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March 1, 2006

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Federal Communications Commission
Office of Secretary

BY HAND DELIVERY

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: ***Ex Parte Presentation in <u>MB Docket No 05-192</u>***

Dear Ms. Dortch:

DIRECTV, Inc. ("DIRECTV") has begun its analysis of the electronic data produced by Comcast Corporation ("Comcast") and Time Warner Cable Inc. ("Time Warner"). This letter presents results from the first stage of that analysis, which focuses on perhaps the key question in this proceeding – whether the proposed Transactions would give Applicants the incentive and ability to withhold or raise the price of "must have" regional sports network ("RSN") programming. Attached hereto is a report by Gustavo Bamberger and Lynette Neumann of Lexecon ("Lexecon Report") that answers this question – in the affirmative – by applying the foreclosure assessment methodology used by the Commission two years ago in the *News/Hughes* proceeding. This report demonstrates the following:

REDACTED

- ***Temporary RSN foreclosure would be profitable for Comcast if it caused as few as of rivals' subscribers to switch to cable, and would be made substantially <u>more</u> profitable in markets throughout the country by the Transactions at all switching levels.***

REDACTED

- ***Permanent foreclosure – a far more serious anticompetitive strategy not found problematic in News/Hughes – would be profitable with a subscriber switching rate as low as , and even a "quite modest" gain in market share caused by the Transactions would make such withholding substantially more likely to be profitable.***

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- ***Where a cable-affiliated RSN concludes that foreclosure – temporary or permanent – is profitable, it can engage in a variety of anticompetitive pricing strategies to obtain the same economic outcome.***

In light of this evidence, there can no longer be any doubt: the public interest compels the imposition of targeted conditions on the Transactions. Just two years ago, the Commission found that pro-competitive safeguards were necessary in a transaction where temporary foreclosure was likely, even where permanent foreclosure was not. Since the case is worse here, the Commission must – at a minimum – apply similar safeguards if it approves the Transactions proposed in this proceeding.

The Lexecon Report also addresses an argument that has been allowed to linger far too long in this proceeding – the allegedly "solely horizontal" nature of this proceeding. To hear Applicants tell it, because the Transactions will not create new vertical relationships, the vertical analysis from *News/Hughes* is inapposite, or at most the Commission must limit its examination to areas where Time Warner and Comcast *already* have RSN affiliates. As explained in the Lexecon Report, these Transactions are not simply horizontal: they will immediately create new vertical relationships for thousands of subscribers to be acquired by Comcast and Time Warner. More importantly, they will also create market conditions that will enable Comcast and Time Warner to launch new RSNs, expanding vertical integration to many more markets across the country. This, of course, is exactly what Comcast did in Chicago and Sacramento after acquiring systems from AT&T Broadband,[1] and what the Commission can expect Applicants to do if the Transactions are approved without adequate safeguards.

* * *

At the outset, it is perhaps worth discussing the methodology behind the Lexecon Report – and the ways in which the lack of data has limited the number of observations available to analyze the profitability of foreclosure strategies. In its Information and Document Request of December 5, 2005, the Commission directed Comcast and Time Warner to produce certain operational and financial data related to the cable systems that they operate or manage and RSNs that they own, control or in which they have an attributable interest.[2] In response, Comcast identified eight such RSNs:

Comcast SportsNet Philadelphia ("CSN Philly")
Comcast SportsNet Mid-Atlantic ("CSN MidAtlantic")

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1 *See, e.g.*, Comments of DIRECTV at 20, 23-25 (July 21, 2005); DIRECTV Surreply at 8 (Oct. 12, 2005).

2 *See* Information and Document Request, Items II A-C, III B-C (Dec. 5, 2005)..

Comcast SportsNet Chicago ("CSN Chicago")
Comcast SportsNet West ("CSN West")
Comcast/Charter Sports Southeast ("CCSS")
Comcast Local (Detroit)
Fox Sports New England ("FSNE")
SportsNet New York ("SN-NY")[3]

However, Comcast did not provide the requested data for all of these RSNs. For example, it provided no data for CSN Chicago, although Comcast holds a 30% interest in and manages that RSN.[4] It provided only limited data for FSNE, which is managed by a subsidiary of Cablevision, and SN-NY, which has not yet begun operations. For its part, Time Warner stated that it has no "operational" RSN upon which to report.[5] Thus, complete data is available only for CSN Philly, CSN MidAtlantic, CSN West, and CCSS. As noted in the Lexecon Report, neither DBS operator carries CSN Philly or CCSS, making a foreclosure analysis largely inapposite in those markets.[6] Accordingly, the analysis in the Lexecon Report focuses primarily on CSN MidAtlantic and CSN West.

This means, of course, that there are only two "markets" with which to analyze foreclosure – one (CSN MidAtlantic) in which Comcast claims that the Transactions will result in only "quite modest" changes, and another (CSN West) in which Comcast has already engaged in anticompetitive pricing. Lexecon was thus unable to analyze other markets where the Transactions will greatly increase concentration (*e.g.*, Cleveland), or in which less elaborate pricing strategies have been employed (*e.g.*, Chicago).

