Before the
Federal Communications Commission
Washington, D.C. 20554

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In the Matter of	)	
	)	
Applications of Comcast Corporation, General Electric Company, and NBC Universal, Inc., to Assign and Transfer Control of FCC Licenses	)	MB Docket No. 10-56
	)	

REPLY

Matthew M. Polka
President and Chief Executive Officer
American Cable Association
One Parkway Center
Suite 212
Pittsburgh, Pennsylvania 15220
(412) 922-8300

Ross J. Lieberman
Vice President of Government Affairs
American Cable Association
2415 39th Pl, NW
Washington, DC 20007
(202) 494-5661

Christopher C. Cinnamon
Barbara S. Esbin
Jeremy M. Kissel
Cinnamon Mueller
307 North Michigan Avenue
Suite 1020
Chicago, Illinois 60601
(312) 372-3930

Thomas W. Cohen
Kelley Drye & Warren LLP
Washington Harbour, Suite 400
3050 K. Street, NW
Washington, DC 20007
(202) 342-8400

Attorneys for the American Cable Association

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SUMMARY

From the time the proposed combination of Comcast and NBCU was announced some eight months ago, the ACA has sought to precisely assess the competitive harms and provide empirical evidence as to their nature and magnitude. The ACA appreciates that the Commission too is conducting a very serious, fact-driven review. After all, the proposed combination is a "big deal," whose harmful effects will be widespread and extensive.

This Reply filing represents the final part of the ACA's case that without sufficient relief, the Commission cannot find the proposed combination is in the public interest. In its initial comments, the ACA demonstrated that the proposed transaction, if consummated, would have significant deleterious horizontal and vertical competitive effects. In its July 21, 2010 filing responding to the initial comments, the ACA, using documents submitted by the Applicants pursuant to the Commission's directive buttressed its arguments and the conclusion that, if the proposed combination were permitted, significant competitive harms would result and therefore the transaction should not be approved absent enforceable conditions sufficient to protect competition and consumer welfare. In this Reply, the ACA, relying on a new report from its economic expert, Professor William Rogerson, first addresses and rebuts arguments raised by the Applicants and their economists in their response to comments. Second, the ACA, again using the Rogerson Report, sets forth proposed conditions that the Applicants would need to adopt to ameliorate the harms caused by the proposed transaction, including by enabling smaller MVPDs to enforce any rights provided in the remedies either directly or through a bargaining agent.

At its core, the ACA's remedies ensure that MVPDs – especially smaller MVPDs – can carry NBCU's broadcast stations, its cable networks and Comcast's RSNs at rates, terms, and conditions reflecting pre-combination conditions. To achieve this aim, the ACA first proposes general measures most of which were either used in or based upon previous Commission decisions. These measures, which apply generally to all MVPDs, include expanding the reach of the program access rules to cover all programming sold by Comcast-NBCU and all platforms by which MVPDs may distribute that programming, the stand-alone sale by Comcast-NBCU of

local broadcast stations and RSNs, and commercial arbitration for all programming. The ACA then proposes three critical measures to ensure that smaller MVPDs can effectively employ these remedies. The following summarizes the key features of these two integrated proposals:

1. General Remedies to Address Increases in Programming Prices

- The program access rules shall be applied to Comcast-NBCU's sale of its broadcast stations and its other programming regardless of the means by which any of the programming is delivered to subscribers (e.g. online and mobile).

- Comcast-NBCU must sell each NBC O&O and each Comcast RSN on a stand-alone basis to all MVPDs. This remedy will significantly decrease the complexity and cost of commercial arbitration, including the proposed special commercial arbitration process for smaller operators.

- Comcast-NBCU is subject to a commercial arbitration process to ensure that it does not sell programming – broadcast stations, RSNs, and national cable networks – at a price that exceeds fair market value.

2. Special Provisions to Ensure Remedies are Useful for Smaller MVPDs

- MVPDs with fewer than 125,000 MVPD subscribers in the relevant market cannot be charged more than 5% higher than the lowest Net Effective Rate charged to other MVPDs for NBC O&Os and Comcast RSNs. To ensure transparency and assist in enforcing this right, Comcast-NBCU and Comcast must file annual certifications.

- To enable smaller MVPDs to enforce their ability to access NBC O&Os and Comcast RSNs at competitive rates, a new, lower-cost arbitration process with an automatic right of continued carriage is established.

- Comcast-NBCU must negotiate in good faith with Bargaining Agents, and these agents shall have comparable rights to MVPDs to obtain programming from Comcast-NBCU.

Finally, to ensure the remedies adequately address the harms and reflect the dynamic of the programming market and other carriage agreements entered into by the Applicants with other parties to the FCC's proceeding, they should remain in effect for 9 years.

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REPLY

Pursuant to the Public Notice issued by the Federal Communications Commission ("FCC" or "Commission") in the above-captioned proceeding on March 18, 2010,[1] the American Cable Association ("ACA"),[2] by its attorneys, hereby files its Reply to responses on the applications by Comcast Corporation ("Comcast"), General Electric Company ("GE") and NBC Universal ("NBCU") (hereinafter referred to jointly as the "Applicants") for consent to assign and transfer control of certain

[1] *Commission Seeks Comment on Applications Filed by Comcast Corporation, General Electric Company and NBC Universal, Inc. to Assign and Transfer Control of FCC Licenses*, Public Notice, DA 10-457, MB Docket No. 10-56 (rel. Mar. 18, 2010) ("Public Notice").

[2] The ACA represents approximately 900 small and medium-sized cable companies serving mostly smaller markets and rural areas throughout the United States. ACA's membership encompasses a wide variety of businesses – family-owned companies serving small towns and villages, multiple system operators serving predominantly rural markets in several states, and hundreds of companies in between. Together, these companies serve more than 7.6 million households and businesses. All ACA members transact with Comcast, NBCU and their affiliates for "must have" cable and broadcast programming, and other popular and important video offerings.

spectrum licenses to a new limited liability company that would constitute a joint venture of GE and Comcast ("Joint Venture").[3] The ACA explained in its initial comments that the proposed transaction, if consummated, would have significant deleterious horizontal and vertical competitive effects.[4] In its July 21, 2010 filing responding to the initial comments,[5] the ACA demonstrated that documents submitted by the Applicants pursuant to the Commission's directive[6] buttressed its arguments and the conclusion that, if the proposed combination were permitted, significant competitive harms would result and therefore the transaction should not be approved absent enforceable conditions sufficient to protect competition and consumer welfare. In this Reply, the ACA, relying on a new report from its economic expert, Professor William Rogerson,[7] first addresses and rebuts arguments raised by

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[3] *In the Matter of Applications of Comcast Corporation, General Electric Company and NBC Universal, Inc. For Consent to Assign Licenses or Transfer Control of Licensees*, Applications and Public Interest Statement (filed Jan. 28, 2010) ("Application").

[4] *In the Matter of Applications of Comcast Corporation, General Electric Company, and NBC Universal, Inc., to Assign and Transfer Control of FCC Licenses,* MB Docket No. 10-56, Comments of the American Cable Association (filed June 21, 2010) ("ACA Initial Comments"). ACA's initial comments included a report from its economist, Professor William Rogerson, analyzing the nature and extent of horizontal and vertical harm that would result from the proposed combination. William P. Rogerson, "Economic Analysis of the Competitive Harms of the Proposed Comcast-NBCU Transaction," June 21, 2010 ("Rogerson I").

[5] *In the Matter of Applications of Comcast Corporation, General Electric Company, and NBC Universal, Inc., to Assign and Transfer Control of FCC Licenses,* MB Docket No. 10-56, Response to Comments of the American Cable Association (filed July 21, 2010) ("ACA Response Comments").

[6] Letter from William T. Lake, Chief, Media Bureau, to Michael H. Hammer, Esquire, James H. Casserly, Esquire, Michael D. Hurwitz, Esquire, Brien C. Bell, Esquire, Willkie Farr & Gallagher LLP, Counsel for Comcast Corporation, MB Docket 10-56, May 21, 2010; Letter from William T. Lake, Media Bureau, to Bryan N. Tramont, Esquire, Kenneth E. Satten, Esquire, David H. Solomon, Esquire, Natalie G. Roisman, Esquire, Wilkinson Barker Knauer, LLP, Counsel for NBC Universal, Inc., MB Docket No. 10-56, May 21, 2010.

[7] William P. Rogerson, "A Further Economic Analysis of the Proposed Comcast-NBCU Transaction," Aug. 19, 2010, attached hereto as Attachment A ("Rogerson II).

the Applicants and their economists in their response to comments.[8] Second, the ACA, again using Rogerson II, sets forth proposed conditions that the Applicants would need to adopt to ameliorate the harms caused by the proposed transaction. These conditions, which operate as an integrated package, will protect consumers from higher prices and the loss of programming that otherwise would result from the transaction.

I. A BRIEF REVIEW OF THE COMPETITIVE HARMS CAUSED BY THE PROPOSED COMBINATION.

Horizontal Harm:[9] The proposed combination creates horizontal competitive concerns because key programming assets now separately owned by NBCU and Comcast -- NBCU's 10 Owned & Operated ("O&O") and affiliated broadcast television stations, its block of national cable programming and Comcast's 9 Regional Sports Networks ("RSNs") -- will be joined post-transaction. Moreover, these assets, which are "must have" programming, are substitutes in the sense that the value of one network to a multichannel video programming distributor ("MVPD") is lower conditional on already carrying the other network. Under standard economic theory, if two different programmers own two different networks (or blocks of networks) that each create market power, combined ownership of both will generally create

[8] *In the Matter of Applications of Comcast Corporation, General Electric Company, and NBC Universal, Inc., to Assign and Transfer Control of FCC Licenses,* MB Docket No. 10-56, Opposition to Petitions to Deny and Response to Comments, Comcast Corporation, General Electric Company, NBC Universal, Inc. (filed July 21, 2010) ("Applicants' Opposition"). The Applicants' Opposition includes two exhibits: Exhibit 1, Gregory L. Rosston, Ph.D. and Michael D. Topper, Ph.D, "The Proposed Comcast-NBCU Transaction: Response to Comments and Petitions Regarding Competitive Benefits and Advertising Competition" (July 21, 2010); and, Exhibit 2, Mark Israel and Michael L. Katz, "Economic Analysis of the Proposed Comcast-NBCU-GE Transaction" (July 20, 2010) ("Israel/Katz Report").

[9] *See* ACA Initial Comments at 18-25.

significant additional market power. That is what would occur from the proposed combination of NBCU's and Comcast's programming assets, which would allow the new Joint Venture to charge much higher programming fees. These fee increases will be substantially passed through to subscribers in the form of higher subscription prices. In its prior comments, the ACA offered evidence in support of this claim and the magnitude of the harm.[10]

The greatest threat of horizontal harm from this proposed combination occurs in regions of the country served by an NBC O&O[11] and a Comcast RSN. In such regions, NBCU's control over retransmission consent for the NBC broadcast signal and control over its popular national cable networks will be combined with Comcast's control over its RSN. Approximately 12.1% of all TV households in the United States,

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[10] The retransmission consent market supplies the best available evidence on the effect of combined ownership or control on programming fees. This is because retransmission consent markets are local and the extent to which multiple Big 4 stations in the same market are jointly owned or controlled varies from market to market. The available evidence suggests that joint control or ownership of multiple Big 4 stations in the same DMA can increase retransmission consent fees by 20% and possibly much more. This level exceeds the threshold for harm in the *Horizontal Merger Guidelines* used by the Department of Justice and the Federal Trade Commission.

The ACA's concern about the effects of Big 4 collusion leading to increased retransmission fees was recently echoed by the National Cable Telecommunications Association: "Permitting a broadcaster to negotiate retransmission consent on behalf of two stations in a market …is likely to result in consumer harm rather than the pro-competitive efficiencies envisioned when LMAs were created. As Time Warner Cable explains, "[b]y aggregating their market power and negotiating in tandem instead of in competition with one another, broadcasters can more easily raise the price of retransmission consent and more effectively threaten to withhold their signals during negotiations." (Comments of the National Cable Telecommunications Association, MB Docket No. 09-182, July 26, 2010, at 4.)

[11] For purposes of assessing the extent of harm and discussing remedies in these comments, the term "NBC O&O" shall include NBC Owned and Operated broadcast television stations currently or in the future owned or controlled by Comcast-NBCU and any other NBC local television affiliate on whose behalf Comcast-NBCU negotiates retransmission consent agreements.

spread over six different metropolitan areas, are located in DMAs with these characteristics.[12]

The transaction also threatens horizontal harm in regions served by a Comcast RSN but not served by an NBC O&O. In such regions, NBCU's control over its popular national cable networks will be combined with Comcast's control over its RSN. Approximately 28% of TV households are located in designated market areas ("DMAs") with these characteristics. Therefore, regions containing at least 40% of all TV households are threatened with the horizontal harm from this transaction. The harm in fact may be even more widespread if the Applicants swap assets to aggregate programming in markets or if the Applicants are able to negotiate on behalf of NBCU affiliates for retransmission fees.[13]

Vertical Harm:[14] Vertical harm will arise from the proposed combination when the programming assets of NBCU are combined with Comcast's ownership of the country's largest MVPD. This union will increase Comcast-NBCU's ability to command higher programming fees from MVPDs that compete with Comcast. These fee increases will be substantially passed through to subscribers in the form of higher subscription fees.

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[12] These are Chicago, IL, Philadelphia, PA, San Francisco-Oakland-San Jose, CA, Washington, DC, Miami-Fort Lauderdale, FL, and Hartford and New Haven, CT.

[13] *See* ACA Response to Comments at 13-18 (a "review of the documents produced by Applicants demonstrates that in fact they recognize there is substantial overlap in the programming assets of Comcast and NBCU, that they intend to sell these assets in combination to MVPDs and that they are likely to add to them to increase the number of programming overlaps. In other words, Professor Rogerson's analysis *should be viewed as a conservative assessment of the post-transaction behavior in which the Applicants plan to engage and the impact such behavior is likely to have on MVPDs and subscribers.*") (emphasis added).

[14] *See* ACA Initial Comments at 25-37.

The economic theory underlying the ACA's analysis is as follows: So long as the Joint Venture and Comcast are able to coordinate their actions to take advantage of opportunities to maximize their combined profits, the Joint Venture and Comcast will collectively make decisions to maximize their combined profits. The reason that programming fees will rise is because the Joint Venture will seek to recoup through its negotiations for programming the opportunity cost of not acquiring new customers from rival MVPDs through the permanent withholding of programming. Increases in opportunity cost have the same impact on programming fees as increases in direct cost. In the absence of other information, a standard and well-accepted practice in economic theory is to predict that the negotiated price between a buyer and seller will rise by half the amount of any cost increase.

The impact of the transaction will be most significant in DMAs served by an NBC O&O where Comcast has a significant presence as the incumbent multichannel video programming distributor ("MVPD"). Approximately 12% of all TV households in the United States, spread over six metropolitan areas, are located in such DMAs, which happen to be the same markets that will also suffer the most significant horizontal harm from the transaction. Under plausible parameter values, the retransmission consent fees charged by NBC O&Os will increase by approximately 100% in these DMAs.

The transaction also would have a significant impact on the fees that the joint venture charges for NBCU's national cable networks. Under plausible parameter values, the fees for this programming will increase by approximately 18-20% for large

MVPDs who compete against Comcast, such as DirecTV, DISH Network, Verizon's FiOS service and AT&T's U-verse offering.

Cable overbuilders will experience higher programming fee increases to the extent that Comcast passes a high percentage of their subscribers. Under plausible parameter values, if Comcast passes almost all of an overbuilder's customers, its retransmission consent fees will increase by 100% and its fees for NBCU's national cable networks will increase by 44%. However, cable overbuilders will still experience significant price increases even if the share of their customers passed by Comcast drops to much more modest levels. ACA has identified 40 members who are Comcast rivals in all or some of their service areas.

II. <u>THE APPLICANTS' AND THEIR ECONOMISTS DO NOT PROVIDE COGENT ARGUMENTS TO COUNTER THE CONCLUSION THAT THE PROPOSED COMBINATION WILL CAUSE SIGNIFICANT HORIZONTAL AND VERTICAL HARMS.</u>

A. <u>Horizontal Harm.</u>

1. Introduction.

In Rogerson I, Professor Rogerson described how the horizontal combination of NBCU and Comcast programming networks would result in MVPDs paying higher prices "so long as the networks are substitutes for one another in the weak sense that the value of one network to an MVPD is lower conditional on already carrying the other network."[15] The economic rationale for this conclusion is that when negotiations for NBCU and Comcast networks occur separately, each can only

[15] *See* Rogerson I at 4-5 for a summary of the horizontal harms. The NBCU and Comcast programming networks can be substitutes even if subscribers have a strong preference to subscribe to a MVPD that carries both networks.

extract a limited share of the joint profit from adding the last network. However, when NBCU and Comcast combine networks, they will be able to extract the full share of the profit from adding the entire bundle, which will be greater than twice the surplus from adding just the last network. This result holds even if the NBCU and Comcast programming networks are not perfect or even relatively close to perfect substitutes and are merely partial substitutes.

Applicants' economists, Drs. Israel and Katz, attempt to rebut Professor Rogerson's analysis by making a series of claims that the NBCU and Comcast programming are not close substitutes and that empirical evidence shows that combining such networks does not raise prices. In the next section, the ACA, using the attached report by Professor Rogerson, responds to each of these arguments.

2. The arguments of the Applicants do not undermine the conclusion demonstrated by the ACA in its initial comments that horizontal harms will result from the proposed combination.

The Applicants' make five different arguments in attempting to counter the ACA's conclusion that the combination of NBCU and Comcast programming networks will lead to significantly increased prices for consumers. In each instance, these shots fired by the Applicants either fall wide or short of their mark. Below the ACA, relying on Rogerson II, discusses each of the Applicants' arguments and shows that they do not undermine the conclusion that the proposed combination will result in substantial horizontal harms to MVPDs and their subscribers.

