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Federal Communications Commission
Office of Secretary

April 6, 2006

BY HAND DELIVERY

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

Re: Ex Parte Presentation in MB Docket No 05-192

Dear Ms. Dortch:

Last month, DIRECTV, Inc. ("DIRECTV") submitted a report by Lexecon that sought to replicate the framework for analyzing foreclosure incentives used by the Commission in the *News-Hughes* proceeding.[1] Based on that analysis, Lexecon concluded that the proposed transactions would substantially increase the profitability (and therefore likelihood) of foreclosure of regional sports network ("RSN") programming by Comcast Corporation ("Comcast") and Time Warner Cable Inc. ("Time Warner") in markets that they dominate.[2]

In response, Comcast submitted a critique of Lexecon's analysis that took issue with several aspects of its methodology and underlying assumptions.[3] Upon closer inspection, however, it becomes clear that Comcast's quarrel is not with Lexecon – which

1 *See General Motors Corp., Hughes Electronics Corp. and The News Corporation Ltd.*, 19 FCC Rcd. 473 (2004) ("*News-Hughes*").

2 *See* Letter from William M. Wiltshire to Marlene H. Dortch (March 1, 2006) ("Economic Ex Parte") (submitting Further Statement of Gustavo Bamberger and Lynette Neumann ("Lexecon Further Statement")).

3 *See* Letter from Martha E. Heller to Marlene H. Dortch (Mar. 24, 2006); Letter from James R. Coltharp to Marlene H. Dortch (Mar. 15, 2006) ("Comcast Response") (submitting Further Declaration of Janusz A. Ordover and Richard Higgins ("Ordover Further Declaration")).

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faithfully replicated the Commission's methodology – but rather with the Commission's *News-Hughes* framework itself. Because Comcast fails to acknowledge the true focus of its critique, it also fails to explain why the Commission should abandon the methodology it adopted just over two years ago. Here, as in *News-Hughes*, application of that methodology shows that the transactions in question will make foreclosure more profitable – Comcast's protestations to the contrary notwithstanding.

There is another problem with Comcast's critique. Comcast argues that, if properly estimated, the number of "sports fans" that would have to switch providers in order for foreclosure to be profitable is "highly implausible."[4] But this number is not only plausible – *it is well within Comcast's own internal estimates.*

It is also worth noting that Comcast's critique, as with its other submissions in this proceeding, glosses over a primary thrust of DIRECTV's argument: that where permanent foreclosure would be profitable for a dominant cable operator, other strategies can be used to achieve the same anticompetitive ends while attracting less regulatory scrutiny. Comcast's experts make no attempt at all to rebut this contention – perhaps because it is indisputable.

I. COMCAST'S CRITIQUE OF THE LEXECON ANALYSIS IS, IN ACTUALITY, A CRITIQUE OF THE COMMISSION'S *NEWS-HUGHES* METHODOLOGY.

The Comcast Response, and the Ordover Further Declaration upon which it is based, reflect a fundamental misapprehension of Lexecon's analysis. Lexecon did not create out of whole cloth a methodology for analyzing potential foreclosure arising from these transactions. Instead, it set out to replicate the analytical framework used by the Commission in the *News-Hughes* proceeding, since that is the most recent and authoritative precedent on point. Accordingly, Lexecon followed the methodology set forth in Appendix D to the *News-Hughes* order, modifying it only as necessary to accommodate application to a cable operator rather than a DBS operator.[5]

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4 *See* Comcast Response at 9; *see also* Ordover Further Declaration at ¶¶ 7, 25.

5 For example, 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. Cable operators, however, do not typically require such agreements for new subscribers. For its analysis of temporary foreclosure by a cable operator, therefore, Lexecon assumed that subscribers who switch from DBS to cable can switch back as soon as the service interruption ends – an assumption that makes temporary foreclosure *less* profitable than under the *News-Hughes* assumptions. *See* Lexecon Further Statement at 8.