In any event, the Lexecon Report begins by essentially replicating the methodology recently used by the Commission in the *News/Hughes* proceeding to assess the profitability (and therefore likelihood) of foreclosure given MVPD/RSN affiliation.[7]

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3 *See* Letter from Martha E. Heller to Marlene H. Dortch, Attachment at 15 (Dec. 22, 2005).

4 Comcast appears to have declined to produce data related to CSN Chicago on the grounds that Comcast is not acquiring any systems in the CSN Chicago footprint as part of the Transactions. *See id.* However, the Commission's request seeks information on any RSN with a footprint in which "an Applicant's" interest – not necessarily the Submitting Party's interest – in a system changes. Since Time Warner – undeniably an Applicant – is acquiring systems in the CSN Chicago footprint, the requested data should also have been produced for that RSN.

5 *See* Letter from Arthur H. Harding to Marlene H. Dortch at 10 (Dec. 19, 2005). Time Warner did provide information related to Turner South, a channel that carries certain sports programming but which Time Warner believes not to be an RSN. Time Warner also recently announced the sale of this channel. *See* Time Warner Newsroom, Fox Cable Networks to Acquire Turner South (Feb. 23, 2006) *available at* http://www.timewarner.com/corp/newsroom/pr/0,20812,1167428,00.html.

6 *See* Lexecon Report at ¶ 9. In addition, CCSS has no professional sports content.

7 *See General Motors Corp., Hughes Electronics Corp, and The News Corporation Ltd.*, 19 FCC Rcd. 473, Appendix D (2004) ("*News/Hughes*").

That is, it addresses both temporary foreclosure and permanent foreclosure of RSN programming.

Temporary Foreclosure. Using the methodology set forth by the Commission in *News/Hughes*, the Lexecon Report first determines the "switching rate" required to make temporary foreclosure profitable, and concludes that Comcast would need to induce only of DBS subscribers to switch to make withholding a profitable strategy for CSN MidAtlantic and CSN West.[8] Moreover, even what Applicants characterize as a "quite modest" increase in market share for CSN MidAtlantic would substantially increase the profitability of vertical strategies at all levels of switching. For example, Comcast's profit from withholding CSN MidAtlantic at the switching level would increase

REDACTED . In addition, using average Comcast margins, Lexecon calculates that temporary **REDACTED**

foreclosure would be profitable at switching rates of to were Comcast or Time Warner to launch new RSNs in markets where concentration will be created or enhanced by the Transactions.[9]

Though short-lived, temporary foreclosure can have serious anticompetitive effects. As the Commission has recognized, in markets exhibiting consumer inertia and partial lock-in – both characteristics of the MVPD market because of switching costs and bundled service offerings – temporary foreclosure may generate profits that continue long after foreclosure has ended and upstream losses have ceased.[10] Temporary foreclosure may also be profitable by enabling the integrated firm to improve its bargaining position so that it is able to extract a higher price from MVPD rivals than it could have negotiated if it were a non-integrated RSN supplier.[11] "This increased ability and incentive to seek and obtain higher programming rates through unilateral temporary foreclosure would likely lead to higher prices to MVPD consumers than would otherwise occur and thereby harm the public interest."[12] These considerations led the Commission to impose conditions on the *News/Hughes* transaction "to maintain the balance of bargaining power" between the vertically integrated entity and other MVPDs at roughly pre-

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8 *See* Lexecon Report at ¶¶ 17, 23.

9 *See id.* at ¶¶ 24-26.

10 *See News/Hughes*, 19 FCC Rcd. at 511.

11 *Id.* Moreover, even if a specific instance of temporary foreclosure is not profitable, it might nevertheless be a profitable strategy over the longer run if it allows the vertically integrated firm to "signal to other downstream competitors its willingness to foreclose," which may cause MVPD rivals to agree to a higher price without the necessity of repeated foreclosures. *Id.*

12 *Id.* at 514. "A secondary public interest harm is that MVPD subscribers are deprived of programming that is highly desired during such a period [of temporary withholding]." *Id.* at 551.

transaction levels.[13] They should lead to the imposition of similar conditions in this proceeding as well.

Permanent Foreclosure. In *News/Hughes*, the Commission imposed conditions even though it concluded that permanent withholding – a more serious form of foreclosure – would not be made profitable by the transaction proposed in that proceeding.[14] Here, by contrast, Applicants' dominant market share makes permanent foreclosure an economically rational strategy. For example,

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[15] The Lexecon Report calculates that permanent withholding of CSN West would be profitable for Comcast at a switching rate of .[16]
REDACTED

Lexecon also analyzed permanent withholding of CSN MidAtlantic and found that the "quite modest" increase in concentration caused by the Transactions would **REDACTED** reduce the switching rate necessary for profitability by – from pre-transaction **REDACTED** to post-transaction. In other words, the Transactions would make permanent foreclosure of CSN MidAtlantic profitable at a switching rate nearly identical to that required for CSN West.

REDACTED

Other Pricing Strategies. The empirical analysis used in *News/Hughes* focused only on actual "withholding" of RSN signals. It has become abundantly clear from recent events, however, that where withholding is profitable, a variety of alternative vertical strategies are available to achieve similarly anticompetitive results. For example, an integrated cable/RSN firm can raise its price significantly but uniformly. Competitors then are presented a Hobson's choice of either (1) accepting the inflated rate and granting the cable operator a supra-competitive return, or (2) refusing to overpay and thereby

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13 *Id.* at 514.