> **1. Applicants' Contention:** "A basic review of the content carried suggests that Comcast's RSN's and NBC broadcast stations are not likely to be close substitutes."[16]

ACA Response: Drs. Israel and Katz present a much too narrow view of what constitutes substitutability. As Professor Rogerson states, "To the extent that substitutability between networks is caused simply by the fact that subscribers value increases in variety at a decreasing rate, it is perfectly possible and reasonable that two very different types of networks could be partial substitutes for one another in the sense that the value of adding one of the two networks decreases conditional on the other network already being carried." [17] In other words, subscribers may pay $1 extra to add either a sports or general entertainment network but, once one of those were added – and overall variety increased -- subscribers would only be willing to pay a significant amount less than $1 to add the other network. Thus, contrary to the Applicants' claim, content alone is not sufficient to determine substitutability.

> **2. Applicants' Contention**: "The Commission has previously found that RSNs, broadcast networks, and national cable networks 'differ significantly in their characteristics, focus, and subject matter,' and are imperfect substitutes that should be analyzed in separate 'categories.'"[18]

ACA Response: Drs. Israel and Katz seem to be asking the Commission to conclude that because it has stated that RSN programming differs significantly from programming on other networks, these other networks and the RSNs cannot be close substitutes. If that is the case, the ACA believes they are overstating the effect of the

[16] Israel/Katz Report, ¶ 111.

[17] Rogerson II at 27-28.

[18] Israel/Katz Report, ¶ 104.

Commission's finding as it applies to Professor Rogerson's analysis. As stated above, for Professor Rogerson's results to hold, the networks do not have to be perfect or near-perfect substitutes. Rather, it is sufficient that the networks be partial substitutes, and the Commission's previous statements do not foreclose such a finding.

> **3. Applicants' Contention:** "The demographic profiles of the NBC broadcast network and the Comcast RSNs look nothing like each other."[19]

ACA Response: Just because demographic profiles of viewers on different types of networks may differ does not necessarily mean that the networks are not substitutes. First, even assuming the demographic profiles of two types of networks differ, a substantial number of viewers may still watch both networks – and thus view the networks as partial substitutes. Second, most households (the decision making entity for procuring programming from a MVPD) have multiple viewers with different demographic profiles – and thus even if individual viewers may only watch one type of network, the overall household watches both types of networks, viewing them as substitutes.

> **4. Applicants' Contention:** "The transaction involves a relatively small share of television viewing and will not substantially increase the concentration of broadcast and cable networks combined, or cable networks on their own."[20]

ACA Response: Drs. Israel and Katz base their examination of concentration in the programming market on the share of total viewing hours that households devote –

[19] Israel/Katz Report, ¶ 113.

[20] Israel/Katz Report, ¶ 109.

before and after the proposed combination -- to watching all the networks produced by a programmer. Using their approach, the shares are relatively low pre-combination and do not rise substantially post-combination, especially to the levels that normally concern antitrust authorities. While superficially plausible, this approach, as Professor Rogerson states, "completely ignores the Commission's own determination that calculating concentration ratios in this manner is not the correct way to assess the extent of market power in programming markets."[21] For example, their approach runs counter to the Commission's conclusion that programmers with RSNs or local broadcast networks have significant market power.

> **5. Applicants' Contention**: An empirical analysis of the combination of Fox's O&Os and its RSNs indicates that "on average, joint ownership by New Corporation had no significant effect on the level of RSN affiliate fees."[22]

ACA Response: The ACA does not disagree that the effects of the combination of Fox's O&Os and RSNs would provide a good indication of the potential harms that would result from the combination proposed by the Applicants. However, because no such evidence was available, the ACA presented the next best evidence -- the effects of combining multiple Big 4 local broadcast stations – to make the general point that combined control of multiple networks (especially "must have" networks) can lead to higher programming fees. Using this evidence, the ACA showed that prices from the proposed combination would increase by 20% if not more.

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[21] Rogerson II at 30.

[22] Israel/Katz Report, ¶ 124.

To date, no one has attempted to analyze the pricing effects of combining Fox O&Os and RSNs. Professor Rogerson notes this is because there are "limitations in the amount and type of data available and the inherent impossibility of controlling for other factors that might affect RSN fees."[23] For example, it is well-known that the attractiveness of a RSN can change dramatically if a sports team enters into or walks away from a carriage agreement with the network. In addition, the ownership of a RSN may play a large role in determining prices, terms, and conditions and the type of programming carried. These and other variables may be viewed as not that significant – that is, important to control – if there are a very large number of events. However, if the data set is limited, controlling for these unusual events so that the results are credible becomes essential.

In their filing, Drs. Israel and Katz take on this daunting challenge. They gathered data and then analyzed the pricing effects of the Fox's O&O and RSN combinations. From this work, they concluded there is no substantial effect, that is, where combinations existed, prices did not rise significantly.

The flaws in the empirical analysis conducted by Drs. Israel and Katz are numerous and serious, and the Commission should not rely on its conclusion. To begin with, Drs. Israel and Katz have a limited data set – "eleven transactions" that occurred between 2000 and 2008. Professor Rogerson, in the attached report, reviews each of these transactions.[24] First he finds that six of these transactions are

[23] Rogerson II at 32.

[24] Rogerson II at 33-37.

not suitable for analysis because they are based on a single post-transaction year of data, an especially troubling problem where most agreements between programmers and MVPDs are multi-year deals:

> The first thing to notice about this list of transactions is that six of the listed eleven transactions all occurred in 2008 when News Corp. sold a number of Fox O&Os. Since Drs. Israel and Katz have annual fee data from 1999-2009, this means that they only have one post-transaction year of data for RSN fees for these six transactions. Furthermore, it is typically the case that programmers and MVPDs sign multi-year agreements. Therefore it may well be the case that many of the RSN fees paid in 2009 were determined by contracts signed prior to News Corp.'s sale of the Fox affiliates. Therefore, in my judgment, these six transactions should not be included in the study.[25]

The remaining five transactions involve Fox purchasing a RSN. As discussed above, a change in ownership by itself can have dramatic effects on the objectives, operations, and content of – and, of course, carriage fees charged by -- a RSN. One of these five transactions involved the purchase of Turner South, which aired both regional sports and non-sports programming. After Fox's purchase, the RSN changed programming line-ups and carried only regional sports programming. Another transaction involved Fox Sports Ohio, which just after its purchase by Fox in 2005 lost the rights to carry its anchor-tenant, the Cleveland Indians baseball games. It is likely that this occurrence led Fox to drop its prices, or, at the very least, refrain from any increases. This in turn would greatly affect the overall results of the analysis by Drs. Israel and Katz; yet, they did not control for it. As for the other three events, there may well have been uncontrolled-for events as well. In sum, their empirical study has far too many problems for it to be considered reliable by the Commission,

[25] Rogerson II at 35.

and the best available evidence continues to be the ACA's submission of price increases resulting from the combination of Big 4 local television stations.

B. Vertical Harm.

1. Introduction.

Professor Rogerson's first report set forth the theory of vertical harm that arises from the proposed combination of Comcast and NBCU and then calculated the extent of this harm. In essence, because the Joint Venture will take account of the fact that selling programming to MVPDs that compete with Comcast will reduce Comcast's profits, the combination of Comcast's ownership share of the Joint Venture and its ownership of its MVPDs assets would cause the Joint Venture to bargain for higher programming fees from MVPDs that compete with Comcast and these higher fees would be substantially passed through to subscribers, increasing their fees (The "Raising Rival's Costs" effect). Professor Rogerson then calculated that in regions with an NBCO O&O, the expected increase in fees charged to competing MVPDs (DBS and telephone providers) for both retransmission and for carriage of cable networks would be approximately $.95 per subscriber per month.[26]

The Applicants' Opposition, relying on the Israel/Katz Report, seeks to refute Professor Rogerson's analysis by contending:

1. "[I]t would be inappropriate to consider the potential programming-cost increases that may arise because NBCU may internalize Comcast's profits…without also accounting for programming cost decreases flowing from

[26] For a cable overbuilder where Comcast passed 80% of the same homes, the price increase would be larger, $1.06 per subscriber per month.

efficiencies – notably the reduction in double marginalization – that will arise because Comcast, while paying the same price to NBCU for programming as determined in arm's-length negotiations, will internalize NBC profits…Once these efficiencies are incorporated, the net effect of the transaction on average MVPD programming costs is negative."[27]

2. The "Raising Rival's Costs" approach used by Professor Rogerson "does not predict how players will allocate the surplus generated by their agreement" and, in any event, his calculation overstates the likely effect.[28]

3. The Commission should not be concerned if post-combination the Joint Venture raises programming fees for cable overbuilders since these providers have an insignificant number of subscribers.[29]

In the following sections, the ACA uses Rogerson II to demonstrate the fundamental flaws in the arguments propounded in the Applicants' Opposition and the Israel/Katz Report.

2. Contrary to the Applicants' claim, the reduction in Comcast's costs post-combination because of double marginalization is relatively insignificant.

The Applicants contend that double marginalization exists pre-combination because "although the marginal cost of NBCU when MVPDs distribute programming to an additional subscriber is typically near zero, NBCU charges Comcast (and other

[27] Applicants' Opposition at 149-150.

[28] Applicants' Opposition at 143-144.

[29] Israel/Katz Report, n.100.

MVPDs) a pre-subscriber price that is above zero for most of its content."[30] They then argue that double marginalization will be reduced post-combination because "for every dollar that Comcast pays to NBCU, it will retain ownership of 51 cents through its interest in NBCU" and that "these double marginalization savings represent a true reduction in the average cost (across MVPDs) for NBCU programming."[31] Finally, they maintain that the reduction in costs as the result of double marginalization is so great that the price increases calculated by Professor Rogerson are "swamped by the price effects of transaction-related efficiencies."[32]

While the Applicants' double marginalization analysis may at first seem appealing, Professor Rogerson demonstrates in Rogerson II that Drs. Israel and Katz "make a grave error in economic reasoning that results in a completely false conclusion."[33] Professor Rogerson does not disagree that post-combination Comcast will operate as if its marginal cost of providing NBCU programming to its cable subscribers is zero. He, however, finds that Drs. Israel and Katz ignore in their analysis the new opportunity cost that arises because the Joint Venture charges a programming fee not only to Comcast but to all competing MVPDs and that this entire programming fee charged to competing MVPDs represents profit to the Joint Venture. As a result, should Comcast lower its subscription price slightly to attract more customers, the Joint Venture will lose these fees paid by other MVPDs and the

[30] Israel/Katz Report at 150.

[31] Israel/Katz Report at 151.

[32] Israel/Katz Report at 152.

[33] Rogerson II at 8.

attending profit.[34] Professor Rogerson shows (using $1.56 as a reasonably plausible value for the cost of NBCU programming) that when the new opportunity cost is taken into account the effect of reduced double marginalization is minimal:[35]

> [I]f θ is the switcher share for Comcast, then this means that θ of the customers that it would attract by lowering its price slightly would be customers that switch from some other MVPD. This means that the opportunity cost of attracting a new customer is θ x $1.56, because this is the amount of profit that the vertically integrated firm will lose when it attracts new customers. Therefore a complete accounting of the effects of vertical integration on the marginal cost to the combined entity of serving new MVPD customers is as follows. First, because the payment of Comcast to the joint venture of $1.56 is now simply a transfer payment, the marginal cost goes down by $1.56. However, second, because θ of the customers that Comcast attracts will be from other MVPDs, there is a new opportunity cost of θ x $1.56 per subscriber per month. A decrease in cost of $1.56 combined with an increase in cost of θ x $1.56 yields a net decrease in cost of (1-θ) x $1.56. In particular, if θ is close to 1 [which should be expected since most new customers will be existing MVPD customers], then the net decrease in cost due to the double marginalization effect will be close to 0.[36]

Even if the share of new customers that are "switchers" from competing MVPDs is somewhat lower – that is, the value of θ is not 1 but .9 – the cost reduction from double marginalization would only be $.16 per subscriber per month. To provide context for this reduction, Rogerson I found that post-combination, competing MVPDs would see an increase of $.95 in their cost to carry NBCU programming. Thus,

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[34] This is based on the perfectly reasonable assumption that, given the large percentage of MVPD subscribers, almost all of the new customers switch from other MVPDs.

[35] For purposes of reading the following passage, Professor Rogerson defines the "switcher share," denoted by the parameter θ, as follows. Suppose that an MPVD lowers its price slightly in an attempt to attract new customers. Some of the new customers will be people who switch from some other MVPD (the "switchers") and some will be people who previously subscribed to no MVPD. The switcher share, θ, is defined to be the share of new customers that are "switchers." Professor Rogerson argues that the switcher share is likely very close to 1.

[36] Rogerson II at 10.

contrary to the claim of the Applicants, the harm from the proposed combination dwarfs the putative benefits.[37]

3. Applicants' arguments do not lessen concerns that Comcast-NBCU will raise programming prices to rival MVPDs post-combination.

The Applicants present a series of arguments in their attempt to undermine the validity of the Raising Rivals' Costs approach used by Professor Rogerson to demonstrate that post-combination Comcast would raise the prices competing MVPDs would pay for NBCU programming. The ACA responds to each:

> **1. Applicants' Contention**: The benefits of double marginalization can be achieved without close coordination and redistribution of profits and thus could occur with Comcast only holding 51% of the Joint Venture. In contrast, the Raising Rivals' Costs approach requires close coordination and redistribution of profits which will not occur because of General Electric's interest in the Joint Venture.[38]

ACA Response: First, as discussed above, the efficiencies gained by double marginalization are minimal. Thus, even if Comcast fully internalized all of the upstream profits, the effects of double marginalization would not give it sufficient incentive to make significantly different pricing decisions at the downstream level.

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[37] The ACA also notes that Professor Rogerson highlights another concern the Commission should consider in addressing the issue of double marginalization. In n.17 in Rogerson II, he states: "I would also like to raise the more minor point that even if the reduced double marginalization effect was of the same order of magnitude as raising rivals' costs effect, this would still potentially create an issue of concern for the Commission. In the markets that Comcast serves, it is generally the dominant provider. Any transaction that had the effect of giving Comcast a significant cost advantage over its competitors might threaten to drive Comcast's competitors out of the market entirely or at least weaken them considerably, and thus damage competition. Thus, even if the effect of the transaction was to lower Comcast's own costs and raise its rivals' costs by approximately the same amount, it is not at all clear that the net effect on subscribers would be minor. If the result of this was to drive Comcast's competitors from the market or at least considerably weaken them, the reduction in competition might ultimately make it profitable for Comcast to raise its own subscription prices."

[38] Israel/Katz Report, ¶ 26.

Second, there are important classes of efficiencies that can only be achieved by close coordination and profit redistribution. Thus, the Applicants' cannot contend the proposed combination will produce meaningful efficiencies if they do not also believe they can and will act in concert.

> **2. Applicants' Contention**: The bargaining model used by Professor Rogerson is too stylized and "cannot generate reliable predictions about the pricing effects of the proposed transaction."[39]

ACA Response: While Drs. Israel and Katz criticize the bargaining model, they also admit that it "commonly is used in academic settings to derive basic insights about various types of negotiations." Moreover, Dr. Katz found the bargaining model sufficiently valuable to use as the basis of a paper he submitted to the Commission late last year to justify a client's policy position.[40] As Professor Rogerson notes, "Almost all economic models are highly stylized, including most of the game theoretic models that provide the foundation for modern industrial organization theory and that play a key role in providing guidance for antitrust policy…[and in deriving] basic insights useful for policy analysis."[41] Finally, in its most recent review of a significant vertical integration, the Adelphia-Time Warner-Comcast transaction, the Commission relied on a type of bargaining model to analyze the vertical effects.[42]

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[39] Israel/Katz Report, ¶ 35. *See* also Israel/Katz Report, ¶¶ 43-48.

[40] See *In the Matter of Mediacom Communications Corporation v. Sinclair Broadcast Group, Inc.*, Retransmission Consent Complaint, CSR-8233-C, CSR-8234-M, Comments of Comcast, Submission of Michael Katz, Jonathan Orszag, and Theresa Sullivan, "An Economic Analysis of Consumer Harm From the Current Retransmission Consent Regime," Nov. 12, 2009 (filed Nov. 25, 2009).

[41] Rogerson II at 14.

[42] *In the Matter of Applications for Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation, (and subsidiaries, debtors-in-possession), Assignors, to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation, (and subsidiaries,*

3. Applicants' Contention: Professor Rogerson used the wrong parameter value for the share of subscribers leaving a competing MVPD and switching to Comcast as opposed to some other MVPD.

ACA Response: The Initial Rogerson Report used the formula $\Delta P = \alpha\, d\, \pi / 2$ to calculate the fee increase that a MPVD competing with Comcast would face due to the transaction. ΔP denotes the per subscriber fee increase due to the transaction; d the share of the customers that would leave the rival MVPD if it were unable to offer the NBCU programming, α the share of these customers that would switch to Comcast, and π the per subscriber profit margin of Comcast. Professor Rogerson inserted into the formula plausible values which yielded a fee increase of $.95 per subscriber per month.[43]

The primary issue Drs. Israel and Katz have with Professor Rogerson's calculation is the value he used for the parameter α, the share of the customers that would switch to Comcast.[44] In his initial report, Professor Rogerson used the same procedure to calculate the parameter α that Drs. Israel and Katz used in their initial report accompanying the Application: customers leaving an MVPD will be distributed to other MVPDs according to their relative market shares.[45] In the Israel/Katz Report, while they maintain this approach is correct as it applies to cable overbuilders and telephone companies, they argue, based on two pieces of evidence involving the

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debtors-in-possession), Assignors and Transferors, to Comcast Corporation (subsidiaries), Assignees and Transferees; Comcast Corporation, Transferor, to Time Warner Inc., Transferee; Time Warner Inc., Transferor, to Comcast Corporation, Transferee, Memorandum Opinion and Order, 21 FCC Rcd 8203, (2006) ("*Adelphia Order*").

[43] Rogerson I at 26-40.

[44] Drs. Israel and Katz recommend slightly higher values for π and d than those used by Professor Rogerson, which would lead to a greater degree of harm.

[45] Rogerson I at 34.

DBS provider DISH, that customers subscribing to a satellite providers tend to switch in large numbers only to another satellite provider and, therefore, for DBS providers α should be one-third of the "market share" value.[46]

The ACA raises several concerns with the Applicants' new value for α for DBS providers:[47]

1. The evidence provided by the Applicants is limited and relies heavily on the Applicants' own reported analysis of its own private data. Thus, the Commission should not rely on it if (1) it does not have a larger set of data and (2) it does not obtain independent verification of the proposed effect, such as from data from another major cable operator.