The Ordover Further Declaration takes issue with several aspects of this foreclosure analysis. But each of these items was part of the *News-Hughes* analytical framework.[6]

- *"[W]e understand that Comcast is prohibited from engaging in permanent foreclosure of CSN Mid-Atlantic under applicable FCC rules and regulations. This by itself renders Lexecon's analysis irrelevant to a competitive assessment of the transaction."*[7]

  All of the RSNs at issue in the *News-Hughes* proceedings were subject to the same program access rules that apply to RSNs affiliated with Comcast.[8] Nonetheless, the Commission did not deem a competitive analysis to be "irrelevant" in that proceeding and found that existing safeguards would not be sufficient to ensure competitive access to this "must have" programming. Comcast has failed to show that a similar analysis – and a similar result – are not warranted in this proceeding.

- *"Lexecon failed to account for churn or for discounting in its permanent foreclosure model."*[9]

  While the *News-Hughes* framework calls for consideration of these factors in its analysis of temporary foreclosure, it does not include them in the analysis of permanent foreclosure where temporal issues are deemed less important. Indeed, the Commission found that "[u]nlike the case of permanent foreclosure, with temporary foreclosure, the timing of the various effects becomes important."[10] Here again, Lexecon followed the Commission's lead.

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6 In this regard, it is telling – but hardly surprising – that the Ordover Further Declaration cites only sparingly to the *News-Hughes* order – and none of those citations show any discrepancy with the methodology used by Lexecon. *See* Ordover Further Declaration nn.12-14, 24.

7 Ordover Further Declaration at ¶ 27.

8 *See News-Hughes*, 19 FCC Rcd. at 525 ("all of News Corp.'s national and regional satellite cable programming networks are already subject to the Commission's program access rules due to Liberty's approximately 17.6% interest in News Corp., and, in some cases, direct interests in those networks held by Liberty or another cable operator, and will continue to be if the proposed transaction is completed"). DIRECTV has already called this fact to the Applicants' attention, and finds it surprising to see it discussed again here. *See* DIRECTV Surreply at 16 (Oct. 12, 2005).

9 Ordover Further Declaration at ¶ 22.

10 *See News-Hughes*, 19 FCC Rcd. at 638-39.

- *"Lexecon understates the costs of implementing a temporary foreclosure strategy by ignoring several substantial costs. The cost of foregone affiliate fees from foreclosed subscribers is only a small fraction of the total cost of temporary foreclosure. Other costs include (1) the cost of acquiring and retaining former DBS subscribers, (2) the public relations costs and loss of goodwill borne by both the RSN and the withholding operator, (3) regulatory and legal risks as a result of potential program access complaints, and (4) transaction costs related with implementing the strategy."*[11]

  The Commission did not consider any of these factors in *News-Hughes* – and thus, neither did Lexecon in replicating that methodology. Moreover, the *News-Hughes* analysis does not attempt to capture every benefit to a foreclosing cable operator, such as the price increases that may be achieved through temporary foreclosure. Accordingly, the Commission viewed the resulting estimates to be "the *minimum* increase in incentive and ability to obtain additional compensation from MVPDs."[12] The additional "costs" Comcast identifies would offset the additional benefits of foreclosure not reflected in the analysis.

- *"Lexecon thus ignores the largest cost of implementing permanent foreclosure, the regulatory risk that Comcast would incur. . . . [I]f Comcast were to withhold either network permanently, it would almost surely be faced with defending program-access complaints and could potentially incur further harm related to violations of the program-access rules."*[13]

  Once again, there is no indication that the Commission considered the cost of "regulatory risk" in its assessment of permanent foreclosure in *News-Hughes*, and the Ordover Further Declaration provides no citation to that order in connection with this criticism. More fundamentally, however, this line of argument ignores the alternatives available to a dominant cable operator once permanent foreclosure is an option – such as uniform overcharge pricing and stealth discrimination – that achieve the same anticompetitive ends while making regulatory redress less likely.

It is also worth noting that Comcast misapprehends the significance of Lexecon's analysis of temporary foreclosure incentives related to CSN-MidAtlantic. The Ordover Further Declaration dismisses Lexecon's analysis as showing that Comcast's incentive to withhold – *i.e.,* the switching rate at which withholding would be profitable – is

[11] Ordover Further Declaration at ¶ 29.

[12] *News-Hughes*, 19 FCC Rcd. at 638.