14 *See id.* at 544.

15 *See* Letter from William M. Wiltshire to Marlene H. Dortch at 4-5 (Feb. 14, 2006).

16 Lexecon Report at ¶ 33. Since the Transactions will not substantially change Comcast's market share in the CSN West footprint, the required post-transaction switching rate would remain virtually the same.

granting the cable operator a *de facto* exclusive (which the integrated firm already knows to be profitable).[17]

The Lexecon Report shows that, as DIRECTV has asserted, Comcast's pricing structure for CSN West imposes a much higher effective price on DBS operators than on cable operators. Specifically,

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DIRECTV pays approximately 150% the rate paid by cable operators.[18] Comcast, of course, "pays" for subscribers in the "outer outer" zone, but as the Commission has recognized, this is not an economically meaningful fact – and the requirement for non-discriminatory pricing provides no protection to rival MVPDs.

> Where the downstream affiliate is wholly owned, the integrated firm can always raise the internal transfer price of an input so that it equals the price charged to downstream competitors. Under these conditions, however, the increase in the internal transfer price is not particularly meaningful, since the integrated firm in making business decisions will consider the real economic cost of the input and not its nominal transfer price. Thus, in the case of a wholly owned downstream affiliate, it may be difficult to detect if price discrimination is occurring and anti-discrimination rules may not function effectively.[19]

Accordingly, rival MVPDs must be allowed to invoke commercial arbitration when confronted with nominally uniform but effectively discriminatory pricing strategies such as Comcast has employed.

Vertical Issues. Applicants have asserted that the Transactions proposed in this proceeding can be distinguished from those in *News/Hughes* because they involve horizontal concentration rather than vertical integration.[20] As explained in the Lexecon Report,[21] that assertion is erroneous for at least two reasons. First, many of the systems

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17 The Commission discussed such a uniform price increase strategy in *News/Hughes*, finding that the program access rules and other non-discrimination safeguards would not prevent a firm from uniformly raising prices to both its downstream affiliate and its downstream competitors where it had economic incentive to do so, and providing for commercial arbitration of carriage prices, terms and conditions as an additional "safeguard." *See News/Hughes*, 19 FCC Rcd. at 513, 551-55.

18 *See* Lexecon Report at ¶ 44.

19 *Id.* at 512.

20 *See, e.g.,* Reply Comments of Adelphia, Comcast and Time Warner at 57 (Aug. 5, 2005).

21 *See* Lexecon Report at ¶¶ 45-46.

and subscribers trading hands in the Transactions will be acquired by an Applicant in a market where that Applicant currently operates an RSN. For those systems and subscribers, the transaction is vertical in nature. Thus, for the hundreds of thousands of subscribers being acquired by Comcast in the MidAtlantic, New England, San Francisco, New York, Philadelphia, and the Southeast, or being acquired by Time Warner in Cleveland and New York, the Transactions enhance vertical integration of distribution and programming. Second, DIRECTV has demonstrated that both Comcast and Time Warner can be expected to use the market power created or enhanced by the Transactions to secure team rights and form new RSNs in other areas (or expand existing RSNs by acquiring the rights to more professional teams). For existing and acquired subscribers in those areas, the Transactions will predictably lead to still more vertical integration in the future. Accordingly, the distinction Applicants seek to draw simply is not tenable.

* * *

Pursuant to the First and Second Protective Orders, one non-redacted copy and two redacted copies of this letter are being filed with the Office of the Secretary, and two non-redacted copies are also being provided to the Media Bureau. A redacted copy will also be served upon Outside Counsel of Record for Comcast and for Time Warner,[22] and a non-redacted copy will be made available at our offices during regular business hours for review by such counsel that have signed the appropriate Acknowledgements of Confidentiality.

Respectfully submitted,

William M. Wiltshire
Michael D. Nilsson
S. Roberts Carter III
Counsel for DIRECTV, Inc.

Enclosure

22 Upon receipt of appropriate authorization from the Submitting Parties, we would be happy to provide non-redacted service copies. *See, e.g.*, Letter from Arthur H. Harding to Martha Heller (Feb. 16, 2006) (authorizing service of non-redacted versions of two letters filed by DIRECTV on February 14).

cc: *Julie Salovaara (Media Bureau)*
Wayne D. Johnsen, Wiley Rein & Fielding LLP (counsel for Comcast)
Aaron I. Fleischman, Fleischman and Walsh LLP (counsel for Time Warner)

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

Applications of	)	
ADELPHIA COMMUNICATIONS CORPORATION,	)	
COMCAST CORPORATION,	)	
and	)	MB Docket No 05-192
TIME WARNER CABLE INC.,	)	
For Authority to Assign and/or Transfer Control of Various Licenses	)	

FURTHER STATEMENT OF GUSTAVO BAMBERGER AND LYNETTE NEUMANN

I. INTRODUCTION.

1. In a report submitted earlier in this proceeding,[1] we analyzed the potential anticompetitive effects of the proposed transactions (the "Transactions") in which the cable assets of Adelphia Communications Corporation ("Adelphia") would be acquired (directly and indirectly) by Comcast Corporation ("Comcast") and Time Warner Cable Inc. ("Time Warner"), and Comcast and Time Warner would exchange other cable assets.[2] In that report, we explained that, all else equal:

1. See Lexecon, "Analysis of Potential Anticompetitive Effects of the Proposed Adelphia/Comcast/Time Warner Transactions" ("Lexecon Analysis"), attached to DIRECTV's Surreply (filed Oct. 12, 2005). Our qualifications were previously described in the Statement of Gustavo Bamberger and Lynette Neumann ("Bamberger-Neumann Statement"), submitted with DIRECTV's Comments (filed July 21, 2005).