2. If customers who subscribe to one DBS provider tend to switch to another DBS provider, then it is equally plausible that the same occurs among wireline MVPDs. Thus, if Comcast withheld programming from a cable overbuilder or a telephone company, it would receive a larger share of switchers than the relative market share method would suggest.

3. Even if Drs. Israel and Katz are correct, the predicted level of harm from the Raising Rivals' Costs effect would still dwarf any possible projected benefits from the reduced double marginalization effect. In other word, reducing the estimate of a $.95 per subscriber per month increase in programming fees by two-thirds yields a projected increase in programming fees of $.32 per subscriber per month. This is approximately ten times greater than the

[46] Drs. Israel and Katz provide no data to justify for the use of one-third of the "market share" value.

[47] *See* Rogerson II at 17-18.

reduction in cost by the double marginalization effect (assuming the switching rate for Comcast is 98%).

> **4. Applicants' Contention**: Empirical analysis does not show that previous vertical mergers have resulted in price increases for programming to competing MVPDs.

ACA Response: In their report, Drs. Israel and Katz seek to analyze the impact on programming prices in four instances of vertical integration and disintegration: Cablevision/Bravo (2002); Cox/Travel Channel (2007); News Corp./DirecTV integration (2004); and, News Corp./DirecTV disintegration (2008). They conclude that "these data provide no support for the hypothesis that vertical integration leads to higher equilibrium affiliate fees."[48] The ACA disagrees. As Professor Rogerson discusses in the attached report, the empirical analysis of Drs. Israel and Katz suffers from a series of problems that undermine their ability to draw any conclusions, much less the bold conclusion that experience does not indicate that vertical integration leads to higher prices for rival MVPDs:

(1) <u>Results from Cablevision and Cox Instances are Inapt</u>.

> "The instances involving Cablevision and Cox are completely inappropriate to use for this study…because the networks involved are national networks and Cablevision and Cox both have extremely small subscriber shares on a national level…Therefore, the raising rivals cost theory would suggest that vertical integration of a national cable network with Cox or Cablevision would have absolutely no effect on the fees it would charge to the other major incumbent cable operators such as Comcast and Time Warner and would also have an extremely modest effect on the fees it would charge the two DBS providers."[49]

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[48] Israel/Katz Report, ¶ 80.

[49] Rogerson II at 20.

(2) <u>The Data Set used in the News Corp.-DirecTV Disintegration Instance is Too Limited.</u>

"Although Drs. Israel and Katz do not explicitly state the source of their pricing data, they do explicitly state that the most recent year for which they have pricing data is 2009 and that their data is annual. This means that they have only one year of data for post-transaction pricing - 2009. Furthermore, it is typically the case that programmers and MVPDs sign multi-year contracts. Therefore it may well be the case that many of the prices paid in 2009 were determined by contracts signed prior to News Corp.'s spin off of DirecTV."[50]

(3) <u>The Data used in the News Corp.-DirecTV Integration is Unclear and Potentially Flawed</u>.

"Even for the one event that in principal might be able to provide useful information, Drs. Israel and Katz are not clear how they deal with the issue of long term contracts that extend over the transaction date. Given that they must have interpreted 2009 data as being post transaction data to be able to include News Corp.'s 2008 sale of DirecTV in their study, it seems likely that they interpreted data in 2005 and later as being post transaction data for News Corp.'s 2004 purchase of DirecTV. Once again, to the extent that program fees were determined by longer term contracts that spanned the transaction date, we would not necessarily expect there to be much of an immediate impact."[51]

(4) <u>The Controls used in News Corp.-DirecTV Integration Analysis are Unknown and Potentially Flawed</u>.

"Although I am confident that Drs. Israel and Katz were likely able to control effectively for any general trends in network prices over the period, I am much less confident that they were able to control properly for issues such as age of the network, quality changes to the network, entry or exit of networks that compete with the networks being studied, and how the networks were bundled together. In a study with a large amount of data this may not be as important, since one might hope that some of randomness associated with uncontrolled-for events may simply wash out. However, given that Drs. Israel and Katz actually have only one data point that appears to be a reasonable candidate for them to study, the inability to properly control for other factors is an extremely serious issue."[52]

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[50] Rogerson II at 21.

[51] Rogerson II at 21.

[52] Rogerson II at 21-22.

4. Cable overbuilders provide significant competition, and the Commission needs to account for harm to them caused by the proposed combination.

Professor Rogerson in Rogerson I demonstrated that cable overbuilders suffered the greatest harm caused by vertical integration from the proposed combination.[53] Drs. Israel and Katz, however, believe because these overbuilders do not have a large number of subscribers, concerns about harm to them should be dismissed.[54] The ACA strongly disagrees.

Forty ACA members are cable overbuilders that compete directly with Comcast's cable systems, and their presence in many of these local markets is significant. If they were no longer in business, customers would experience higher prices, lower quality customer service, and fewer innovative products. Moreover, even if the market share held by these overbuilders may be small, because they have already invested to construct extensive networks, they remain a constant threat to enter (provide service) throughout a large area. In other words, their "competitive punch" is much greater their weight (current subscribership) may indicate.

WOW! provides an example of valuable overbuilder competition to Comcast. It provides residential services to over 460,000 customers in five Midwest markets, including 22 communities in the Chicago metro area, and 66 percent of its video customers today are passed by Comcast, who it competes against in Illinois and Michigan. To compete, it must provide exceptional service, and MVPD customers

[53] Rogerson I at 40.

[54] Israel/Katz Report, n.100.

have rated WOW! the #1 Cable, Internet and Phone provider in Consumer Reports and have recognized it with 10 JD Powers awards in 7 years. [55]

In sum, while the Applicants' may dismiss the importance of WOW! and other cable overbuilders, the harm both the cable overbuilders and their subscribers will experience because of the proposed combination is no less real than that experienced by larger competing MVPDs. Further, the Commission has long recognized the value of competition in the multichannel video distribution market and encouraged entry by competing MVPDs. The proposed combination, if approved without appropriate conditions, will set back this objective.

III. THE COMMISSION SHOULD NOT APPROVE THE TRANSACTION WITHOUT FIRST ENSURING THAT THE APPLICANTS ADOPT THE FOLLOWING TARGETED, ROBUST, AND DURABLE CONDITIONS, WHICH WILL AMELIORATE THE COMPETITIVE HARMS THAT WOULD RESULT FROM THE PROPOSED COMBINATION.

A. The Commission's standard of review and authority to adopt conditions.

Under Section 310(d) of the Communications Act,[56] the Commission must find that, on balance, the proposed transfer of control of certain FCC licenses and authorizations held by NBCU and Comcast as part of the proposed transaction will

[55] *See, e.g.,* "J.D. Power and Associates Reports: Overall Satisfaction with Television Service Providers Rebounds Due to Improvements in Product Performance and Customer Service," Press Release, Oct. 7, 2009, *available at* http://businesscenter.jdpower.com/news/PressRelease.aspx?ID=2009219 (last visited Aug. 19, 2010); "J.D. Power and Associates Reports: Improvements in Performance and Reliability Drive Increase in Overall Customer Satisfaction with Residential Internet Service Providers," Press Release, Oct. 28, 2009, *available at* http://businesscenter.jdpower.com/news/PressRelease.aspx?ID=2009238 (last visited Aug. 19, 2010); and "J.D. Power and Associates Reports: Customers Respond Positively as Cable and Voice Providers Leverage Web Sites to More Effectively Address Customer Service Issues," Press Release, Sept. 10, 2008, available at http://businesscenter.jdpower.com/news/PressRelease.aspx?ID=2008180 (last visited Aug. 19, 2010).

[56] 47 U.S.C. § 310(d).

serve the public interest, convenience, and necessity.[57] As the ACA stated in its Comments, the Commission then employs a balancing test weighing any potential public interest harms of the proposed transaction against any potential public interest benefits.[58] In this case, the Applicants have failed to carry their burden of proving, by a preponderance of the evidence, that the proposed transaction, on balance, will serve the public interest.[59] As detailed in ACA's initial comments and response to comments, the record in this proceeding discloses substantial public interest harms for which there are no off-setting public interest benefits.[60]

In such cases, the Commission's public interest authority enables it to impose and enforce narrowly tailored, transaction-specific conditions that ensure that the

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[57] Section 310(d) of the Act, 47 U.S.C. § 310(d), requires that the Commission consider applications for transfer of Title III licenses under the same standard as if the proposed transferee were applying for licenses directly under Section 308 of the Act, 47 U.S.C. § 308. *See, e.g.*, *In the Matter of Applications for Consent to the Transfer of Control of Licenses, XM Satellite Radio Holdings Inc., Transferor, To Sirius Satellite Radio Inc., Transferee, MB Docket No. 07-57,* Memorandum Opinion and Order, 23 FCC Rcd 12348, 12363, ¶ 30 (2008) ("*XM-Sirius Order*"); *In the Matter of News Corp. and DIRECTV Group, Inc. and Liberty Media Corp. for Authority to Transfer Control*, 23 FCC Rcd 3265, 3276, ¶ 22 (2008) ("*Liberty Media-DIRECTV Order*"); *Adelphia Order*, ¶ 23; *In the Matter of SBC Comm. Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, 20 FCC Rcd 18290, 18300, ¶ 16 (2005) ("*SBC-AT&T Order*"); *In the Matter of Verizon Comm., Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, 20 FCC Rcd 18433, 18443, ¶ 16 (2005) ("*Verizon-MCI Order*"); *In the Matter of General Motors Corporation and Hughes Electronics Corporation, Transferors, and The News Corporation Limited, Transferee*, MB Docket No. 03-124, Memorandum Opinion and Order, 19 FCC Rcd 473, 485, ¶ 18 (2004) ("*News Corp.-Hughes Order"*). *See also In the Matter of SkyTerra Communications, Inc., Transferor and Harbinger Capital Partners Funds, Transferee Applications for Consent to Transfer of Control of SkyTerra Subsidiary, LLC,* IB Docket No. 08- 184 et al., *Memorandum Opinion and Order and Declaratory Ruling,* DA 10-535, ¶ 10 (rel. Mar. 26, 2010) .

[58] ACA Initial Comments at 5-6. *See, e.g.*, *XM-Sirius Order*, 23 FCC Rcd at 12364, ¶ 30; *Liberty Media-DIRECTV Order*, 23 FCC Rcd at 3277, ¶ 22; *SBC-AT&T Order*, 20 FCC Rcd at 18300, ¶ 16; *Verizon-MCI Order*, 20 FCC Rcd at 18443, ¶ 16; *News Corp.-Hughes Order*, 19 FCC Rcd at 483, ¶ 15.

[59] *See, e.g.*, *XM-Sirius Order*, 23 FCC Rcd at 12364, ¶ 30; *Liberty Media-DIRECTV Order*, 23 FCC Rcd at 3277 ¶ 22; *SBC-AT&T Order*, 20 FCC Rcd at 18300, ¶ 16; *Verizon-MCI Order*, 20 FCC Rcd at 18443, ¶ 16; *In the Matter of Application of , Communications Corporation (a Nevada Corporation), General Motors Corporation, and Hughes Electronics Corporation (Delaware Corporations) (Transferors) and EchoStar Communications Corporation (a Delaware Corporation) (Transferee)*, CS Docket No. 01-348, Hearing Designation Order, 17 FCC Rcd 20559, 20574, ¶ 25 (2002) ("*EchoStar-DirecTV Order*").

[60] ACA Initial Comments at 9-37; ACA Response Comments at 2-23.

public interest is served by the transaction.[61] In contrast, to the analysis undertaken by the antitrust enforcement agencies, the Commission's public interest authority enables it to rely upon its extensive regulatory and enforcement experience in crafting and enforcing conditions to ensure that the transaction will yield overall public interest benefits.[62] In the past, the Commission has imposed conditions to remedy harms that arise from transactions involving license transfers that are related to the Commission's responsibilities under the Act and related statutes.[63]

For the reasons explained above, the proposed Comcast/NBCU transaction threatens significant public interest harms that are not outweighed by the projected public interest benefits of the combination. Accordingly, unless the Applicants sufficiently address these threatened harms, the Commission must consider the imposition of conditions to ensure that the transaction will be, on balance, consistent with the public interest. Unfortunately, as the ACA demonstrates in the following section, the conditions proposed so far by the Applicants fall far short of this standard.

B. A review of the flaws with the Applicants' proposed conditions.

The Applicants effectively admit that the proposed combination raises anticompetitive concerns, but they contend that the existing program access

[61] *See*, *e.g.*, *XM-Sirius Order*, 23 FCC Rcd at 12366, ¶ 33; *Liberty Media-DIRECTV Order,* 23 FCC Rcd at 3279, ¶ 26.

[62] *See, e.g.*, *XM-Sirius Order*, 23 FCC Rcd at 12366, ¶ 33; *Liberty Media-DIRECTV Order,* 23 FCC Rcd at 3279 ¶ 26; *News Corp.-Hughes Order*, 19 FCC Rcd at 477, ¶ 5; *see also Schurz Communications, Inc. v. FCC*, 982 F.2d 1043, 1049 (7th Cir. 1992) (discussing Commission's authority to trade off reduction in competition for increase in diversity in enforcing public interest standard).

[63] *See, e.g.*, *Liberty Media-DIRECTV Order,* 23 FCC Rcd at 3279 ¶ 26; *SBC-AT&T Order*, 20 FCC Rcd at 18303, ¶ 19; *Verizon-MCI Order*, 20 FCC Rcd at 18445, ¶ 19.

regulations are a sufficient remedy.[64] The ACA disagrees. In its initial comments, the ACA provided a lengthy discussion on the many flaws with the conditions proposed by the Applicants.[65] First, the Applicants propose no conditions whatsoever to address the horizontal harms demonstrated by the ACA in its filings. In addition, neither the Applicants' proposed voluntary conditions nor the process of resolving disputes through arbitration – a requirement imposed by the FCC in previous transactions with vertical competitive harms – is an adequate remedy – particularly for smaller and medium-sized operators. The Applicants' suggestion that the program access rules, even when extended to retransmission consent negotiations, are adequate to ensure fair dealings are unpersuasive because these regulations place no restriction on quantity discounts, provide no automatic right to continued carriage of programming during the pendency of a complaint, cannot address arbitrary internal transfer pricing, and may not apply to online distribution of programming. Moreover, binding arbitration has proven not to be a cost-effective option for smaller and medium-sized operators.

Because the conditions proposed by the Applicants are so patently inadequate, the task now falls to the Commission. As discussed above, the Commission has both the authority and obligation to not approve the transaction without first adopting conditions sufficient to protect the public interest. In the next section, the ACA discusses the strengths and weaknesses in conditions adopted as part of two previous Commission license transfer approvals. The ACA then builds

[64] Application at 116-117.

[65] ACA Initial Comments at 37-47.

upon this analysis and proposes conditions that are sufficient to address the harms that would ensue if the Comcast-NBCU transaction is approved.

C. <u>Conditions imposed by the Commission in the past are insufficient, standing alone, to remedy the likely horizontal and vertical harms of this transaction.</u>

Comcast and NBCU come before the Commission seeking approval of license transfers necessary to effectuate an unprecedented combination of programming and distribution assets. The ACA has demonstrated that the transaction will create both horizontal and vertical competitive harms. Below, ACA demonstrates the need for the Commission to improve and go beyond remedies previously utilized to combat the deleterious effects of enhanced post-transaction market power.

1. News Corp.-Hughes and Adelphia-Time Warner-Comcast conditions targeted only vertical harms.

Previous transactions reviewed by the Commission involving MVPDs have not included the horizontal combination of programming assets, with the result that there is no Commission precedent on how to condition such license transfers to avoid or lessen such harms. To the extent the Commission has addressed harms arising from the horizontal combination of telecommunications companies, it has employed structural remedies, such as divestiture of assets, to ensure that the transaction minimizes the possibility of harm while preserving the overall benefits, if any, to the public.[66]

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[66] *See, e.g., In the Matter of Applications of Cellco Partnership d/b/a Verizon Wireless and Atlantis Holdings LLC for Consent to Transfer Control of Licenses, Authorizations, and Spectrum Manager and De Facto Transfer Leasing Arrangements, Memorandum Opinion and Order and Declaratory Ruling*,

In cases where the Commission has previously addressed vertical harms arising from the combination of video programming assets with video distribution systems, it has relied principally on a combination of extending the reach of the program access rules to cover non-satellite cable programming networks and providing an option to take carriage disputes involving "must have" programming to commercial arbitration to establish fair market value for carriage when market negotiations fail to produce an acceptable agreement between the parties.[67]

In the *News Corp.-Hughes Order*, the Commission found that both the program access rules and the applicant's proposed program access commitment were insufficient, standing alone, to protect against harms arising from News Corp.'s enhanced incentive and ability post-transaction to use its market power in the market for RSNs and local broadcast stations (both O&Os and any local affiliate on whose behalf the broadcaster negotiates retransmission consent) to raise prices charged to competing MVPDs for programming. The Commission therefore conditioned its approval of the transaction on compliance with a series of safeguards, including mandatory arbitration of carriage disputes.

The Commission found substantial evidence that competitive and consumer harms would likely result from the increase in News Corp's ability to leverage its market power with respect to both regional sports networks and local broadcast television stations once it acquired DirecTV.[68]

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23 FCC Rcd 17,444 (2008) (requiring that Verizon Wireless divest business units and associated licenses and authorizations in 105 markets).

[67] *See News Corp.-Hughes Order*, ¶¶ 175-76, 218-21; *see also Adelphia Order*, ¶¶ 159-63.

[68] *News Corp.-Hughes Order*, ¶ 366.

Specifically, with respect to RSNs, the Commission found that the primary public interest harm likely to follow the combination of News Corp's RSN programming assets and DirecTV's nationwide distribution platform "is the competitive harm of an across-the-board MVPD price increase resulting from News Corp.'s ability to extract rents or other unfair carriage concessions from MVPDs for carriage of RSN programming."[69] Neither the existing program access rules nor the applicants' proposed safeguards, according to the Commission, would be sufficient to protect against these harms "because they were not intended to regulate or address the level of rates *per se*."[70]

Similarly, with respect to broadcast television, the Commission found that substantial public interest harms would flow from News Corp.'s enhanced post-transaction market power to "extract more compensation for its broadcast station signals from competing MVPDs than it could reasonably expect to achieve absent the transaction."[71] Absent remedial action, the Commission found that ". . . News Corp.'s use of market power to extract artificially high levels of compensation from MVPD rivals, or other carriage concessions, could make rival MVPDs less viable options for consumers, thus limiting consumer choice."[72]

To remedy these harms, the Commission created a mechanism, available at the option of any aggrieved MVPD, to demand neutral resolution of carriage disputes through commercial arbitration. The Commission postulated that the availability of

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[69] *News Corp.-Hughes Order*, ¶ 172.