[13] Ordover Further Declaration at ¶ 33.

essentially the same before and after the transactions.[14] Lexecon's analysis, however, also showed that the profitability of temporary foreclosure *at all levels* of switching increases significantly post-transaction. This alone would make a withholding threat more credible and create additional bargaining leverage to be used against MVPD rivals.[15] The Commission has recognized that, where competitors have incomplete information about the integrated firm's revenues and costs, the credibility of the threat may be more important than the actual consequences of withholding.[16] The result: "an increase of rival MVPD's programming costs, and ultimately end-user prices."[17]

II. EVEN USING THE ALTERNATIVE METHODOLOGY COMCAST ADVOCATES FOR ESTIMATING SWITCHING, ITS INTERNAL DOCUMENTS DEMONSTRATE THAT FORECLOSURE WOULD BE LIKELY.

Clearly, neither Comcast nor its experts approves of the Commission's methodology for evaluating RSN foreclosure. In the main, they offer nothing other than criticism. However, there is one aspect of the analysis – the estimation of likely switching in response to foreclosure – where they offer an alternative methodology. The Ordover Further Declaration seeks to show that, when properly estimated, the "switching rate" required to make foreclosure of CSN-MidAtlantic profitable is unrealistic.[18] Yet even assuming the validity of that approach, Comcast's own internal documents demonstrate that this switching rate is readily achievable.

As the Ordover Further Declaration notes, the Commission derived its estimation of likely subscriber switching in response to temporary foreclosure by analyzing the impasse between Cablevision and the YES Network. It did so because "[t]his episode of availability, followed by withdrawal, followed by availability exhibits the pattern of temporary foreclosure proposed by some parties in this proceeding."[19] The Commission then applied this derived "estimation" to the full range of RSNs in which News Corp. had an interest, without regard to which or how many teams each RSN was carrying.[20] To

[14] Ordover Further Declaration at ¶ 6.

[15] *See* Economic Ex Parte at 4; Lexecon Further Statement at ¶¶ 24-26.

[16] *See News-Hughes*, 19 FCC Rcd. at 511, 543-44.

[17] *Id.* at 544.

[18] *See* Ordover Further Declaration at ¶¶ 20-25.

[19] *News-Hughes*, 19 FCC Rcd. 646.

[20] *See id.* at 546 ("the staff analysis [of the Cablevision-YES dispute] indicates that, depending on the assumptions, between [redacted] and [redacted] of News Corp.'s RSN subscribers could be vulnerable

DIRECTV's knowledge, there have been no intervening instances of temporary RSN foreclosure that would shed better light on switching rates.

In its filing, Comcast challenges the use of the Cablevision-YES episode as a basis for estimating the likelihood of switching in the context of other RSNs, and specifically for CSN-MidAtlantic.

- *"We believe that the News Corp./Hughes predicted switching number is a poor estimate for the predicted switching number for CSN Mid-Atlantic in these Transactions. . . . By simply importing those estimates into the instant calculations, the Commission would be assuming without any basis that all RSNs are the same with respect to consumer demand and competitive significance."*[21]

DIRECTV agrees with the general proposition that not all RSNs are created equal, and that foreclosure would not have identical consequences in every RSN market. Nonetheless, the Cablevision-YES data was the evidence available to and used by the Commission, and Lexecon followed that lead. In order to tailor the analysis more closely to local market conditions, Comcast and its experts advocate using RSN ratings data to identify the pool of regular viewers from which "switchers" would most likely be drawn. Without conceding the validity of this approach, we evaluate the consequences of such an approach below.

Applying the Commission's *News-Hughes* methodology to the confidential data provided for CSN-MidAtlantic, the Lexecon Further Statement calculated that permanent foreclosure would be profitable for Comcast today if % of DBS subscribers in the **REDACTED**
RSN footprint were to switch to cable in response, whereas that figure would drop to
REDACTED % if the transactions are consummated.[22] Comcast notes that CSN-MidAtlantic achieves an average weekly cumulative audience in the Washington and Baltimore DMAs of approximately %.[23] Thus, Comcast argues, a % switching rate across all
REDACTED DBS subscribers really means that **REDACTED** of those DBS subscribers who are regular **REDACTED**
CSN-MidAtlantic viewers (*i.e.*, % divided by %) would have to switch in order for foreclosure to be profitable.[24] The Ordover Further Declaration concludes that there is

to this tactic because News Corp. would find it profitable to attempt temporary foreclosures to increase its RSN fees").