2. The Transactions also involve the partitioning between Comcast and Time Warner of systems currently jointly held by Comcast and Time Warner through Time Warner Entertainment Company, L.P.

- Withholding regional sports network ("RSN") programming from an affiliated cable operator's rivals becomes more profitable as the affiliated cable operator gains *additional share within the RSN's footprint.*

- Where withholding is deemed profitable, a cable-affiliated RSN can engage in variety of "substitute" strategies such as discriminatory price increases.

We concluded, based on publicly available data, that: (1) the proposed Transactions would significantly increase the total number of subscribers served by Comcast and Time Warner in a number of markets; and (2) this "clustering" would increase the incentive and ability of Comcast and Time Warner to reduce competition in the multichannel video programming distribution ("MVPD") market.

2. We have now had the chance to review non-public information submitted by Comcast and Time Warner in response to the Commission's information requests. We have used this information to analyze the profitability of various vertical strategies. In particular, we adopt the framework used by the Commission in *News-Hughes* to analyze the profitability of temporary and permanent foreclosure strategies.[3] We also add to the Commission's approach by analyzing discriminatory price increases, another form of vertical strategy. Based on Comcast's own data, we find that clustering of the sort made possible by the proposed Transactions – even the "quite modest" clustering that Applicants claim will occur in some areas – substantially increases the profitability of these strategies. Specifically:

- The proposed Transactions substantially increase the profitability of a temporary foreclosure strategy.
    - A temporary foreclosure strategy is profitable for two major Comcast RSNs at a "switching rate" (i.e., the percentage of DBS subscribers who would switch to cable in response to a denial of RSN programming) of only about percent. **REDACTED**
    - Even a "quite modest" change in market share for one such RSN makes temporary foreclosure more profitable at a percent switching rate.

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3. See *General Motors Corp., Hughes Electronics Corp. and The News Corporation Ltd., 19 FCC Rcd. 473 and Appendix D (2004)* (*"News-Hughes"*) (see also Lexecon Analysis, at 8-12).

- *This analysis yields similar results if applied to currently unaffiliated RSNs that* have footprints in which Comcast or Time Warner would hold a 40 percent or greater share of cable subscribers as a result of the proposed Transactions.

- The proposed Transactions substantially increase the profitability of a permanent foreclosure strategy.

  - Even a "quite modest" change in market share caused by the proposed Transactions would lower the switching rate at which permanent foreclosure is profitable for a major Comcast RSN by percent.
    REDACTED
  - **REDACTED**
    .

- Comcast's pricing structure for its Comcast SportsNet-West ("CSN-West") RSN effectively discriminates against DBS providers by
  REDACTED .

3. The remainder of our statement is organized as follows. In Section II, we show that the proposed Transactions substantially increase the profitability to Comcast of a temporary foreclosure strategy. In Section III, we show that the proposed Transactions substantially increase the profitability to Comcast of a permanent foreclosure strategy. In Section IV, we show that the newly available information confirms that Comcast has used pricing strategies that effectively discriminate against DBS providers. In Section V, we explain why it is relevant and appropriate to analyze the "vertical" issues raised by the proposed Transactions.

II. ANALYSIS OF TEMPORARY FORECLOSURE.

A. Introduction.

4. Our analysis of Comcast's incentive to engage in a temporary foreclosure strategy is based on the framework used by the Commission in its analysis of the *News-Hughes* transaction. In particular, we assume that temporary foreclosure consists of a one-month interruption in service, and we use a discounted cash flow approach to compare the costs and benefits of a temporary foreclosure strategy. As we explain in this section of our statement, we

find that a temporary foreclosure strategy is profitable for Comcast RSNs at a switching rate of approximately REDACTED percent.

5. In *News-Hughes*, the Commission compared the rate at which subscribers would have to switch MVPDs to make withholding profitable to the rate at which subscribers had actually switched in a real-world case of temporary RSN foreclosure.[4] Based on this comparison, the Commission concluded that "there is a strong possibility that this type of behavior [i.e., temporary foreclosure] can be profitable following the transaction."[5] Although the switching rate the Commission derived from its empirical analysis of temporary RSN foreclosure was not made public, the Commission may wish to compare that switching rate to the percent figure applicable to Comcast to assess the likelihood that Comcast would find temporary foreclosure profitable.

6. Consistent with the Commission's methodology, we use the following variables in our analysis:

DBS Subs	=	number of DBS RSN subscribers;
Affiliate fee	=	affiliate fee per RSN subscriber per month;
Ad revenue	=	advertising revenue per RSN subscriber per month;
Cable profit	=	Comcast's incremental margin per subscriber per month; and
α	=	Comcast's share of cable subscribers in the RSN footprint.