[70] *News Corp.-Hughes Order*, ¶ 162.

[71] *News Corp.-Hughes Order*, ¶ 209.

[72] *News Corp.-Hughes Order*, ¶ 209.

commercial arbitration would provide a “useful backstop” mechanism to prevent New Corp. from exercising its increased market power to force rival MVPDs to either adopt inordinate affiliate fee increases for access to RSN programming, broadcast station signals, and/or other unwanted programming concessions or potentially cede critical content to their most powerful MVPD competitor, DirecTV.[73] The commercial arbitration remedy was intended to restore, to the degree possible, the pre-transaction “balance of terror” between upstream programming suppliers and their downstream distributors by providing a “fair and neutral” mechanism by which disputants could quickly resolve carriage disputes that had reached an impasse.[74]

In addition, the Commission extended coverage of the non-discriminatory access provisions of the program access rules to any broadcast station that News Corp. owns and operates, or on whose behalf it negotiates retransmission consent. To further temper increases in News Corp.’s market power arising from the transaction and protect the public interest in continued access to local broadcast stations carried by their MVPD as part of their package of video programming services, the Commission extended the good faith and exclusivity requirements of the Satellite Home Viewer Improvement Act of 1999 for as long as its program access rules are in effect.[75]

In theory, the arbitration remedy would permit MVPDs to demand commercial arbitration when they are unable to come to a negotiated “fair” price for the

[73] *News Corp.-Hughes Order*, ¶¶ 173, 180.

[74] *News Corp.-Hughes Order*, ¶ 220.

[75] Pub. L 106-113, 113 Stat. 1501, 1501A-526 to 1501A-545 (Nov. 29, 1999) (“SHVIA”).

programming.[76] The goal, as stated by the Commission, was "to push the parties toward agreement prior to a complete breakdown in negotiations. Final offer arbitration has the attractive 'ability to induce two sides to reach their own agreement, lest they risk the possibility that a relatively extreme offer of the other side may be selected by the arbitrator.'"[77]

To help achieve this goal, the Commission specified that the final offers for RSNs be submitted to the arbitrator in the form of a contract for carriage of the programming that may not include any provision to carry any video programming networks or any other service.[78] For agreements involving retransmission of the broadcast signal, the final offers may not include any provision to carry any video programming networks or any other service other than the broadcast signal.[79]

To further temper increased market power post-transaction, the Commission imposed a pair of standstill carriage requirements. That is, News Corp. was prohibited from "deauthorizing" carriage of an RSN after an MVPD has chosen to avail itself of the arbitration condition,[80] and required to allow continued retransmission of the broadcast station signal under the same terms and conditions of the expired contract upon receiving notice of intention to submit a dispute to arbitration.[81]

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[76] *News Corp.-Hughes Order*, ¶ 175.

[77] *News Corp.-Hughes Order*, ¶ 174.

[78] *News Corp.-Hughes Order*, ¶ 177.

[79] *News Corp.-Hughes Order*, ¶ 222.

[80] *News Corp.-Hughes Order* at ¶ 175

[81] *News Corp.-Hughes Order* at ¶ 221.

The Commission later employed a similar set of remedies extending program access rules and imposing a commercial arbitration remedy for RSNs in its approvals of the license transfers incident to the Adelphia-Time Warner-Comcast transaction.[82] The Commission found that the transaction was likely to result in a public interest harm based on the ability of the applicants to impose uniform price increases on carriage of RSN programming; that these price increases would harm consumers of existing MVPDs and deter competitive entry by new MVPD competitors; and that the program access rules do not afford a remedy for allegations of competitive harm due to uniform price increases.[83]

Accordingly, the Commission imposed a condition based on a combination of the requirements of the program access rule and commercial arbitration, modeled on the News Corp.-Hughes remedy, primarily to "constrain Comcast's and Time Warner's ability to increase rates for RSN programming uniformly or otherwise disadvantage rival MVPDs via anticompetitive strategies."[84] The Commission also found that, in addition to tempering across-the-board price increases through enhanced bargaining power, the conditions would "provide protection, if necessary, against "'stealth discrimination,' permanent foreclosure, and temporary foreclosure.[85]

Comcast and Time Warner were prohibited, *inter alia*, from offering any RSN on an exclusive basis to any MVPD, regardless of means of delivery, and that carriage be offered on a non-exclusive basis and on nondiscriminatory terms and

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[82] *Adelphia Order* at 159-63, Appendix B.

[83] *Adelphia Order*, ¶ 155.

[84] *Adelphia Order*, ¶ 156.

[85] *Adelphia Order*, ¶ 160.

conditions under the requirements of the program access rules, regardless of the means of program delivery.[86] Aggrieved MVPDs were given the right to bring program access complaints against Comcast and Time Warner or their covered RSNs using the procedures set forth in the Commission's program access rules.[87] Similar to the News Corp.-Hughes arbitration remedy, carriage of RSN programming was to continue on the terms and conditions of the expired affiliation agreement during the pendency of the arbitration proceeding and the final offer made to the arbitrator must be for standalone carriage of the RSN and no other programming or service.[88]

In summary, to temper the ability of vertically-integrated programming providers post-transaction to raise rates above the level they would have been able to command pre-transaction, the Commission has conditioned its license transfer approvals by extending the reach of its program access rules; created a commercial arbitration remedy; imposed standstill provisions ensuring carriage during the pendency of the dispute resolution mechanism; and required that final offers presented to the arbitrator in "baseball arbitration" be in the form of contracts for stand-alone carriage of the affected programming – RSNs and local broadcast station signals. In addition, as discussed below, certain provisions were made for small cable systems.

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[86] *Adelphia Order*, ¶ 156, Appendix B.

[87] *Adelphia Order*, ¶ 156.

[88] *Adelphia Order*, Appendix B.

While these remedies were clearly necessary in order for the Commission to find, on balance, that it was in the "public interest" to approve the license transfers attendant upon these transactions, the remedies themselves have proven insufficient *in practice* to cure the harms for small and mid-sized MVPDs.

2. ACA has demonstrated that neither the program access rules nor arbitration, standing alone, provide adequate remedies for the harm of this transaction.

While the Commission's goals in extending the program access rules to cover broadcast programming and establishing a commercial arbitration remedy to address transaction-specific competitive and consumer harms resulting from increased vertical market power were well-intended, for small and mid-sized MVPDs they have fallen far short of a cure.

First, because, as discussed above, the News Corp.-Hughes and Adelphia-Time Warner-Comcast transactions did not involve significant horizontal effects, the remedies discussed above do not address the substantial horizontal harms the combination of Comcast and NBCU programming assets will visit upon MVPDs in affected markets. That said, the Commission has extensive experience in addressing horizontal harms arising from mergers and acquisitions and either rejecting proposed transactions or imposing stringent conditions, usually structural remedies. For example, in the proposed combination of Dish and DirecTV, the Commission effectively rejected (by setting the petition for hearing) the horizontal combination of multichannel video programming distribution assets finding:

> Based on the record before us, we find that Applicants have not met their burden of demonstrating that approval of the Application is in the public interest. As discussed more fully below, we are concerned that ownership of

> all satellites in the full-CONUS orbital locations by one entity, New EchoStar, could likely undermine our goals of increased and fair competition in the provision of DBS service...Accordingly, pursuant to Section 309(e) of the Communications Act of 1934, as amended (the "Communications Act" or the "Act"), we hereby designate the Application for hearing.[89]

Several years later, in reviewing the proposed acquisition of BellSouth by AT&T, the Commission found that the horizontal overlap in the local private line market was of sufficient concern – "likely to have an anticompetitive effect" – that it approved the transaction only after accepting AT&T's commitment to divest assets.[90] The Commission also has employed the divestiture remedy on numerous occasions to address horizontal harms arising from mergers in the mobile radio (cellular) industry.[91] Thus, the Commission has demonstrated its understanding that transactions producing serious horizontal harms warrant the imposition of robust relief.

Second, as ACA has demonstrated, the program access rules are inadequate to deal with discrimination since it permits price differentials based on more than the

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[89] *EchoStar-DirecTV Order,* ¶ 3.

[90] *In the Matter of AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, Memorandum Opinion and Order, 22 FCC Rcd 5662, 5664, ¶ 3 (2007) ("The record indicates that, in a small number of buildings in the BellSouth in-region territory where AT&T and BellSouth are the only carriers with direct connections, and where other competitive entry is unlikely, the merger is likely to have an anticompetitive effect on the market for Type I wholesale special access services. We further find, however, AT&T's voluntary commitment to divest at least eight fiber strands in the form of ten-year IRUs for these two-to-one buildings where entry is unlikely [to] adequately remedies [sic] these potential harms.").

[91] *In the Matter of Applications of AT&T Inc. and Centennial Communications Corp. For Consent to Transfer Control of Licenses, Authorizations, and Spectrum Leasing Arrangements*, Memorandum Opinion and Order, 24 FCC Rcd 13,915, ¶ 2 (2009) ("[T]he proposed transaction raises competition issues because it would result in the combination of overlapping AT&T and Centennial mobile communications coverage and services in various local areas…Accordingly, we require divestiture of Centennial's wireless operations in these areas….").

cost of delivery.[92] The problem is compounded, as ACA wrote in its comments, by the lack of "publicly available systematic data about the degree of volume discounts in the marketplace," rendering the program access rules difficult to enforce.[93] As ACA explained:

> A vertically integrated programmer will always have a "volume-related" justification to charge smaller competitors discriminatory prices by claiming benefits attributable to differences in the number of subscribers served. In practice, the Commission has rarely reached a finding that anticompetitive price discrimination has occurred in instances when a larger vertically integrated programmer charges its affiliated MVPD lower prices than a smaller rival MVPD. The ACA is aware of only two such decisions, one in 1997 and one in 1998, and in neither case nor in other orders has the Commission explicitly described the approach that it would take to dealing with this problem. Since Comcast is the largest MVPD in the nation, and vastly larger than any ACA member, the program access rules will be particularly ineffective in preventing the combined entity from charging high discriminatory prices to its MVPD competitors.[94]

Moreover, as ACA and its economic expert Professor Rogerson have also found, even if the program access rules are extended to retransmission consent negotiations, "'to the extent that program access rules allow Comcast to charge higher prices to MVPDs smaller than itself, program access rules will place no restriction at all on the retransmission consent prices that Comcast will be able to

[92] ACA Initial Comments at 38-40; Rogerson I at 41-44. Professor Rogerson also describes this as the "quantity discounts problem" in Rogerson II. *See* also Rogerson II at 38.

[93] ACA Initial Comments at 39.

[94] ACA Initial Comments at 39-40 (footnotes omitted).

charge its rivals' in the six DMAs where there is both an NBC O&O and where Comcast is the most significant cable operator."[95]

In addition, ACA has demonstrated that the program access rules will fail to prevent Comcast-NBCU from raising its rival MVPDs' rates by simply charging itself supra-competitive prices.[96]

> Professor Rogerson finds that "vertically integrated firms who wish to charge high discriminatory prices to rival MVPDs may be able to do so without violating program access rules simply by raising the internal transfer price they charge themselves to the same high level, and then instructing their downstream divisions to continue to purchase the integrated programming at the artificially high internal transfer price.[97]

Thus, while the rules serve the admirable function of prohibiting exclusive program access agreements and preventing vertically integrated cable programming networks from discriminating against unaffiliated MVPDs in the prices, terms and conditions of program access, they do not, as the Commission itself has recognized, address the question of price level.[98] As ACA has concluded, unless these well-known shortcomings of the program access are adequately addressed, they cannot provide redress for the harms of the Comcast-NBCU combination.

Third, arbitration has proven too costly for small MVPDs (even with a bargaining agent provision). The Commission recognized the particular risk of supra-

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[95] ACA Initial Comments at 40 (*quoting* Rogerson I at 44).

[96] ACA Initial Comments at 42-43.

[97] ACA Initial Comments at 42 (*quoting* Rogerson I at 46).

[98] *See* ACA Initial Comments at 42-43 (*citing News Corp.-Hughes Order*, ¶¶ 170, 211; *Adelphia Order*, ¶ 119).

competitive RSN and retransmission consent prices being extracted from small and medium-sized MVPDs, and the relative inability of such MVPDs to bear the costs of commercial arbitration due to smaller subscriber base and financial resources in the News Corp.-Hughes Order.[99] In the hope of ensuring that it provided all MVPDs a useful procedure, the Commission specified that an MVPD meeting the definition of "small cable company" could choose to appoint a bargaining agent to bargain collectively on its behalf in negotiating carriage of RSNs; the designated collective bargaining agent was give all the rights and responsibilities granted an MVPD in the arbitration conditions.

Additionally, the Commission recognized that the "costs of arbitration may overwhelm MVPDs with fewer than 5000 subscribers, thereby providing them with little relief from the harms associated with this transaction. For such systems, News Corp. was required to either elect "must carry" status or negotiate retransmission consent for its owned and operated stations without any requirements for cash compensation or carriage of programming other than the broadcast signal.[100]

Unfortunately, in ACA's experience, the costs of arbitration not only overwhelm small MVPDs with 5000 or fewer subscribers, as the Commission accurately predicted, they have in fact overwhelmed the utility of this remedy for MVPDs even with far greater subscriber levels. Colleen Abdoulah, President and Chief Executive Officer of WOW!, emphasized this point in her February 4, 2010

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[99] *News Corp.-Hughes Order*, ¶¶ 176, 220, 223.

[100] *News Corp.-Hughes Order*, ¶ 224.

testimony before the Senate Committee on Antitrust, Competition Policy and Consumer Rights:

> WOW! considered using the arbitration process imposed on Comcast in the Adelphia decision but determined the cost of the process was likely to exceed $1 million, take one year or longer, and require key personnel to take large amounts of time from their regular jobs. In other words, the costs of using arbitration were going to be close enough to the extra price Comcast was going to charge us in the first place. Instead, we had no choice but to "eat" an enormous rate increase to carry Comcast's RSN. In effect, the program access process has essentially given us a right without a remedy.[101]

In the attached declaration, Robert Gessner, President of Massillon Cable TV,[102] buttresses this conclusion in his discussion of the high cost of his company's arbitration with Fox over carriage of Fox Sports Ohio, which began in 2005 and is still not completely resolved:

> When all costs of the arbitration are considered, Massillon spent approximately $1,000,000 from the date of the arbitration request (October 2006) through the present day. This amount does not include the consideration out-of-pocket costs (including travel expenses) incurred by Massillon and substantial time and resources spent by Massillon management and employees to participate in the dispute and arbitration process.[103]

Mr. Gessner goes on to state that "Fox was intent on…using its 'deep pockets' to make a small cable operator 'cry uncle.'"[104]

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[101] Testimony of Colleen Abdoulah, President and Chief Executive Office, WOW!, Board Member, American Cable Association, Before the Senate Committee on Antitrust, Competition Policy and Consumer Rights, The Comcast/NBC Universal Merger: What does the Future Hold for Competition and Consumers?, February 4, 2010, at 8, *available at* http://judiciary.senate.gov/pdf/10-02-04%20Abdoulah%20Testimony.pdf (last visited Aug. 19, 2010).

[102] Massillon Cable TV has approximately 40,000 subscribers.

[103] Declaration of Robert Gessner, ¶ 15, attached hereto as Attachment B ("Gessner Declaration").

[104] Gessner Declaration, ¶ 18.

Nor has the arbitration process been quick and efficient, as hoped by the Commission. In fact, the opposite is the case. Mr. Gessner vividly concludes about Massillon's arbitration experience:

> "In the final analysis, the arbitration process was far different than any expectations. It was not a relatively straightforward process. It did not live up to its potential as an expeditious and low-cost dispute resolution mechanism. Rather, it proved that one party can frustrate the process to the point where it is not feasible for a smaller entity to remain engaged either for lack of financial resources or personal time. Large program entities may say Massillon has 'learned its lesson' because it would not be inclined to commit to binding arbitration again."[105]

Moreover, arbitration has been of extremely limited value even for bargaining agents chosen by smaller MVPDs seeking to avail themselves of the collective bargaining option the Commission has used in the past. In the News Corp.-Hughes Order, the Commission specified (i) that an MVPD meeting the definition of "small cable company" under its rules "may choose to appoint a bargaining agent to bargain collectively on its behalf in negotiating for carriage" of both RSN and broadcast station programming and (ii) that the programmer may not refuse to negotiate carriage of the covered programming such entity.[106] The designated collective bargaining entity was also granted "all the rights and responsibilities granted" by the arbitration conditions.[107] In theory, permitting collective bargaining on behalf of the small operators would "counter-balance the increase in News Corp. market power" with respect to the covered programming.[108]

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[105] Gessner Declaration, ¶ 20.

[106] *News Corp.-Hughes Order*, ¶¶ 176, 223.

[107] *News Corp.-Hughes Order*, ¶¶ 176, 223.

[108] *News Corp.-Hughes Order*, ¶ 176.

These bargaining agent provisions proved to be of extremely limited value for the small MVPDs' chosen bargaining representative, the National Cable Television Cooperative ("NCTC"). NCTC is a buying cooperative that primarily negotiates program carriage agreements for national satellite cable programming networks on behalf of 950 member companies. NCTC is not formally designated as an agent for its members. Nonetheless, NCTC effectively operates as a "non-binding agent" for them. That is, NCTC negotiates the rates, terms, and conditions of carriage agreements with programmers, and its individual members may then opt into the agreement. In practice, structural limitations prevented NCTC from representing a meaningful class of its members in arbitration for several reasons.

First, "collective bargaining" for carriage agreements does not work for non-binding agents like NCTC, because it only extends protection to the MVPDs that are bound by the terms of the agreement while it is being negotiated, and, in the case of a non-binding agent, that number will be zero. Because the prices for programming are based on the number of subscribers the MVPD brings to the table, NCTC cannot get the best terms for its members unless all are considered "represented" even though NCTC is not in a binding agent-principal relationship with them for purposes of the negotiation. Therefore, even if NCTC is bargaining on behalf of, for example, 80 MVPDs with 100,000 or more subscribers for carriage of a particular programming network, the programmer is not obligated to make an offer based on the largest number of subscribers who may benefit from the deal but is free to offer the relatively higher rates for a far lower number of subscribers.

