.

CONCLUSION

For the reasons set forth above, the Working Paper is of no practical use in analyzing the likely anti-competitive effects of the proposed AT&T/Comcast merger.

Respectfully submitted,



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11 In this scenario, the second largest MVPD is a single DBS provider. The largest other cable system has a share of 13.4%.