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4. See *News-Hughes*, Appendix D, ¶ 45. The Commission's analysis was based on switches from cable to DBS in response to the unavailability of an RSN on cable. In general, all else equal, switching rates from cable to DBS are likely to be lower than switching rates from DBS to cable because typically not all households in a cable service area can receive satellite transmissions (e.g., because a household may not be able to place a satellite receiver in a position that it can "see" the satellite). This may be offset by the fact that, because DBS subscribers generally must commit to the service for the first year of service, relatively newer DBS subscribers may be relatively unlikely to switch to cable in response to a temporary service interruption. We account for this potential effect in our analysis.

5. *News-Hughes*, Appendix D, ¶ 37.

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7. The cost to Comcast of a one-month interruption of service to DBS *providers can* be expressed as:

DBS Subs * (Affiliate fee + Ad revenue).

That is, for each DBS subscriber that is denied RSN programming, Comcast forgoes the per-subscriber RSN affiliate fee and advertising revenue.

8. The benefit of a service interruption to Comcast per subscriber who switches from DBS to cable equals:

(α * Comcast profit) + Affiliate fee + Ad revenue.

That is, the RSN recaptures the affiliate fee and ad revenue from subscribers who switch from DBS to cable. In addition, depending on where those switchers live, some would switch to Comcast, while others would switch to other cable firms in the RSN footprint. If Comcast's share of the switchers equals its share of cable subscribers in the RSN footprint (i.e., α), then Comcast also gains, on average, (α * Comcast profit) for each switcher.

9. Comcast has provided information on subscribers, affiliate fees and ad revenue for three RSNs that offer major professional sports programming (i.e., Major League Baseball ("MLB"), National Basketball Association ("NBA") or National Hockey League ("NHL")) – Comcast SportsNet-MidAtlantic ("CSN-MidAtlantic"), CSN-West and Comcast SportsNet Philadelphia ("CSN-Philadelphia"). CSN-Philadelphia currently is delivered terrestrially and thus has not been made available to DBS suppliers (i.e., DBS providers already are foreclosed from CSN-Philadelphia). Thus, we focus primarily on CSN-MidAtlantic and CSN-West in this statement.

B. Temporary Foreclosure of CSN-MidAtlantic.

10. In a declaration filed on behalf of Comcast, Professor Janusz A. Ordover and Dr. Richard Higgins ("Ordover/Higgins Declaration") claim that "Comcast's increase in the number of subscribers from the proposed transaction in the RSN footprints where it controls a bona fide

RSN is quite modest."[6] In particular, they report that Comcast's share of TV households in the CSN-MidAtlantic footprint is 30 percent "Pre-Deal" and 38 percent "Post-Deal."[7] Professor Ordover and Dr. Higgins do not provide any analysis, however, that purports to show that this "quite modest" increase in Comcast share in the CSN-MidAtlantic footprint will not substantially increase Comcast's incentive to engage in a temporary (or permanent) foreclosure strategy.[8] By contrast, we have now assessed that claim based on information provided by Comcast.

11. We first analyze the benefits to Comcast of employing a temporary foreclosure strategy prior to the proposed Transactions. We then repeat our analysis with post-transaction information. We find that a temporary foreclosure strategy is profitable for Comcast at low switching rates, and that the proposed Transactions substantially increase the profitability of temporary foreclosure, even after only a "quite modest" increase in market share.[9]

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6. *See* Exhibit G to Reply of Adelphia Communications Corp., Comcast Corp., and Time Warner Inc. (Aug. 5, 2005), ¶ 27 ("Ordover/Higgins Declaration").

7. Ordover/Higgins Declaration, Table 1, at 17. See also Ordover/Higgins Declaration, ¶ 59 ("In the footprint of Comcast-Mid Atlantic, according to data provided by Comcast, 30 percent of the television households subscribe to Comcast for MVPD service. In the same area, Adelphia accounts for roughly eight percent of TV households [footnote omitted]. The ultimate issue of concern is therefore whether the *addition* of eight market share points is sufficient to tilt the profitability calculus" (emphasis in original)).

8. Professor Ordover and Dr. Higgins note that CSN-MidAtlantic (and other Comcast RSNs) "are <u>at this time</u> satellite delivered" (Ordover/Higgins Declaration, ¶ 48, emphasis added). They also report that "we understand that Comcast already possesses regional terrestrial networks, but it has never attempted to transition delivery of an RSN to any of these networks" (Ordover/Higgins Declaration, footnote 43). We are unaware of any commitment by Comcast that it will not attempt to "transition delivery of an RSN" to a terrestrial network in the future. **REDACTED**

9. We understand that DIRECTV has not renegotiated its contract with CSN-MidAtlantic since Comcast acquired that RSN.

REDACTED

12. Based on information provided by Comcast, we use the following values for the pre-transaction CSN-MidAtlantic temporary foreclosure analysis.

DBS Subs = .[10] REDACTED

Affiliate fee = per month;[11] REDACTED

Ad revenue = per month;[12] REDACTED

Cable profit = per month;[13] and REDACTED

α = percent.[14] REDACTED

13. For a one-month interruption of CSN-MidAtlantic programming to DBS providers, the cost to Comcast is:

DBS Subs * (Affiliate fee + Ad revenue)

=

REDACTED

=

10.