Second, when NCTC sought to apply the Commission's collective bargaining provision to RSN negotiations, it found that the programming supplier limited any NCTC negotiation to a "sub-class" of its members with subscribers distributing that RSN. This effectively decreased NCTC's ability to negotiate a fair market rate for the programming.

Third, the "small cable company" restriction removed the larger NCTC members from potential representation in a class for collective bargaining purposes, with the effect of further limiting NCTC's representation to an even smaller sub-class of its "small cable company" members.

Fourth, those "small cable companies" typically had widely disparate contract expiration dates, whereas the bargaining agent provisions effectively required any small cable companies that wanted to be represented by a bargaining agent to have simultaneous contract expiration dates. This had two effects. First, this fact precluded all the small cable operators from being represented. Second, since any "small cable companies" whose contracts expired later could only join a separate class, which would have to negotiate its own agreement with its own three-year term, it effectively precluded those small cable companies from ever joining an earlier class. Thus, by negotiating staggered contract expiration dates, a programmer could easily, effectively, and permanently preclude a meaningful class from ever being formed.[109]

[109] NCTC's historic solution to this problem, which has been its uniform practice in all affiliation agreements with programmers throughout its 25-year history, is to provide in NCTC's agreements with programmers the right for NCTC's members to opt into NCTC's agreements and to simultaneously terminate any direct pre-existing contractual arrangements such members might have with the programmers.

In the one instance where NCTC invoked the arbitration procedures, it reversed its historic business practice and secured appointments of agency from a small number of its members. Without acknowledgement of the effect of its "opt-in" procedure on its ability to collectively bargain, however, NCTC was precluded from assembling for the arbitration (or for that matter, for any agreement resulting from the arbitration or for any subsequent arbitration), a meaningful class of members to conduct an effective collective bargaining.

In summary, because of the juxtaposition of collective bargaining with the opt-in nature of NCTC's actual bargaining position, where NCTC has acted as bargaining agent and invoked the Commission's arbitration remedy, it has been unable to secure the benefits of lower programming costs that true collective bargaining would provide, thus frustrating the goals of the Commission in establishing the arbitration remedy.

ACA's proposed conditions, described below, build upon the strengths and correct the weaknesses of the conditions imposed on the News Corp.-DirecTV and Adelphia-Comcast-Time Warner transactions to better target the transaction-specific horizontal and vertical harms posed by the combination of Comcast and NBCU programming and distribution assets.

D. The ACA's conditions are targeted to addressing the competitive harms of the proposed combination and are sufficiently robust and durable to ameliorate these effects.

1. Introduction and Summary of Remedies.

In these and earlier comments, the ACA has demonstrated that the proposed combination of NBCU's programming assets with Comcast's programming and distribution assets would generate diverse and significant harms that affect both traditional and new multichannel distribution platforms. While the MVPDs throughout the industry and their subscribers would incur these harms, smaller MVPDs – especially those that compete with Comcast's distribution assets – and their subscribers would suffer the greatest. The Commission thus faces real challenges in fashioning sufficient remedies that would ensure the proposed transaction is in the public interest. These challenges are magnified by the fact that remedies used in previous combinations have often proven insufficient.

It is from these perspectives that the ACA has fashioned its proposed remedies. In the proposals that follow the ACA provides an integrated series of remedies with two overarching objectives:

- Address the principal harms from the proposed combination, i.e. increases in the programming prices MVPDs and their subscribers will pay to Comcast-NBCU when the programming assets of NBCU and Comcast are combined; and increases in programming prices rival MVPDs and their subscribers will pay to Comcast-NBCU when the programming assets of NBCU are combined with the distribution assets of Comcast.

- Enable smaller MVPDs to enforce any rights provided in the remedies either directly or through a bargaining agent.

At its core, the ACA's remedies ensure that all MVPDs – and especially smaller MVPDs -- can carry NBCU's O&Os and its cable networks and Comcast's RSNs at rates, terms, and conditions reflecting pre-combination market conditions. To achieve this aim, the ACA proposes two sets of measures. The first are general measures, most of which were either used in or based upon previous Commission decisions. These general measures, which apply to all MVPDs, include extension of the program access rules to cover all programming sold by Comcast-NBCU and all platforms by which MVPDs may distribute that programming, the stand-alone sale by Comcast-NBCU of local broadcast stations and RSNs, and commercial arbitration for all programming. The ACA then proposes three critical special measures to ensure that smaller MVPDs can effectively utilize these remedies. The following summarizes the key features of these two integrated proposals:

1. <u>General Remedies to Address Increases in Programming Prices</u>

- The program access rules shall be expanded so that they apply to Comcast-NBCU's sale of its broadcast stations and its other programming regardless of the means by which any of the programming is delivered to consumers (*e.g.*, online and mobile).

- Comcast-NBCU must sell each NBC O&O and each Comcast RSN on a stand-alone basis to all MVPDs. This remedy will significantly decrease the complexity and cost of commercial arbitration, including the proposed special commercial arbitration process for smaller operators.

- Comcast-NBCU is subject to a commercial arbitration remedy to ensure that it does not sell programming – broadcast stations, RSNs, and national cable networks – at a price that exceeds fair market value.

2. <u>Special Provisions to Ensure Remedies are Useful for Smaller MVPDs</u>

- MVPDs with fewer than 125,000 MVPD subscribers in the relevant market cannot be charged more than 5% higher than the lowest Net Effective Rate charged to other MVPDs for NBC O&Os and Comcast RSNs. To ensure transparency and assist in enforcing this right, the Joint Venture and Comcast must file annual certifications.

- To enable smaller MVPDs to enforce their ability to access NBC O&Os and Comcast RSNs at competitive rates, a new, lower-cost arbitration process with an automatic right of continued carriage is established.

- Comcast-NBCU must negotiate in good faith with Bargaining Agents, and these agents shall have comparable rights to MVPDs to obtain programming from Comcast-NBCU.

Finally, to ensure the remedies adequately address the harms and reflect the dynamic of the programming market and other agreements entered into by the Applicants with other parties to the FCC's proceeding, the license conditions should remain in effect for 9 years. The sections that follow discuss the conditions and enforcement mechanisms in detail.

2. ACA Proposed Conditions.[110]

a. Definitions.

Proposal:[111] *For purposes of the conditions set forth below, the following definitions apply:*

- ***"Bargaining Agent"*** *means any entity that negotiates retransmission consent or carriage agreements on behalf of one or more of its principals or members, regardless of whether they are bound by the prices, terms and conditions entered into by the Bargaining Agent.*[112]

- ***"Comcast-NBCU"*** *shall include Comcast Corporation ("Comcast") and the joint venture, composed of assets of Comcast and NBC Universal, Inc., ("NBCU"), and each of the companies' subsidiaries, affiliates, parents, successors, and assigns.*

- ***"Covered NBC Stations"*** *means all NBC broadcast television stations currently or in the future owned, controlled or managed by Comcast-NBCU and all independent NBC affiliates on whose behalf Comcast-NBCU currently or in the future negotiates retransmission consent agreements.*

[110] ACA's Proposed Comcast-NBCU License Transfer Conditions are attached hereto as Attachment C.

[111] The ACA discusses these definitions further in the next sections.

[112] It is intended that the National Cable Television Cooperative (NCTC), as currently organized and as it operates, would be considered a Bargaining Agent for purposes of these conditions.

- ***"Covered RSNs"*** *means all regional sports networks ("RSNs") that are currently or in the future owned, controlled or managed by Comcast-NBCU.*[113]

- ***"Covered National Cable Networks"*** *means all national cable programming networks that are currently or in the future owned, controlled, or managed by Comcast-NBCU.*

- ***"Covered Programming"*** *means all Covered NBC Stations, Covered RSNs, and Covered National Cable Networks.*

- ***"Net Effective Rate"*** *means the net cash consideration charged under a retransmission consent agreement or an RSN carriage agreement, adjusted to reflect the value of: (1) all other economic consideration exchanged, including marketing or launch support, penetration or other discounts, advertising availabilities, channel positioning, and payment terms; and (2) any other rights or obligations related to such agreement, including the packaging of the Covered NBC Station or Covered RSN, and other distribution rights or obligations, which may include digitization, streaming, and/or dual feeds, and the distribution of the Covered NBC Station or Covered RSN on a video-on-demand basis or via a high-definition format or interactive version or broadband technology.*

- ***"Smaller MVPD"*** *means a multichannel video programming distributor ("MVPD") that serves 125,000 MVPD subscribers or less in either the DMA served by a Covered NBC Station, or the region commonly served by a Covered RSN.*

- ***"Stand-Alone Retransmission Consent Agreement"*** *means a retransmission consent agreement that does not include any provision to carry any video programming networks, other services, or other items unrelated to the carriage of a broadcast station signal, other than the primary and multicast streams of a single broadcast station, and any ancillary programming or service.*

[113] "Regional Sports Network" shall have the same meaning as in the Adelphia-Time Warner-Comcast Order. *Adelphia Order*, ¶ 158 ("For purposes of the foregoing conditions the term 'RSN' means any non-broadcast video programming service that (1) provides live or same-day distribution within a limited geographic region of sporting events of a sports team that is a member of Major League Baseball, the National Basketball Association, the National Football League, the National Hockey League, NASCAR, NCAA Division I Football, NCAA Division I Basketball and (2) in any year, carries a minimum of either 100 hours of programming that meets the criteria of subheading 1, or 10% of the regular season games of at least one sports team that meets the criteria of subheading 1.").

- ***"Stand-Alone RSN Carriage Agreement"*** *means a carriage agreement that does not include any provision to carry any video programming networks, other services, or other items unrelated to the carriage of a RSN, other than a single RSN, and any ancillary programming or service.*

b. General Remedies Applicable to all MVPDs to Ameliorate Price Increases Caused by the Proposed Combination.

Proposal: Extended Applicability of Program Access Rules

1. *The program access rules will apply to Covered NBC stations and all other broadcast television stations currently or in the future owned, controlled or managed by Comcast-NBCU and all independent broadcast television station on whose behalf Comcast-NBCU currently or in the future negotiates retransmission consent agreements.*

2. *The program access rules will apply to Covered RSNs and Covered National Cable Networks, regardless of the means of delivery to MVPDs, including terrestrially delivered programming.*

3. *The program access rules will apply to all programming discussed in Conditions II.A.1 and II.A.2., which shall include all means by which such programming is offered, in whole or in part, to consumers by Comcast-NBCU through any platform, including online and mobile platforms.*

Discussion:

The ACA proposes that the Commission extend the applicability of the non-discrimination and non-exclusive requirements of the existing program access rules to retransmission consent agreements for NBCU broadcast stations and all terrestrially transmitted networks. Moreover, the ACA proposes that the program access rules apply to Comcast-NBCU's distribution of Covered Programming to consumers over any distribution platform (*e.g.* linear, online, or mobile). For example, to the extent that Comcast-NBCU distributes Covered Programming online either directly or through an unaffiliated entity to consumers, a MVPD shall have the right to access the Covered Programming for delivery online to its subscribers. As discussed earlier in this Reply and in Rogerson II,[114] the program access rules are somewhat beneficial to ensure rival MVPDs have recourse when Comcast-NBCU discriminate against them, although they are clearly not sufficient to address the vertical harms from the proposed combination. The ACA's proposal expands the existing rules to correct some of their flaws by:

- Extending the rules to retransmission consent agreements for all of Comcast-NBCU's broadcast television stations, including its NBC and Telemundo O&Os – a condition proffered by the Applicants;
- Applying the conditions to the carriage of all Comcast-NBCU programming regardless of the means of delivery, including terrestrial delivery – an issue addressed to some extent earlier this year by the Commission; and
- Providing MVPDs with the right to obtain carriage of all Comcast-NBCU programming delivered to consumers on any platform, including online distribution and distribution on mobile networks.

In regard to ensuring that program access requirements extend to additional consumer distribution platforms used by MVPDs, the Applicants recognize this trend and discuss in their Application the fact that high-quality video content is increasingly being distributed online by both traditional, new media, and user-generated sources,[115] and "[a]ny relevant market(s) for online video distribution would share many characteristics with the market(s) for traditional video programming."[116] The ACA agrees. "Must have" video programming will retain its "must have" nature regardless distribution platform. Further, Comcast and other MVPDs are developing

[114] Rogerson II at 38-39.

[115] Application at 4.

[116] Application at 88.

sophisticated business strategies to permit their existing video subscribers to have access to the same content online. Thus, the rapidly accelerating movement of video programming online as a complement to existing offerings will make online access to "must have" local broadcast stations, RSNs, and national cable programming essential for competing MVPDs. As a result, the concerns about the vertical harms of the transaction discussed above with respect to MVPD distribution networks extend to the evolving online marketplace.[117] It is clear that by controlling such a significant amount of "must have" programming post-transaction, Comcast-NBCU would have the incentive and ability to use this newfound market power to either withhold consent from competitors or impose higher fees and discriminatory or other unreasonable conditions for carriage.

Proposal: Require Stand-Alone Agreements for Covered NBC Stations and Covered RSNs

1. *All retransmission consent agreements entered into by Comcast-NBCU for Covered NBC Stations must be Stand-Alone Retransmission Consent Agreements.*

2. *All RSN carriage agreements entered into by Comcast-NBCU for Covered RSNs must be Stand-Alone RSN Carriage Agreements.*

Discussion:

The ACA proposes that Comcast-NBCU sell Covered NBC Stations and Covered RSNs on a stand-alone basis. The term "stand-alone" means the economic value of carrying only the broadcast station or RSN, respectively, without any linkage to carriage of other programming or the exchange of any other items of value. This

[117] ACA Initial Comments at 41-42.

proposal will simplify contracts for must have programming, thereby facilitating compliance with the ACA's commercial arbitration and special arbitration proposals. Having a process that is more straightforward and has greater transparency is important for all MVPDs, but particularly important to smaller MVPDs which have limited resources to participate in arbitrations.

Proposal: Provide Rights to Binding Commercial Arbitration

> *When negotiations fail to produce a mutually acceptable set of prices, terms, and conditions for carriage of (i) Covered NBC Stations, (ii) Covered RSNs, or (iii) Covered National Cable Networks, an aggrieved MVPD may submit a dispute over the prices, terms, and conditions of retransmission consent or carriage agreements for Covered Programming to commercial arbitration, subject to the arbitration rules outlined in the Adelphia-Time Warner-Comcast Order.*[118]

Discussion:

The ACA proposed that the Commission again adopt as a condition a commercial dispute resolution process – baseball-style arbitration -- that can be used by MVPDs unable to achieve carriage at fair market rates for any Covered Programming from Comcast-NBCU. As discussed in the previous section, the Commission adopted this mechanism to address vertical harms in the News Corp.-Hughes transaction and again used it in the more recent Adelphia-Time Warner-Comcast transaction. The ACA agrees that, if properly structured, this process will create incentives for the parties to reach a negotiated solution, and the use of arbitration should be limited.

While the Commission has used commercial arbitration to address vertical

[118] The ACA would not object to the Commission enhancing the terms and conditions of this commercial arbitration remedy to make it more efficient and effective.

effects in recent mergers, ACA notes that it also may prove beneficial to remedying horizontal harms. As Professor Rogerson observes:

> "An important point to note about the regular arbitration process in the context of Comcast-NBCU transaction is that it can remedy both the vertical and horizontal harms of the transaction. That is, to the extent that the arbitration process allows MVPDs to obtain programming from Comcast-NBCU at fair market value, it will prevent Comcast-NBCU from charging fees higher than fair market value regardless of whether the problem originates with the horizontal or vertical aspect of the transaction. The fact that the condition remedies both vertical and horizontal competitive harms is one of the rationales for applying it to all types of Comcast-NBCU programming and not just to programming that was owned by NBCU prior to the transaction."[119]

The ACA proposes this remedy despite the fact that it is too expensive and resource intensive to be used by smaller MVPDs. The Commission should note that the ACA proposes two measures that can rectify some of the shortcomings in the current process. First, as discussed above, the ACA proposes a requirement that Comcast-NBCU sell carriage for its broadcast stations and RSNs on a stand-alone basis, which would simplify the process and significantly lower the cost of accurately valuing the carriage price. Second, as discussed in the next section, for smaller MVPDs, the ACA proposes the creation of a new special arbitration process, which is more streamlined and cost-efficient.

Finally, the ACA's commercial arbitration proposal applies to all Covered Programming, whereas the Commission previously used the arbitration process only to settle disputes for carriage of local broadcast stations and RSNs. The ACA submits that disputes over Comcast-NBCU national cable networks should be covered by the arbitration remedy because of the demonstrable harm to competition

[119] Rogerson II at 44-45.

that arises when NBCU's national cable networks are combined with Comcast's distribution assets. As argued by Professor Rogerson in his report accompanying the ACA's initial comments, the fact that the block of NBCU national cable networks has ratings similar to, if not greater than, Big 4 broadcast networks, provides evidence that withdrawal of this block would have a similar significant effect on rival MVPDs to withdrawal of an NBC O&O or Comcast RSN.[120]

c. Special Provisions to Ensure Remedies are Useful for Smaller MVPDs.

Proposal: Establish Special Requirements for Stand-Alone Agreements for Covered NBC Stations and Covered RSNs for Smaller MVPDs

1. *Upon entering into a Stand-Alone Retransmission Consent Agreement for a Covered NBC Station with an MVPD that serves 125,000 MVPD subscribers or less in the DMA served by the Covered NBC Station, and throughout the life of the agreement, Comcast-NBCU may neither require nor accept fees, terms, and conditions from the MVPD that result in a Net Effective Rate more than 5% higher than the lowest Net Effective Rate of any retransmission consent agreement for the Covered NBC Station with any MVPD including itself, that is currently in force. Moreover, Comcast-NBCU may neither withhold terms and conditions related to carriage of the Covered NBC Station that are made available to other MVPDs, including itself, nor require terms and conditions related to carriage of the Covered NBC Station that are technically infeasible or commercially prohibitive for the MVPD.*

2. *Upon entering into a Stand-Alone RSN Carriage Agreement for a Covered RSN with an MVPD that serves 125,000 MVPD subscribers or less in the region commonly served by the Covered RSN, and throughout the life of the agreement, Comcast-NBCU may neither require nor accept fees, terms, and conditions from the MVPD that result in a Net Effective Rate more than 5% higher than the lowest Net Effective Rate of any carriage agreement for the Covered RSN with any MVPD including itself, that is currently in force. Moreover, Comcast-NBCU may neither withhold terms and conditions related to*

[120] Rogerson I at 37-40. *See* also Rogerson II at 45.

carriage of the Covered RSN that are made available to other MVPDs, including itself, nor require terms and conditions related to carriage of the Covered RSN that are technically infeasible or commercially prohibitive for the MVPD.