[21] Ordover Further Declaration at ¶ 30. *See also* Comcast Response at 7-8 (arguing for uniqueness of Yankees programming).

[22] *See* Lexecon Further Statement at 15-16.

[23] *See* Comcast Response at 8-9.

[24] *See id.*

"nothing in Lexecon's statement or in DIRECTV's letter that would suggest that such a large percentage of viewers would respond in such a dramatic fashion to withholding of the RSN."[25]

Comcast need look no further than its own confidential documents to find evidence that such a response to foreclosure is not only possible, but perhaps expected. Those documents include

REDACTED

[26] This summary conclusion is accompanied by

REDACTED

[27]

Had Comcast shared this analysis with its experts, perhaps they would not have been so hasty to conclude that "switch[ing] in response to foreclosure would be unlikely to approach the number required."[28]

Yet the conclusions reached in **REDACTED** should come as no surprise to Comcast and its experts, since applying the methodology they advocate to the most notorious case of permanent RSN foreclosure yields similar results. DBS operators have been denied Comcast's RSN programming in Philadelphia for years, and Comcast itself **REDACTED** .[29] According to the data supplied by Comcast, CSN-Philadelphia had an average weekly cumulative audience of % during the first three quarters of 2005.[30] Applying this data to **REDACTED**
REDACTED

[25] Ordover Further Declaration at ¶ 25.

[26] **REDACTED**

[27] *Id.*

[28] Ordover Further Declaration at ¶ 7.

[29] *See* Letter from William M. Wiltshire to Marlene H. Dortch at 2-3 (Feb. 14, 2006) (discussing **REDACTED**).

[30] **REDACTED**

REDACTED **REDACTED**

REDACTED indicates that approximately % (*i.e.*, % divided by %) of the RSN's regular viewers switched in response to permanent foreclosure. However, Lexecon used a regression analysis of publicly available data to show that the DBS shortfall in Philadelphia is actually over 10%.[31] Using that figure instead of **REDACTED** indicates that % (*i.e.*, % divided by %) of the **REDACTED** RSN's regular viewers switched in response to permanent foreclosure. Accordingly, assuming *arguendo* the validity of its approach, Comcast has more than ample evidence from which to conclude that permanent foreclosure of CSN-MidAtlantic would achieve the required switching rate.

This presents a very real and immediate concern, **REDACTED** **REDACTED**, providing Comcast a near-term opportunity to exercise its enhanced market power to the detriment of its MVPD rivals in the area. The Commission must impose appropriate conditions if the interests of competition and consumers are to be safeguarded against the anticompetitive strategies that the transactions will predictably foster.

Respectfully submitted,

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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)

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[31] *See* G. Bamberger and L. Neumann, "Updated Analysis of RSN Availability on DBS Penetration," at 4-5 (Mar. 17, 2006).

SUPPORTING DECLARATION OF GUSTAVO BAMBERGER AND LYNETTE NEUMANN

We previously filed a statement in which we utilized the Commission's *News-Hughes* framework to analyze the effect of temporary and permanent foreclosure of regional sports network programming.[1] In response, Comcast Corporation ("Comcast") submitted a declaration that criticized our analysis.[2] We participated in the preparation of, and agree with, the response to Comcast's criticisms contained in the April 6, 2006 letter from counsel for DIRECTV, Inc. to the Commission.

Gustavo Bamberger

4/5/06
Date

Lynette Neumann

4/5/06
Date

1. *See* Letter from William M. Wiltshire to Marlene H. Dortch (March 1, 2006) ("Economic Ex Parte") (submitting Further Statement of Gustavo Bamberger and Lynette Neumann ("Lexecon Further Statement")).
2. *See* Letter from Martha E. Heller to Marlene H. Dortch (Mar. 24, 2006); Letter from James R. Coltharp to Marlene H. Dortch (Mar. 15, 2006) ("Comcast Response") (submitting Further Declaration of Janusz A. Ordover and Richard Higgins ("Ordover Further Declaration")).