11.

REDACTED

12.

13.

REDACTED

Comcast's operating margin per subscriber may be less than its incremental profit per subscriber (i.e., its operating costs may include fixed components). Thus, our analysis may understate the benefit to Comcast of foreclosure strategies.

14. REDACTED

We understand that all major cable systems in the CSN-MidAtlantic footprint offer CSN-MidAtlantic to their subscribers.

14. To calculate the total benefits of a service interruption to Comcast, we adjust some of the assumptions in the Commission framework because of differences in DBS and cable contracting practices. In particular, new DBS subscribers typically agree to purchase 12 months of service in exchange for subsidized equipment and/or installation. In general, we understand that cable suppliers do not make such offers available. In its *News-Hughes* analysis, the Commission assumed that all customers who switched from cable to DBS agreed to purchase 12 months of service, and so none of these switchers could immediately switch back to cable once the service interruption was over.[15]

15. For the purpose of our analysis, we assume that subscribers who switch from DBS to Comcast can switch back as soon as the service interruption ends, and that "churn rates" are relatively high but subsequently return to pre-interruption levels relatively quickly. In particular, we assume that Comcast's churn rate (on switchers from DBS) is 20 percent above normal for three months, and then returns to its prior level. For example, suppose that a one-month service interruption results in the switch of of DBS CSN-MidAtlantic **REDACTED** subscribers to cable. Because there are DBS CSN-MidAtlantic subscribers, a switch rate represents subscribers. Based on Comcast's pre-transaction share **REDACTED** of cable RSN subscribers (percent), Comcast would gain of these subscribers. For **REDACTED** the three months after service is restored, we assume that percent of these subscribers **REDACTED** (i.e., 20 percent more than the Comcast churn rate of percent) return to DBS; after the **REDACTED** initial three months, we assume that the churn rate returns to percent.[16]

16. The gains to Comcast from a one-month service interruption therefore equal the profits associated with an additional subscribers in the month service is interrupted; the **REDACTED**

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15. However, we understand that a substantial percentage of new DIRECTV subscribers terminate their service during the first year of service.

16. **REDACTED**

profits associated with an additional REDACTED *subscribers in the month after service is interrupted* (i.e., REDACTED subscribers minus the percent of subscribers who return to DBS); the profits associated with an additional REDACTED subscribers in the following month (i.e., REDACTED subscribers minus the REDACTED percent of subscribers who return to DBS); and so on. We calculate gains over a 60-month period, and use a 10 percent discount rate to calculate the net present value ("NPV") of these gains. These results are summarized in Table 1.

17. As Table 1 shows, a temporary foreclosure strategy is profitable at a switching rate of REDACTED percent. We repeat our analysis for switching rates between REDACTED percent and find that a temporary foreclosure strategy remains profitable if the switching rate is as low as REDACTED percent.[17]

18. We also repeat our temporary foreclosure analysis assuming that the proposed Transactions are consummated. Our post-transaction analysis is the same as the pre-transaction analysis except we increase the value of α. Because Aldephia has REDACTED CSN-MidAtlantic subscribers who will be acquired by Comcast, Comcast's share of CSN-MidAtlantic cable subscribers would increase from REDACTED percent pre-transaction to REDACTED percent post-transaction (i.e., we increase the value of α in our analysis from to).[18]

19. We find that, for any level of switching, a temporary foreclosure strategy would

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17. As we have discussed, all else equal, switching rates from cable to DBS may be lower than switching rates from DBS to cable (because not all households can receive DBS service). However, because some DBS customers will be in the first year of their contract at the time of any service interruption, such customers may be relatively unlikely to switch to cable in response to a temporary outage. As a result, not all DBS subscribers may be "available" to switch to cable in response to a temporary outage. We estimate that approximately 30 percent of DIRECTV's current subscribers have signed contracts within the past 12 months, so only about 70 percent of DIRECTV's subscribers may be "available" to switch to cable. If temporary foreclosure is profitable with a total switch rate of percent, then temporary foreclosure is profitable if percent (i.e., percent divided by) of "available" DBS subscribers switch to cable in response to a one-month service interruption. As we have discussed, however, DIRECTV's "first-year churn" is such that a substantial percentage of first-year subscribers may be "available" to switch to cable. REDACTED

18. REDACTED

become substantially more profitable if the proposed Transactions are approved. For example, *at a switching rate of percent, the profits associated with temporary foreclosure increase by*
REDACTED
a factor of as a result of the proposed Transactions.[19] See Table 2. As the Commission found in *News-Hughes*, this increased profitability may enable the integrated firm to improve its bargaining position so that it is able to extract a higher price from MVPD rivals than it could have negotiated if it were a non-integrated RSN supplier.[20]

C. Temporary Foreclosure of CSN-West.

20. We also perform a temporary foreclosure analysis for CSN-West, using the following values.[21]

DBS Subs = .[22]
REDACTED
Affiliate fee = per month;[23]

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19. Because we assume that cable subscribers do not sign contracts for 12 months of service in exchange for subsidized equipment and/or installation, we assume that Comcast does not incur subscriber acquisition costs ("SAC") for DBS subscribers who move to Comcast as a result of foreclosure. Even if this is not the case, such costs would have no material affect on our conclusions. For example, if Comcast has SAC (e.g., costs of temporarily reduced programming rates for new subscribers) of $100 per subscriber, temporary foreclosure post-transaction remains profitable at a switching rate of percent. If Comcast has SAC of $250 per subscriber, such foreclosure is profitable at a switching rate of percent. **REDACTED**

20. *News-Hughes*, 19 FCC Rcd. at 511.