3. *Each principal executive and financial officer of Comcast-NBCU will certify to the Commission on an annual basis that Comcast-NBCU, based on his or her knowledge, has calculated the Net Effective Rate for each retransmission consent agreement for Covered NBC Stations and for each carriage agreement for Covered RSNs currently in force, and is not in violation of III.A.1. or III.A.2. (1. or 2. above).*

Discussion:

The special requirement for stand-alone agreements for Covered NBC Stations and Covered RSNs for smaller MVPDs establishes the basic right enabling these MVPDs to obtain Comcast-NBCU programming at rates comparable to that of other MVPDs: Comcast-NBCU is required to make Covered NBC Stations and Covered RSNs available to smaller MVPDs at rates no more than 5% higher than the lowest "Net Effective Rate" of any retransmission consent agreement or carriage agreement, respectively; and, Comcast-NBCU cannot as part of these agreements withhold terms and conditions made available in other agreements or impose conditions that are technically infeasible or commercially prohibitive.

The ACA defines smaller MVPDs as those that serve fewer than 125,001 video subscribers in the relevant market served either by the Covered NBC Station or the Covered RSN. This is based on the discussion earlier in these comments regarding the excessive costs incurred by Massillon in its arbitration with Fox and confronted by WOW! as it was considering filing for arbitration against Comcast. In other words, because they have fewer subscribers, for smaller MVPDs the threshold at which the cost of arbitration, which is relatively fixed, exceeds the benefits of any price decrease is much lower. Professor Rogerson described this clearly in the attached report and provides the rationale for the "125,000 level":

> "Suppose that Comcast-NBCU is raising the fee for a particular network above its fair market value by $.50 per subscriber per month. Suppose that an MVPD believes that it has a 50% chance of winning an arbitration case on this issue, which would result in a fee decrease of $.50 per subscriber per month over the life of the contract. I will assume that the contract lasts 3 years (36 months) and that the MVPD uses a cost of capital of 10%. Straightforward calculation shows that the expected discounted gain to the MVPD from engaging in an arbitration is then equal to $7.80 per subscriber. If the MVPD has s subscribers, then its expected net benefit to participating in the arbitration is given by
>
> $$7.80\, s \quad - 1{,}000{,}000 \qquad \text{(IV.1)}$$
>
> The first term of Equation (V.1) is the expected benefit from winning the arbitration and the second term is the cost of the arbitration. Let s* denote the level of subscribership at which the MVPD would just break even from participating in the arbitration. It is given by
>
> $$s^* = 1{,}000{,}000/7.80 = 128{,}205. \qquad \text{(IV.2)}$$
>
> Based on this calculation, it therefore appears that an MVPD with fewer than approximately 125,000 subscribers for any particular piece of programming would not find it affordable to enter into arbitration even when it had a reasonably strong case."[121]

The 5% rate allowance reflects the fact that Comcast-NBCU may have cost savings when, for larger MVPDs, the fixed costs of contracting can be spread over a larger number of subscribers. Professor Rogerson notes that "5% is likely a very generous over-estimate of the extent to which programmers' per subscriber costs of dealing with smaller MVPDs are higher than their per subscriber costs of dealing with larger MVPDs. In the course of reviewing this transaction, the Commission may

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[121] Rogerson II at 42-43 (citations omitted).

consider assessing for itself the magnitude of such cost differences and use this to determine the appropriate percentage."[122]

The term "Net Effective Rate" as used in the special commercial arbitration provision for smaller MVPDs is based upon standard industry Most Favored Nation ("MFN") provisions and practices, including the arbitrator's use of a benchmark value – the "Net Effective Rate" – upon which to base a decision. The definition proposed by the ACA for "Net Effective Rate" reflects current commercial agreements and seeks to account for all consideration, whether in cash or other value, received by the programmer and paid by the MVPD. The ACA recognizes that determination of the "Net Effective Rate" may seem difficult; however, it is important to note that parties regularly enforce MFN provisions in commercial agreements based on calculations of "Net Effective Rate," and the ACA conditions facilitate this by requiring that Comcast-NBCU provide broadcast stations and RSNs on a stand-alone basis.

Finally, due to the lack of transparency for smaller operators with respect to the prices, terms, and conditions paid by other MVPDs and to ensure compliance with ACA's proposed Special Requirements for Smaller MVPDs, the ACA proposes an annual certification from "each principal executive and financial officer of Comcast-NBC." This is similar to certifications used by the Commission to enforce other requirements.[123]

Proposal: Special Commercial Arbitration Remedy for Smaller MVPDs

[122] Rogerson II at 48.

[123] *See, e.g.,* the certification requirement used to ensure compliance with the Commission's Customer Proprietary Network Information ("CPNI") rules. 47 C.F.R. § 64.2009(e).

1. An MVPD that serves 125,000 MVPD subscribers or less in either the DMA served by a Covered NBC Station, or the region commonly served by a Covered RSN, may submit a dispute over the terms and conditions of carriage of a Covered NBC Station or a Covered RSN subject to a special commercial arbitration remedy for smaller MVPDs designed to affordably resolve disputes related to Conditions III.A1. or III.A.2. (1. and 2. under the Special Requirements for Stand-Alone Agreements above).

2. The special commercial arbitration remedy for Smaller MVPDs shall be a traditional arbitration conducted in accordance with the Rules for Special Commercial Arbitration Remedy for Smaller MVPDs contained in Appendix A. (4. below), different from the "final offer" or "baseball" arbitration outlined in Condition II.C.1. (under the commercial arbitration condition above).

3. An aggrieved MVPD shall be granted an automatic right to continued carriage of the Covered NBC Station or Covered RSN until the resolution of the special commercial arbitration remedy for smaller MVPDs.

4. Rules for the Special Commercial Arbitration Remedy for Smaller MVPDs:

> *a. Upon receiving timely notice of a Smaller MVPD's intent to arbitrate, Comcast-NBCU shall submit to the arbitrator in writing its last offer to the MVPD, and may include, at its discretion, an explanation of why its offer complies with Conditions III.A.1. or III.A.2. (1. or 2 under the Special Requirements for Stand-Alone Agreements above).*
>
> *b. Comcast-NBCU shall be obligated to make available to the arbitrator all relevant contracts and other data and information, including its calculations of the Net Effective Rate for each retransmission consent agreement for the Covered NBC Station or for each carriage agreement for the Covered RSNs currently in force, as the arbitrator deems necessary to resolve the dispute.*
>
> *c. The Smaller MVPD may submit to the arbitrator in writing an explanation for why it believes Comcast-NBCU's last offer does not comply with Conditions III.A.1. or III.A.2. (1. or 2. under the Special Requirements for Stand-Alone Agreements above).*

d. Comcast-NBCU may respond in writing to the Smaller MVPD's filing.

e. After receiving the written briefs of both parties and all relevant contracts and other data and information, the arbitrator shall determine whether Comcast-NBCU's last offer complies with Conditions III.A.1. or III.A.2. (1. or .2. under the Special Requirements for Stand-Alone Agreements above). If the arbitrator finds that Comcast-NBCU's offer does not comply, then the arbitrator, after informal consultation with the parties, shall adjust the Comcast-NBCU offer to bring it into compliance. The MVPD and Comcast-NBCU shall be bound to accept the arbitrator's modified terms and conditions.

Discussion:

A special arbitration process is established so that individual smaller MVPDs can benefit from the remedy. This process is a traditional arbitration process (not "baseball" style) and is based on standard commercial practices. This arbitration is less burdensome for smaller MVPDs because it will only focus on whether the "Net Effective Rate" for a programming network is within 5% of the lowest rate obtained by any other MVPD.[124] In addition, the arbitrator's task in making this determination will be facilitated because the Covered NBC Stations and Covered RSNs must be

[124] Professor Rogerson in the attached report discusses the nature and benefits of this arbitration process more fully: "[N]ote that the arbitration process is this case is not baseball-style arbitration where both parties make offers and the arbitrator selects the offer that most closely meets the condition specified in the arbitration rules. Instead, only Comcast-NBCU makes a final offer and then the arbitrator directly determines if this offer meets the 5% condition or not. The rationale for using this simpler type of arbitration is that, since Comcast-NBCU and the arbitrator will both have access to all of Comcast's contracts and the MVPD will not, Comcast-NBCU and the arbitrator will both have vastly superior information about the value of the correct rate than will the MVPD. Furthermore under the specified arbitration process Comcast-NBCU will know that it has to choose a rate that meets the 5% condition because the arbitrator will find it very easy to determine if the condition is met. Therefore there will be no need (or advantage) to try to involve the MVPD in a more active way. That is, the arbitrator is the appropriate actor to discipline Comcast-NBCU because it will have access to the same information that Comcast-NBCU has access to and it will be simple and inexpensive for the arbitrator to directly determine if the 5% condition is met." Rogerson II at 49.

offered on a stand-alone basis. This process thus stands in contrast to the Adephia-Time Warner-Comcast arbitration process where the arbitrator needs to determine the fair market value of programming by estimating the revenue stream of the programming and compare the fees charged for all types of related programming offered on the market. Finally, the ACA proposal includes a "standstill" provision, enabling the smaller MVPD to continue to carry the programming until the dispute is resolved.

Proposal: Enable Bargaining Agents to Represent Smaller MVPDs

1. *Comcast-NBCU shall negotiate in good faith with Bargaining Agents. The following actions by Comcast-NBCU would violate this duty to negotiate in good faith:*

    a. *Refusal to negotiate with a Bargaining Agent on behalf of all its principals or members.*

    b. *Refusal to enter into a retransmission consent or carriage agreement with an MVPD unless it contains a restriction on either being represented by a Bargaining Agent, or opting into an agreement subsequently reached by a Bargaining Agent.*

    c. *Refusal to put forth an offer to a Bargaining Agent with members who are not bound by the prices, terms, and conditions entered into by the Bargaining Agent, for any set of different subscriber levels specified by the Bargaining Agent so long as none of the subscriber levels are greater than the aggregate number of MVPD subscribers served by the entire membership of the Bargaining Agent.*

2. *When negotiations involving Bargaining Agents fail to produce a mutually acceptable set of prices, terms, and conditions for Covered Programming, an aggrieved Bargaining Agent shall have the same rights to submit a dispute over the prices, terms, and conditions of carriage for Covered Programming to commercial arbitration as an MVPD, pursuant to the rules outlined in Condition II.C.1 (under the commercial arbitration condition above), with the following additional rules:*

a. *An aggrieved Bargaining Agent with members who are not bound by the prices, terms and conditions entered into by the Bargaining Agent and Comcast-NBCU shall present final offers to the arbitrator based on each disputed set of subscriber levels specified by the Bargaining Agent so long as none of the subscriber levels are greater than the aggregate number of MVPD subscribers served by the entire membership of the Bargaining Agent. For each set of different subscriber levels, the arbitrator will choose the final offer of the party that most closely approximates the fair market value of the Covered Programming.*[125]

Discussion:

The previous proposal addressed concerns with smaller MVPDs obtaining carriage of Covered NBC Stations and Covered RSNs. The "Bargaining Agent" proposals address Comcast-NBCU's post-combination ability to increase prices for carriage of Covered National Cable Networks by smaller MVPDs. It is important to note that the term "Bargaining Agent" includes the National Cable Television Cooperative (NCTC), as currently organized and as it operates. Because NCTC already bargains on behalf of smaller MVPDs to access national cable networks, the implementation of the ACA's proposal is relatively straightforward. In addition, it permits MVPDs to join together in other ways, including for the purpose of negotiating single or multiple agreements for all or any programming, and employing an individual or entity as an agent to bargain on its behalf with Comcast-NBCU, and such individual or agent also would be considered a Bargaining Agent.

The ACA proposal strengthens the ability of Bargaining Agents (and thus smaller MVPDs) to negotiate programming fees on behalf of its members in two

[125] The actual prices, terms, and conditions of the agreement entered into by the Bargaining Agent's members will then be determined by the aggregate number of MVPD subscribers of the Bargaining Agent's members that subsequently opt into the agreement.

important ways. First, the ACA's proposal requires Comcast-NBCU to negotiate in good faith with a Bargaining Agent. This means that Comcast-NBCU cannot refuse to negotiate with a Bargaining Agent. In addition, it must make an offer to a Bargaining Agent even if the agent's members are not bound by the agreement, and such offer must be for "any set of different subscriber levels specified by the Bargaining agent."

Second, the ACA's proposal gives a Bargaining Agent the ability, just like any MVPD, to request binding commercial arbitration to resolve disputes over programming fees for Covered Programming. This means that the agent can ask for arbitration for any individual covered network (*e.g.,* a NBCU O&O or a RSN) or a group of covered networks (*e.g.,* the block of NBCU cable networks) which it seeks to negotiate with Comcast-NBCU on behalf of a group of smaller MVPDs. In addition, in an arbitration proceeding, the Bargaining Agent and Comcast-NBCU shall provide final offers on "each disputed set of subscriber levels that could opt into the agreement, as specified by the Bargaining Agent." The arbitrator will then select the final offer for each subscriber level that is closest to the fair market value for the programming. Finally, the actual prices, terms, and conditions of the agreement entered into by the Bargaining Agent's members will be determined by the aggregate number of subscribers of the MVPDs (members) that subsequently opt into the agreement.

d. Conditions Should Remain in Effect While Harms are Likely to Occur.

Proposal: *These conditions shall apply to Comcast-NBCU for nine years, regardless of whether, during this period, any statute or regulation referenced in any condition, including the program access rules, are not extended by the Commission or are overturned by the Courts.*

Discussion:

The ACA proposes that its conditions remain in effect for nine years.[126] This is based on several factors. First, the competitive harms from the proposed combination are significant and extensive, and there is little likelihood that market events by themselves will soon diminish the increased market power Comcast-NBCU will obtain by the proposed combination. Second, current program carriage agreements may not be negotiated for some time, and rates tend to ratchet-up as subsequent agreements are negotiated. Thus, conditions need to remain in effect through a series of renegotiation cycles. Finally, the Applicants have already entered into privately negotiated agreements with other parties to the proceeding that have a duration of 7 years.[127]

IV. CONCLUSION.

This Reply is the third set of lengthy and well-documented comments the ACA has filed in this proceeding. In its initial comments, the ACA presented the significant horizontal and vertical harms that would ensue from the proposed combination of

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[126] The ACA notes that the conditions adopted in the Adephia-Time Warner-Comcast proceeding remain in effect for 6 years. (*See Adelphia Order*, Appendix B.)

[127] *See Ex Parte* Letter of Michael H. Hammer, Counsel for Comcast Corporation, and David H. Solomon, Counsel for NBC Universal, Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket No. 10-56 (filed Aug. 6, 2010), and attached Agreements with NBC Television Affiliates, ABC Television Associates Association, CBS Television Network Affiliates Association, and FBC Television Affiliates Association).

Comcast and NBCU. This was supported by a detailed report from Professor Rogerson on the economic rationale underlying such harms and with empirical evidence of the nature and magnitude of the harms. In ACA's Response to Comments, it presented and analyzed documents submitted to the Commission by the Applicants to demonstrate that Comcast and NBCU recognized and understood the proposed combination would enable them to obtain additional market power. This Reply completes the ACA's presentation of its case: the Commission cannot approve the proposed transaction without adopting sufficiently robust and durable conditions. In this Reply, the ACA and its economic expert, Professor Rogerson, first have rebutted the arguments presented by the Applicants' economists, which sought to demonstrate the proposed combination raised little or no competitive concerns. It is clear the horizontal and vertical harms are real and significant. Second, the ACA set forth a series of conditions – both general for all MVPDs and specific for smaller MVPDs – all of which are necessary to ameliorate these harms.

The proposed combination of Comcast and NBCU is a "big deal," and a wide swath of the industry and a great many consumers will suffer grave harm if it is approved without sufficient relief. Consequently, the ACA intends to continue to advocate vigorously and persistently for the Commission to adopt such relief. The ACA recognizes and appreciates that the Commission too has taken a very serious and rigorous approach to reviewing the proposed combination. It stands ready to assist the Commission in further analyzing the transaction and drafting appropriate conditions.

Respectfully submitted,

AMERICAN CABLE ASSOCIATION

By: Barbara Esbin

Matthew M. Polka
President and Chief Executive Officer
American Cable Association
One Parkway Center
Suite 212
Pittsburgh, Pennsylvania 15220
(412) 922-8300

Ross J. Lieberman
Vice President of Government Affairs
American Cable Association
2415 39th Pl, NW
Washington, DC 20007
(202) 494-5661

Christopher C. Cinnamon
Barbara S. Esbin
Jeremy M. Kissel
Cinnamon Mueller
307 North Michigan Avenue
Suite 1020
Chicago, Illinois 60601
(312) 372-3930

Thomas W. Cohen
Kelley Drye & Warren LLP
Washington Harbour, Suite 400
3050 K. Street, NW
Washington, DC 20007
(202) 342-8400

Attorneys for the American Cable Association

August 19, 2010

ATTACHMENT A

A FURTHER ECONOMIC ANALYSIS OF THE PROPOSED COMCAST-NBCU TRANSACTION

WILLIAM P. ROGERSON

A FURTHER ECONOMIC ANALYSIS
OF THE PROPOSED COMCAST-NBCU TRANSACTION*

August 19, 2010

by

William P. Rogerson**

***   Prepared for the American Cable Association.**
****   Professor of Economics, Northwestern University.   FCC Chief Economist, 1998-99.**

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I. INTRODUCTION

In their initial application, the parties to this transaction submitted an economic report prepared by Drs. Mark Israel and Michael L. Katz[1] ("*Israel Katz Report I")* meant to address the issue of competitive harms from the transaction that could occur through its impact on markets for MVPD services. Along with its initial comments, the American Cable Association submitted a paper written by myself [2] ("*Rogerson Report I*") describing and estimating the magnitude of two significant competitive harms that the transaction would create through its impact on MVPD markets that had not been considered in the *Israel Katz Report* I or in any other materials initially submitted by the applicants. In their reply comments, the applicants submitted an additional economic report by Drs. Israel and Katz[3] ("*Israel-Katz Report II*") meant to refute the analysis in *Rogerson Report I.* In this follow-up report, I will present my own analysis of *Israel-Katz Report II*. In particular, I will explain why this report fails to successfully refute any of the arguments

[1]*See* Mark Israel and Michael L Katz, "Application of the Commission Staff Model of Vertical Foreclosure to the Proposed Comcast-NBCU Transaction," February 26, 2010, (*Israel Katz Report I"*), submitted with *Application and Public Interest Statement, In the Matter of Applications for Consent to the Transfer of Control of Licenses, General Electric, Transferor, to Comcast Corporation, Transferee*, MB Docket No. 10-56, February 26, 2010.

[2]*See* William P. Rogerson, "Economic Analysis of the Competitive Harms of the Proposed Comcast-NBCU Transaction," June 21, 2010, ("*Rogerson Report I*"), submitted by the American Cable Association (ACA) along with its initial comments in the Commission's proceeding examining this transaction. *See* ACA, *Comments In the Matter of Applications of Comcast Corporation, General Electric Company, and NBC Universal, Inc., to Assign and Transfer Control of FCC Licenses,* MB Docket No. 10-56, June 21, 2010("*ACA Initial Comments")*

[3]*See* Mark Israel and Michael L. Katz, "Economic Analysis of the Proposed Comcast-NBCU-GE Transaction," July 20, 2010, submitted with *Opposition to Petitions to Deny and Response to Comments, In the Matter of Applications for Consent to the Transfer of Control of Licenses, General Electric, Transferor, to Comcast Corporation, Transferee,* MB Docket No. 10-56, July 21 2010.

that I advanced in my initial report.[4] After this, I will describe a set of conditions proposed by the American Cable Association (that they developed with my advice) and explain why I believe that this set of conditions would substantially address the harms that I have identified, while still allowing the transaction to proceed.

II. VERTICAL HARM

1. INTRODUCTION

The theory of vertical harm that I outline in my initial report[5] is that Comcast's ownership share of the joint venture combined with its ownership of its MVPD business will increase the joint venture's ability to bargain for higher programming fees from MVPDs that compete with Comcast, and that these fee increases will be substantially passed through to subscribers in the form of higher subscription fees. I will refer to this effect as the "raising rivals' costs" effect of the transaction. This effect occurs because the joint venture will take account of the fact that selling programming to MVPDs that compete with Comcast will reduce Comcast's profits. Essentially, this means that the transaction will create a new opportunity cost to the joint venture of selling NBCU programming to rivals of Comcast. I show that the magnitude of the opportunity cost created by the transaction is determined by the simple formula

$$C = \alpha d\pi \qquad \text{(II.1)}$$

[4]In addition to the two reports by Drs. Israel and Katz referenced above, the applicants have submitted three additional economic reports (one additional report by Drs. Israel and Katz and two reports by Dr. Greg Rosston). However, these additional reports deal with other issues and I will not refer to them further in this report.

[5]*See Rogerson Report I,* Section 3.

where C denotes the increased opportunity cost per subscriber due to the transaction, d denotes the share of the customers that would leave the rival MVPD if it were unable to offer the NBCU programming, α denotes the share of these customers that would switch to Comcast, and π denotes the per subscriber profit margin of Comcast. Following the standard and well-accepted Nash bargaining model, I predict that half of this increase in opportunity cost will be passed through to MVPDs in the form of higher programming fees. This means that the formula for calculating the increase in programming fees that the merged entity will charge to MVPDs that compete with Comcast is given by

$$\Delta P = \alpha \, d \, \pi / 2 \qquad \text{(II.2)}$$

Equation (II.2) provides a formula for estimating the cost increase (experienced by MVPDs that compete with Comcast) due to the raising rivals' costs effect of the transaction. To provide some information on the rough order of magnitude of this cost increase, I use publicly available data to determine plausible values for these parameters. I assume that π is equal to $42.98.[6] I assume that d is equal to .05 for the NBC local broadcast signal and is also equal to .05 for the block of NBCU national cable networks.[7] In order to estimate α, I follow the perfectly reasonable procedure of assuming that customers that leave a given MVPD will switch to other MPVDs in proportion to the relative market shares of these other MVPDs. This is the procedure

[6] *See Rogerson Report I* at page 30.

[7] *See Rogerson Report I* at pages 30-31.

that the Commission itself has routinely used in its own calculations of this sort[8] and is also the procedure that Drs. Israel and Katz used in their initial report.[9] The value of α will vary from MVPD to MVPD and from programming type to programming type depending upon the extent to which Comcast has subscribers in the relevant region affected by the programming withdrawal.[10] There are six major urban areas of the country that are served by an NBC O&O where Comcast is the dominant cable operator.[11] These are Philadelphia, Chicago, San Francisco-Oakland-San Jose, Miami-Ft. Lauderdale, Washington DC, and Hartford-New Haven. For withdrawal of retransmission consent for an NBC O&O from a national telco[12] or DBS provider is these areas, the value of α varies between .43 and .7 with an average value of .62.[13] For withdrawal of NBCU cable networks from a national telco or DBS provider, the value of α is approximately equal to

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[8]*See*, for example, *DirecTV-News Corp. Order*, Appendix D, para. 29.

[9]*See Israel Katz Report I* at para. 55, which states "we assume that, if the joint venture chose to foreclose any MVPD (after the contract had expired), then the diversion ratio to each of the remaining, non-foreclosed MVPDs in the DMA would be proportional to the MVPD's share of all MVPD subscribers in that DMA."

[10]*See Rogerson Report I* at pages 33-40 for a detailed explanation of the formula that determines α.

[11]Although the NBC network does not currently negotiate retransmission consent fees on behalf of its affiliate stations, it is possible that the NBC network might begin doing this at some point. To the extent that the NBC network begins to negotiate retransmission consent fees on behalf of NBC affiliates, the transaction will cause retransmission consent fees for NBC affiliates to rise by the same amount that it will cause retransmission consent fees for NBC O&O's to rise. For purposes of simplifying the exposition of my report, I will only explicitly refer to the effect of the transaction on increasing retransmission consent fees for NBC O&Os. However, the reader should keep in mind that these effects will also occur for retransmission consent fees of all NBC affiliates if NBC ever begins negotiating retransmission consent fees on their behalf.

[12]In this report I will use the term "national telco" to refer to AT&T or Verizon, which are the two national telephone companies that are rolling out MVPD service in their service areas.

[13]*See Rogerson Report I*, Table 3, at page 56.

.26.[14] Substitution of these values into formula (II.2) yields

$$
\begin{aligned}
\text{Retrans}\Delta P &= .62 \times .05 \times 42.98 / 2 = \$.67 \\
\text{Cablenet}\Delta P &= .26 \times .05 \times 42.98/2 = \$.28 \qquad \text{(II.3)} \\
\text{Total}\Delta P &= \qquad\qquad\qquad\quad = \$.95
\end{aligned}
$$

Thus, in the six major urban areas of the United States served by an NBC O&O where Comcast is the dominant cable operator we would expect total programming fees charged to national telcos and DBS providers to increase by $.95 per subscriber per month. In the remainder of the country programming fees to these same MVPDs would increase by $.28 per subscriber per month. For regional cable overbuilders, the value of α depends on the share of the MVPD's subscribers passed by Comcast. If 80% of a cable overbuilder's homes were passed by Comcast, the value of α is .49.[15] Substitution of this value into equation (II.2) yields

$$
\begin{aligned}
\text{Retrans}\Delta P &= .49 \times .05 \times 42.98 / 2 = \$.53 \\
\text{Cablenet}\Delta P &= .49 \times .05 \times 42.98/2 = \$.53 \qquad \text{(II.4)} \\
\text{Total}\Delta P &= \qquad\qquad\qquad\quad = \$1.06
\end{aligned}
$$

Thus, a regional cable overbuilder that competes primarily with Comcast will experience a fee increase of $.53 per subscriber per month for NBCU national cable networks and an additional fee increase of $.53 per subscriber per month for retransmission consent for the local NBC broadcast television signal if it is in a region served by an NBC O&O. Thus the magnitude of the likely fee

[14] *See Rogerson Report I* at page 38.

[15] *See Rogerson Report I* at pages 38-40.

increases experienced by regional cable overbuilders that compete primarily with Comcast will be comparable to the magnitude of the fee increases experienced by the two DBS providers and the two national telcos.

Drs. Israel and Katz essentially adopt three different lines of argument in attempting to refute my analysis and estimation. Their first line of argument is that, even if my raising rivals' costs theory is completely correct and programming fees charged to MVPDs that compete with Comcast will increase by the amount that I predict, there is a second additional effect on subscription prices that I am ignoring which will have the reverse impact on subscription fees and overwhelm the effect that I do identify. This second effect is that Comcast's own marginal cost of providing MVPD service will be reduced by the transaction and that a share of this cost reduction will be passed through to subscribers in the form of lower subscription prices. I will refer to this effect as the "reduced double marginalization" effect. Drs. Israel and Katz assert that the magnitude of the cost reduction experienced by Comcast due to the reduced double marginalization effect is equal to the full amount of the programming fees that Comcast currently pays NBCU (before the transaction). Based on this assertion, they argue that the cost reduction (experienced by Comcast) due to reduced double marginalization will likely exceed the cost increase (experienced by Comcast's rivals) due to the raising rivals costs effect and that the beneficial effects of the vertical transaction on Comcast's own pricing will therefore likely overwhelm the harmful effects of the vertical transaction on the pricing of rival MVPDs. Their second line of argument is to advance a number of different reasons why they believe that my raising rivals' costs theory predicting that Comcast will raise programming prices to its rivals is incorrect or why the estimate of this effect that I calculate overstates the likely effect. Their third line of argument is that the programming fee increases experience by regional cable overbuilders can be ignored because regional cable overbuilders serve an insignificant share of the entire U.S. population.

I will deal with each of the lines of argument separately in the next three sections of the paper.

2. REDUCED DOUBLE MARGINALIZATION

As described above, Drs. Israel and Katz argue that an additional effect of the transaction will be that Comcast's own marginal cost of providing MVPD service will be reduced, and that a share of this cost reduction will be passed through to Comcast subscribers in the form of lower subscription fees. I will refer to this effect as the "reduced double marginalization" effect.

To develop a formula for measuring the magnitude of the cost decrease that Comcast will experience due to the reduced double marginalization effect, Drs. Israel and Katz begin by noting that, after the transaction, Comcast will view the true marginal cost of purchasing NBCU programming as zero, since any fee paid by one division of the firm to another division is a simple transfer payment that does not affect the total profit of the firm. They claim that this implies that Comcast's marginal cost will drop by an amount equal to the value of programming fees that Comcast pays NBCU before the transaction occurs. That is, if Comcast currently pays a fee of w dollars per subscriber per month for NBCU programming, Drs. Israel and Katz claim that an additional effect of the vertical transaction will be that, after the transaction, Comcast will view its costs of providing service to subscribers as being w dollars per subscriber per month lower than before the transaction. Thus the pricing effects created by the fact that MVPDs competing with

Comcast will have programming prices that are $.95 per subscriber per month higher than before the transaction must be weighed against the pricing effects created by the fact that Comcast will view its own costs of providing service as being w dollars per subscriber per month lower than before the transaction. In particular, then, Drs. Israel and Katz argue that if w is somewhat larger than $.95 per subscriber per month, then this should be interpreted as suggesting that the effect of reduced double marginalization will outweigh the effect of increased programming fees for MVPDs that compete with Comcast. Publicly available data suggests that a reasonably plausible value to use for w would be $1.56.[16] This obviously is somewhat larger than $.95

I will now explain why the theory of Drs. Israel and Katz is completely incorrect because of a basic error in economic reasoning in their analysis. In particular, although their analysis starts with a grain of truth, they almost immediately make a grave error in economic reasoning that results in a completely false conclusion on their part.

The grain of truth they begin with is the observation that, after the vertical transaction, Comcast will view its true marginal cost of providing NBCU programming to its subscribers as being zero. The fatal error in their analysis is to ignore a new opportunity cost that Comcast will now take account of because of the transaction. For purposes of my explanation of this ignored new opportunity cost, I will use the figure I mention above of $1.56 per subscriber per month as being the programming fee that NBCU charges all MPVDs for its programming. The new opportunity cost is created by the fact that the joint venture charges $1.56 per subscriber per month not only to Comcast but also to all MVPDs that compete with Comcast. Furthermore, since the marginal cost to the joint venture of providing this programming to an additional viewer is

[16] See *Rogerson Report I*, footnote 29, which cites Kagan data as reported in Peter Kafka, "Hate Paying for Cable? Here's Why," *All Things Digital*, http://mediamemo.allthingsd.com/20100308/hate-paying-for-cable-heres-the-reason-why/.

essentially zero, this entire fee of \$1.56 per subscriber per month represents profit to the joint venture. Now suppose that Comcast lowers its subscription price slightly in an attempt to attract more customers. The critical point to recognize (which is the point that Drs. Israel and Katz fail recognize in their analysis) is that to the extent that these new customers are customers that switch from some other MVPD, this will cause the joint venture to lose \$1.56 per subscriber per month in programming profit. In particular, if 100% of the customers that Comcast would attract are customers that would switch from some other MVPD, then the opportunity cost of attracting new customers is exactly equal to \$1.56 per subscriber per month. This is because, when Comcast attracts a new customer, it loses a profit of \$1.56 on sales of NBCU programming to the MVPD that the customer switches from.

More generally, we can define the “switcher share” of Comcast as follows. Suppose that Comcast slightly lowers its subscription price to attract new subscribers. It will attract two different types of subscribers - people who previously subscribed to a different MVPD and people who previously subscribed to no MVPD. Define the “switcher share” of Comcast to be the share of new subscribers that are switchers from some other MVPD. I will let the parameter θ denote Comcast’s switcher share. Although I am not aware of any publicly available data that provides information on the precise magnitude of θ for a typical MPVD, it is completely clear that θ is a very large number and will likely be close to 1. That is, when Comcast lowers its price in an attempt to attract new customers, most of the customers that it attracts will be customers that switch from some other MVPD. To put this another way, Comcast is essentially competing with other MPVDs for most of its business. There are very few customers that view themselves as choosing between the two options of subscribing to Comcast versus not subscribing to any MVPD at all.

To return to the example above, if θ is the switcher share for Comcast, then this means that θ of the customers that it would attract by lowering its price slightly would be customers that switch from some other MVPD. This means that the opportunity cost of attracting a new customer is θ x $1.56, because this is the amount of profit that the vertically integrated firm will lose when it attracts new customers. Therefore a complete accounting of the effects of vertical integration on the marginal cost to the combined entity of serving new MVPD customers is as follows. First, because the payment of Comcast to the joint venture of $1.56 is now simple a transfer payment, the marginal cost goes down by $1.56. However, second, because θ of the customers that Comcast attracts will be from other MVPDs, there is a new opportunity cost of θ x $1.56 per subscriber per month. A decrease in cost of $1.56 combined with an increase in cost of θ x $1.56 yields a net decrease in cost of (1-θ) x $1.56. In particular, if θ is close to 1, then the net decrease in cost due to the double marginalization effect is close to 0.

To summarize, Drs. Israel and Katz erroneously claim that the magnitude of the cost decrease due to the reduced double marginalization effect is $1.56 per subscriber per month. In reality it is actually equal to only (1-θ) x $1.56 per subscriber per month where θ is the switcher share of Comcast. It is completely clear that the value of θ is close to 1. Even if it were as low as .9, the magnitude of the cost reduction due to the reduced double marginalization effect would only be $.16 per subscriber per month, which is completely swamped by the increase in other MVPDs' marginal costs of $.95 I suspect that a more realistic estimate of the correct value θ is much larger than .9. If, for example, the correct value θ is .98, then the correct magnitude of the cost reduction due to the reduced double marginalization effect would be $.03 per subscriber per month. The important point to notice is that over any plausible range of values for the parameter θ, it is clear that the reduced double marginalization effect will be completely swamped by increases in programming fees of rival MPVDs if this latter effect is in the neighborhood of $.95 as I have estimated.

Therefore, in summary, I agree with Drs. Israel and Katz that there are two separate effects that need to be taken into account. The first effect is the increase in programming fees that MPVDs competing with Comcast will experience. The second effect is the decrease in marginal cost that Comcast will experience. The critical mistake of Drs. Israel and Katz is that their estimate of the second effect is orders of magnitude higher than the true value. This is because they erroneously fail to take into account the fact that the vertically integrated firm will still experience a marginal cost of $1.56 per subscriber per month when it attracts new subscribers so long as the subscribers that it attracts shift from some other MVPD that was also carrying the NBCU programming.

To put this another way, I believe that the issue of reduced double marginalization raised by Drs. Israel and Katz is a essentially a red herring. Although this effect exists, its magnitude is almost certainly very small. The real issue is whether or not the vertically integrated firm will have an incentive to increase the programming fees that it charges to its rivals. If the increase in programming fees is anywhere in the neighborhood of the value of $.95 per subscriber per month that I predict, this effect will completely overwhelm the reduced double marginalization effect.[17]

[17] As an aside, I would also like to raise the more minor point that even if the reduced double marginalization effect was of the same order of magnitude as the raising rivals' costs effect, this would still potentially create an issue of concern for the Commission. In the markets that Comcast serves, it is generally the dominant provider. Any transaction that had the effect of giving Comcast a significant cost advantage over its competitors might threaten to drive Comcast's competitors out of the market entirely or at least weaken them considerably, and thus damage competition. Thus, even if the effect of the transaction was to lower Comcast's own costs

I will now turn to the criticisms that Drs. Katz and Israel raise about my raising rivals' costs theory.

Also, note that a more formal version of the economic arguments that I have made in this section is presented in an Appendix to this report.