21. The proposed Transactions do not materially change Comcast's share of cable subscribers in the CSN-West footprint, so we present only one temporary foreclosure analysis for CSN-West.

22. **REDACTED** .

23.

Ad revenue = REDACTED per month;[24]

Cable profit = per month;[25] and

α = REDACTED percent.[26]

21. For a one-month interruption of CSN-West programming to DBS providers, the cost to Comcast is:

DBS Subs * (Affiliate fee + Ad revenue)

=

REDACTED

= .

22. Because there are REDACTED DBS CSN-West subscribers, a switch rate represents REDACTED subscribers. Based on Comcast's share of cable subscribers within the CSN-West footprint (percent), Comcast would gain REDACTED of these subscribers. For the three months after service is restored, we assume that REDACTED percent of these subscribers (i.e., 20 percent more than the Comcast churn rate of percent in the CSN-West footprint) return to DBS; after the initial three months, we assume that the churn rate is percent.[27] REDACTED

24.

REDACTED

25.

26. Because a major cable firm (Charter) does not purchase CSN-West service, Comcast's share of cable RSN subscribers in the CSN-West footprint (percent) overstates its share of cable subscribers in that footprint. For this reason, we estimate Comcast's share of cable subscribers in the CSN-West footprint from public sources. (See Bamberger-Neumann Statement, ¶¶ 6-8.) As we discuss later, the CSN-West footprint includes an "outer outer" zone in which Sacramento Kings games cannot be watched. We exclude this zone from our foreclosure analyses (i.e., because subscribers in that zone already are unable to watch Kings games).

27. REDACTED

23. The gains to Comcast from a one-month service interruption therefore equal the profits associated with an additional subscribers in the month service is interrupted; the REDACTED profits associated with an additional subscribers in the month after service is interrupted (i.e., REDACTED subscribers minus the REDACTED percent of subscribers who return to DBS); the profits associated with an additional subscribers in the following month (i.e., REDACTED subscribers minus the REDACTED percent of subscribers who return to DBS); and so on. We calculate gains over a 60-month period and use a 10 percent discount rate to calculate the NPV of these gains. See Table 3. We repeat our analysis for switching rates between REDACTED percent and find that a temporary foreclosure strategy remains profitable if the switching rate is as low as percent. See Table 4.

D. Temporary Foreclosure in Other Markets.

24. We also evaluate the likelihood that temporary foreclosure would be profitable if Comcast or Time Warner were to acquire or launch RSNs in other markets in which the proposed Transactions will significantly increase their market share. As we discussed in a prior filing, historical experience suggests that RSN affiliation can be expected to change in areas where the proposed Transactions substantially increase Comcast's or Time Warner's share of cable subscribers.[28]

25. As a result of the proposed Transactions, Comcast or Time Warner's post-transaction share of cable subscribers will equal 40 to 55 percent in six RSN footprints – Altitude Sports and Entertainment; Fox Sports Florida; Fox Sports Ohio; Fox Sports Pittsburgh; Fox Sports West/West 2; and Sun Sports.[29] We evaluate the profitability of a temporary foreclosure

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28. Lexecon Analysis, at 17.

29. We treat Fox Sports West and Fox Sports West 2 as one RSN because these two RSNs have almost the same footprint.

strategy if Comcast or Time Warner later acquires or launches an RSN in these areas. For the purpose of this analysis, we assume that: (1) cable company profit is REDACTED per subscriber per month; (2) average affiliate revenue is REDACTED per subscriber per month; (3) average ad revenue is REDACTED per subscriber per month; and (4) churn rate is REDACTED percent per month.[30]

26. We again calculate gains over a 60-month period and use a 10 percent discount rate to calculate the NPV of these gains for switching rates between REDACTED percent. We find that for post-transaction cable shares of 40 to 52 percent (i.e., a range that includes Time Warner's post-transaction shares in the Fox Sports Pittsburgh and Fox Sports West/West 2 footprints and Comcast's post-transaction shares in the Altitude Sports and Entertainment, Fox Sports Florida and Sun Sports footprints), temporary foreclosure is profitable if the switching rate is as low as REDACTED percent. For a post-transaction cable share of 55 percent (Time Warner's post-transaction share in the Fox Sports Ohio footprint), temporary foreclosure is profitable if the switching rate is as low as REDACTED percent. See Table 5.

III. ANALYSIS OF PERMANENT FORECLOSURE.

A. Introduction.

27. To analyze Comcast's economic incentive to permanently withhold RSN programming from its DBS rivals, we again follow the Commission's approach in its analysis of the *News-Hughes* transaction. As we explain in this section of our statement, we find that the post-transaction switching rate needed to make permanent foreclosure a profitable strategy for CSN-MidAtlantic is similar to the level that Comcast internal documents imply could be achieved for CSN-West (an RSN with substantially less programming than CSN-MidAtlantic).

28. If Comcast adopts a permanent foreclosure strategy against DBS providers (i.e.,

30. These values are roughly equal to the average corresponding values per subscriber per month for CSN-MidAtlantic, CSN-West and CSN-Philadelphia.

a "cable only" exclusive[31]), the total RSN loss would equal, on a monthly basis:

DBS Subs * (Affiliate fee + Ad revenue).

On average, the monthly gain to Comcast per subscriber who switched from DBS to Comcast would equal:

(α * Comcast profit) + Affiliate fee + Ad revenue.

Thus, Comcast would find foreclosure profitable if, as a result, the number of switchers from DBS to cable would exceed the "critical value":

$$\frac{\text{DBS Subs} * (\text{Affiliate fee} + \text{Ad revenue})}{(\alpha * \text{Comcast profit}) + \text{Affiliate fee} + \text{Ad revenue}}$$ [32]

B. Permanent Foreclosure of CSN-MidAtlantic.

29. To analyze the effect of the proposed Transactions on Comcast's incentive to engage in permanent foreclosure in the CSN-MidAtlantic footprint, we: (1) calculate the "critical value" based on Comcast's pre-transaction share; and (2) compare it to the "critical value" based on Comcast's post-transaction share. We find that the critical value falls substantially as a result of the proposed Transactions.

30. The total loss to Comcast associated with permanent foreclosure equals:

DBS Subs * (Affiliate fee + Ad revenue)

=

REDACTED

=

The gain to Comcast per subscriber from permanent foreclosure equals:

(α * Comcast profit) + Affiliate fee + Ad revenue

31. This is the type of exclusive that Comcast has used in Philadelphia by making use of the "terrestrial loophole" in the program access rules.

32. See *News-Hughes*, Appendix D, n. 60. For the purpose of this calculation, Comcast profit is net of RSN affiliate fees.

= REDACTED

= per subscriber per month.

REDACTED

The critical value = REDACTED subscribers, which represents percent of DBS subscribers. Thus, prior to the proposed Transactions, permanent foreclosure would be a profitable strategy if, as a result, more than percent of DBS RSN subscribers would switch to cable.

REDACTED

31. To calculate the post-transaction critical value, we combine Comcast's and Adelphia's CSN-MidAtlantic subscribers in the CSN-MidAtlantic footprint. As we have discussed, Comcast's share of CSN-MidAtlantic cable subscribers would increase from percent to percent as a result of the proposed Transactions.

REDACTED

REDACTED

32. The total loss to Comcast associated with permanent foreclosure remains:

DBS Subs * (Affiliate fee + Ad revenue)

= REDACTED

= per month.

The gain to Comcast per subscriber from permanent foreclosure, however, increases because of the increase in α from to :

REDACTED

(α * Comcast profit) + Affiliate fee + Ad revenue

= REDACTED

= per subscriber per month.

The post-transaction critical value is REDACTED subscribers, which represents percent of DBS subscribers. Thus, as a result of the proposed Transactions, the

REDACTED

critical value that makes permanent foreclosure profitable falls by about 20 percent (i.e., from

to subscribers).[33]
REDACTED

C. Permanent Foreclosure of CSN-West.

33. Applying this same methodology to CSN-West, the total loss to Comcast from a permanent foreclosure strategy equals:

DBS Subs * (Affiliate fee + Ad revenue)

=

REDACTED

=

The gain to Comcast per subscriber from permanent foreclosure equals:

(α * Comcast profit) + Affiliate fee + Ad revenue

=

REDACTED

= per subscriber per month. **REDACTED**

The critical value = **REDACTED** subscribers, which represents percent of DBS subscribers.

34.

REDACTED

REDACTED

We note that the percent switching rate required to make permanent foreclosure of CSN-West profitable is almost the same as the percent switching rate that would be required for profitable withholding of CSN-MidAtlantic
REDACTED

REDACTED

33. Our finding that an eight percentage point increase in market share leads to a percent decrease in the number of switchers needed to make permanent foreclosure profitable for CSN-MidAtlantic corroborates the more general case discussed in our prior report. See Lexecon Analysis, at 10-11 (showing that a hypothetical four percentage point increase in market share could reduce the switching rate needed to reach profitability by nine percent).

34. **REDACTED**

post-transaction.

35. CSN-MidAtlantic has substantially more programming than CSN-West (i.e., CSN-MidAtlantic offers MLB, NBA and NHL games, not only NBA games), and thus likely is substantially more attractive to subscribers. For example,

REDACTED

. As a result, we would expect the permanent foreclosure of CSN-MidAtlantic programming to produce a substantially higher switching rate from DBS to cable than the permanent foreclosure of CSN-West programming. Our analysis thus suggests that **REDACTED**

REDACTED if the proposed Transactions are approved.

D. Permanent Foreclosure of CSN-Philadelphia.

36. The economic evidence shows that Comcast finds permanent foreclosure a profitable strategy in Philadelphia – we are unaware of any reason why Comcast could not offer CSN-Philadelphia to DBS providers if it were profitable to do so.

REDACTED

35

35.

REDACTED