3. RAISING RIVALS' COSTS

In this section I will consider Drs. Israel and Katz's second line of argument that my raising rivals' costs theory is incorrect or that the estimated magnitude of this effect that I calculate overstates the effect. They offer four different reasons to support this line of argument and I will consider each separately.

Reason #1: Partial Ownership of the Joint Venture by GE

The raising rivals' costs theory requires that the joint venture have the incentive to take actions that maximize the joint profits of the joint venture and Comcast. This will be true if the joint venture and Comcast are able to closely coordinate their actions and redistribute profits between themselves so as to leave both parties better off from any action that maximizes their joint profits. I stated in my initial paper that it would be completely untenable for the applicants or their economists to attempt to argue that this type of close coordination would be impossible, because many of the claimed efficiencies for the transaction would require exactly the same type of close coordination and redistribution of profits between the joint venture and Comcast.[18] I

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and raise its rivals' costs by approximately the same amount, it is not at all clear that the net effect on subscribers would be minor. If the result of this was to drive Comcast's competitors from the market or at least considerably weaken them, the reduction in competition might ultimately make it profitable for Comcast to raise its own subscription prices.

[18] *See Rogerson Report I* at pages 19-20.

further noted that the Commission itself unequivocally made this same point itself in its analysis of the DirecTV-News Corp. transaction.[19]

Drs. Israel and Katz have responded to this by giving one small example of one particular type of efficiency that could be achieved without close coordination and redistribution of profits. This is the reduced double marginalization efficiency that I have already discussed above. Namely, they point out that if Comcast has a 51% ownership share in the joint venture, it would automatically create incentives for Comcast to internalize 51% of the joint venture's profits when it chose a downstream subscription price for its MVPD services, without the need for any additional consultation or coordination with the joint venture.

I have two observations to offer about this argument. First, as I have already demonstrated in the previous section, Drs. Israel and Katz are largely mistaken when they claim that there is a significant efficiency associated with the reduced double marginalization effect. As I showed in the previous section, even if Comcast fully internalized 100% of the upstream profits, this alone would not cause it to make significantly different pricing decisions at the downstream level. Second, even if it is possible to find an occasional example of an efficiency that could be achieved without close coordination and profit redistribution, it completely clear that achievement of many important classes of efficiencies will require close coordination and profit redistribution.

[19]The DirecTV- News Corp. transaction involved News Corp. purchasing a 34% interest in DirecTV which could be increased to 50%. One of the scenarios which the Commission considered in evaluating foreclosure incentives was the scenario where News Corp. made decisions to maximize the combined profits of both firms. It described one of the rationales for this decision as follows. "The proposed joint endeavors between News Corp. and DirecTV that are a basis for many of the Applicants' claimed benefits provide ample opportunities to compensate News Corp. for the losses in programming revenue associated with foreclosure and make the strategy profitable to both firms and their stockholders." *See Appendix D, Staff Analysis of the Likelihood of Foreclosure in the Broadcast Television Programming Market, See DirecTV-News Corp. Order,* at para. 7 as cited in *Rogerson Report I* at page 20.

Reason #2: Bargaining Models are Too Stylized For Analyzing Competitive Effects

Drs. Israel and Katz suggest the bargaining model that the vertical theory of harm is based on is "far too stylized"[20] to be used for purposes of analyzing the competitive effects of this transaction even though they admit that this same framework "commonly is used in academic settings to derive basic insights about various types of negotiations." [21] It is difficult to know what to make of this critique, especially in light of the fact that Professor Katz himself has recently used precisely this same type of model to provide extensive policy guidance to the Commission on the issue of retransmission consent.[22] Almost all economic models are highly stylized, including most of the game theoretic models that provide the foundation for modern industrial organization theory and that play a key role in providing guidance for antitrust policy. Bargaining models are a completely well-accepted and standard type of model used in the industrial organization literature to derive basic insights useful for policy analysis. Furthermore, as I noted in my previous paper, the Commission itself used precisely this sort of model to analyze the Adelphia-Time Warner-Comcast transaction which is the most recent significant transaction with vertical competitive harms that the Commission has evaluated.[23]

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[20]*See Israel Katz Report II* at para. 43.

[21]*See Israel Katz Report II* at para. 43.

[22] *See* Michael L. Katz, Jonathan Orszag, and Theresa Sullivan, "An Economic Analysis of Consumer Harm From the Current Retransmission Consent Regime," November 12, 2009, ("Katz, Orszag, and Sullivan (2009)"), submitted by NCTA as part of its comments, *In the Matter of A National Broadband Plan for Our Future*, NBP Public Notice #26, GN docket Nos. 09-47, 09-51, 09-137 and *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 07-269, December 16, 2009.

[23]*See Adelphia-Time Warner-Comcast Order*, Appendix D, as cited in *Rogerson Report I* at page 22, including footnote 33.

Reason #3: Parameter Values

As I explained in Section II.1 of this paper, the formula for calculating the fee increase that an MPVD competing with Comcast will face due to the transaction is given by

$$\Delta P = \alpha\ d\ \pi / 2 \qquad \text{(II.5)}$$

where ΔP denotes the per subscriber fee increase due to the transaction, d denotes the share of the customers that would leave the rival MVPD if it were unable to offer the NBCU programming, α denotes the share of these customers that would switch to Comcast, and π denotes the per subscriber profit margin of Comcast. In order to provide some information on the rough order of magnitude of this cost increase, I substituted plausible parameter values into equation (II.4) to yield a predicted fee increase of $.95 per subscriber per month.[24] The only significant disagreement on parameter values that Drs. Israel and Katz have with me regards the parameter α, which is the share of customers leaving a rival MVPD that would switch to Comcast as opposed to some other MVPD. In fact, they recommend using slightly higher values for π and d than I use, which would result in a larger estimate of harm. To determine plausible values of α, I make the completely reasonable assumption that Drs. Israel and Katz used themselves in their initial report[25] and that the Commission routinely uses itself,[26] that customers leaving any particular MVPD will

[24]*See* equation (II.3), above, for details.

[25]*See Israel Katz Report I* at para. 55, which states "we assume that, if the joint venture chose to foreclose any MVPD (after the contract had expired), then the diversion ratio to each of the remaining, non-foreclosed MVPDs in the DMA would be proportional to the MVPD's share of all MVPD subscribers in that DMA."

distribute themselves among other MVPDs according to the relative market shares of the other MVPDs. I will refer to this as the "relative market shares" method of calculating α. In their follow-up report Drs. Israel and Katz report that, although they believe that this is still the correct procedure to use for cable overbuilders and national telcos, they now believe that it would be appropriate for the case of DBS providers, to use a value of α equal to one third of the value produced by the relative market shares method.[27]

Drs. Israel and Katz's explanation for their new approach is as follows. They note that in their initial report they conducted an empirical analysis of Comcast subscription data and determined that Comcast did not appear to gain any additional customers in regions where the DISH network was unable to carry certain broadcast signals for a 6 month period. They also note that in its comments the DISH network filed information indicating that a relatively substantial share of DISH subscribers left DISH during this same time period. Thus, based on these two pieces of evidence it appears that although a relatively significant number of subscribers left DISH, no additional subscribers went to Comcast. Drs. Israel and Katz suggest that this could be explained by the theory that customers of one DBS provider have such a strong preference for DBS over non-DBS MVPD service, that if they decide to leave one of the two DBS providers because programming is unavailable, they almost all choose to switch to the other DBS provider. If one literally accepted Drs. Israel and Katz's data and theory at face value, one would then conclude that α should literally be equal to zero. Instead of recommending that α be set equal to zero, Drs. Israel and Katz recommend that the value of α still be calculated using the relative market shares method but then that the resulting value be divided by 3.

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[26]*See*, for example, *DirecTV-News Corp. Order*, Appendix D, para. 29.

[27]See *Israel Katz Report II* at para. 15, 16 and 67.

I have three major comments on this issue. First, I think that the Commission should be very cautious about basing a major policy decision entirely on one piece of evidence provided by a party with a major interest in the outcome based on that party's own reported analysis of its own private data. This should be especially true when the evidence seems to suggest a somewhat surprising conclusion. Drs. Israel and Katz correctly point out that theirs is the only data available on the particular issue of whether or not local cable operators' subscriptions increase when a DBS provider in the area they serve loses carriage of a piece of must-have programming.[28] However, the Commission should note that no-one other than a major cable operator would be in a position to have data of this sort, and Comcast is the only large cable operator taking any active interest in this proceeding. Furthermore, I expect that Comcast almost surely keeps data on the where their new customers come from, and what proportion of them switch from a DBS provider. This data would likely show that many of Comcast's new customers are, in fact, former DBS subscribers. If this is correct, this would suggest that many DBS subscribers do view cable service as a relevant substitute for DBS. Comcast has not chosen to share any data of this sort with the Commission.

Second, there is a reverse side to this same coin. Namely, if it is true that the two DBS providers are particularly close substitutes for one another, it seems equally plausible to hypothesize that non-DBS providers might also be particularly close substitutes for one another. For example, because of their particular geographic situation, some households are not able to obtain clear reception of DBS signals. As another example, many households apparently prefer to purchase a bundle of services including broadband and telephony from a single provider, which is not possible with a DBS provider. Finally, some households may either have zoning

[28]The more commonly available type of data is the share of subscribers that leave a particular MVPD when programming is withheld from it rather than which particular MVPD the leaving customers switch to.

restrictions prohibiting the placement of a DBS satellite dish or simply view the satellite dish as being too unsightly. To the extent that non-DBS providers are particularly close substitutes, then when Comcast withheld programming from a national telco or cable overbuilder, it would be the case that Comcast would receive a larger share of switchers that the relative market share method would suggest.

Third, even if we divide my prediction of the likely fee increase by three, the predicted level of harm from the raising rivals' costs effect would still clearly swamp any possible projected benefits from the reduced double marginalization effect. Dividing the estimate of a $.95 per subscriber per month increase in programming fees by three yields a projected increase in programming fees of $.32 per subscriber per month. As I discussed above in Section II.2, if the switching rate for Comcast is 98%, the reduced double marginalization effect will reduce Comcast's own costs by only $.03 per subscriber per month. Thus the harm from the raising rivals' costs effect would still be more the 10 times as large as the benefit from the reduced double marginalization effect.

Reason #4: Empirical Analysis of Price Effects of Past Vertical Transactions

Drs. Israel and Katz conduct an empirical analysis to attempt to determine whether or not they can find any evidence that vertical integration of a network with an MPVD results in higher program fees and report that they fail to find any such effect. My own assessment of this study is that it suffers from so many defects and flaws both in design and data, that it is not useful for purposes of providing evidence on this issue. I believe that inherent limitations in data availability would make it very difficult and perhaps even impossible to conduct a study that provided good information on this issue. Therefore, I do not fault Drs. Israel and Katz for being unable to conduct such a study. My only point is that the study they have presented does not provide useful evidence.

To explain the flaws in their study I will have to begin by describing the nature of the study. Drs. Israel and Katz consider four different instances of vertical integration or disintegration. The first instance occurred in 2002, when Cablevision sold its 85% interest in Bravo. The second instance occurred in 2007, when Cox purchased the Travel Channel. The third instance occurred in 2004 when News Corp. purchased a controlling interest in DirecTV. The fourth instance occurred in 2008 when News Corp. sold its controlling interest in DirecTV. For the third and fourth instances, the five networks owned by News Corp. that Drs. Israel and Katz have pricing data for are Fox News, Fox Sports en Espanol, FX, National Geographic, and Speed. For each instance Drs. Israel and Katz have pricing data for the annual fees charged by the networks in the years both before and after the transaction occurred. They attempt to assess the impact of the integration/disintegration events on network prices. Although they do not provide great detail, they report that they attempt to control to some extent for general trends in network pricing over the relevant time periods and some other factors.

I will now make four observations about this study.

First, the instances involving Cablevsion and Cox are completely inappropriate to use for this study. This is because the networks involved are national networks and Cablevision and Cox both have extremely small subscriber shares at the national level, and, in fact, do not compete at all with the major incumbent cable operators, Comcast and Time Warner. Therefore, the raising rivals' costs theory would suggest that vertical integration of a national cable network with Cox or

Cablevision would have absolutely no effect on the fees it would charge to the other major incumbent cable operators such as Comcast and Time Warner and would also have an extremely modest effect on the fees it would charge the two DBS providers. Although Drs. Israel and Katz do not report where their pricing data came from, commonly available fee data such as that published by Kagan is normally interpreted as being data on the average fee charged for various networks weighted by the number of subscribers for which each fee is being charged. Therefore, the theory itself predicts that fee changes associated with these two events would likely be too small to detect. This is because the vast bulk of subscribers that these networks were sold to were subscribers of the major cable operators and the theory predicts no change in these fees. Furthermore, the theory predicts a relatively modest change even in the fees charged to the two DBS providers. A modest change for a small number of subscribers averaged together with no change for most subscribers would likely produce an average effect too small to measure. Therefore, it is immediately clear that two of the four instances that Drs. Israel and Katz report results for are completely inappropriate to use for their study. This leaves Drs. Israel and Katz with two events to study, the integration of News Corp. with DirecTV in 2004 and the subsequent disintegration of News Corp. with DirecTV in 2008.

My second observation relates to the validity of using the disintegration of News Corp. with DirecTV in 20008. Although Drs. Israel and Katz do not explicitly state the source of their pricing data, they do explicitly state that the most recent year for which they have pricing data is 2009 and that their data is annual.[29] This means that they have one year of data for post-transaction pricing - 2009. Furthermore, it is typically the case that programmers and MVPDs sign multi-year contracts. Therefore it may well be the case that many of the prices paid

[29]*See Israel Katz Report II* at para. 82 and 83.

in 2009 were determined by contracts signed prior to News Corp.'s spin off of DirecTV. This leaves Drs. Israel and Katz with only one event to study - the integration of News Corp. with DirecTV in 2004.

Third, even for the one event that in principle might be able to provide useful information, Drs. Israel and Katz are not clear how they deal with the issue of long term contracts that extend over the transaction date. Given that they must have interpreted 2009 data as being post transaction data to be able to include News Corp.'s 2008 sale of DirecTV in their study, it seems likely that they interpreted data in 2005 and later as being post transaction data for News Corp.'s 2004 purchase of DirecTV. Once again, to the extent that program fees were determined by longer term contracts that spanned the transaction date, we would not necessarily expect there to be much of an immediate impact.

Fourth, although I am confident that Drs. Israel and Katz were likely able to control effectively for any general trends in network prices over the period, I am much less confident that they were able to control properly for issues such as age of the network, quality changes to the network, entry or exit of networks that compete with the networks being studied, and how the networks were bundled together. In a study with a large amount of data, this may not be as important, since one might hope that some of randomness associated with uncontrolled-for events may simply average out. However, given that Drs. Israel and Katz actually have only one data point that appears to be a reasonable candidate for them to study, their inability to properly control for other factors is an extremely serious issue.

4. REGIONAL CABLE OVERBUILDERS

As I described above in Section II.1, regional cable overbuilders that compete significantly with Comcast will experience the same general magnitude of programming fee increases as will the two DBS providers and the two national telcos. When Drs. Israel and Katz calculate the dollar value of harm from the raising rivals' costs effect, they decide to only consider the programming fee increases experienced by the two DBS providers and the two national telcos. The reason they give for this decision is that, since regional cable overbuilders serve an insignificant number of subscribers on a national level, the harms that the transaction creates for regional cable overbuilders and their customers are insignificant on a national level. [30]

I have three comments to offer on this. First, I think it is important for the Commission to recognize the factual issue that regional cable overbuilders and their customers will suffer the same magnitude of competitive harm per subscriber from this transaction as will the two DBS providers and the two national telcos and their subscribers. It is certainly part of the Commission's mandate to decide how to weight various harms to various different groups and regions, but I think that it would still be important for the Commission to determine the per subscriber magnitude of the harm for various groups of subscribers before determining whether or not to ignore and of these harms.

Second, to the extent that one of the goals of the Commission is to foster the future growth of competition, it may be that the Commission would determine that competitive harm to overbuilders might be more significant than their current market shares would suggest.

Third, the competitive harm to cable overbuilders that compete with Comcast will also spill over to affect customers of Comcast in the regions where it competes with these overbuilders to the extent the competition from these overbuilders creates pressure for Comcast to lower its own prices and improve the quality of its own services.

[30] *See Israel Katz Report II*, footnote 100, page 54.

III. HORIZONTAL HARM

1. INTRODUCTION

In my initial paper, I present an economic model that explains why a sufficient condition for combined ownership of two networks (or blocks of networks) to raise programming fees is that the two networks be partial substitutes for one another in the particular sense that the value of one network to an MVPD is lower conditional on already carrying the other network. I also argue that, since MVPD subscribers likely value increases in variety at a decreasing rate, this implies that any two "must have" networks will likely have such an effect on one another's' marginal values and thus be partial substitutes for one another in the required sense. In particular, I argue that the NBC O&O's and Comcast RSNs are likely partial substitutes for one another in the particular sense defined above.[31]

Drs. Israel and Katz make five different arguments to attempt to rebut my horizontal theory of harm. In the next section I will begin by reviewing the underlying economic model that my theory of harm is based on. Then I will separately consider each of the five arguments raised by Drs. Israel and Katz.

2. THE UNDERLYING ECONOMIC MODEL

[31] I also argue that NBCU's block of popular national cable networks can be reasonably categorized as "must have" programming and, to the extent this is true, then this block of programming and Comcast's RSNs are also likely partial substitutes for one another in the particular sense defined above. For purposes of describing the disagreements between Drs. Israel and Katz and myself most clearly and simply, I will focus only on the combination of the NBC O&Os with the Comcast RSNs. However, all of the arguments I make with respect to this combination also apply to the combination of the NBCU's block of national cable networks with the Comcast RSNs.

In my initial report, I presented only a numerical example. To fully discuss some of the arguments presented by Drs. Israel and Katz, it will be useful to generalize the example by substituting parameters for the numerical values.

Suppose that an MVPD can carry two networks. Suppose that it would earn a profit of v per subscriber if it carried only one of the networks and would earn an additional profit of v- δ per subscriber if it also carried the second network where

$$0 \leq \delta \leq v \tag{III.1}$$

I will refer to v as the marginal value of carrying the first network and v- δ as the marginal value of carrying the second network. The parameter δ is a measure of substitutability between the two networks, with higher values of δ corresponding to a higher degree of substitutability between the two networks. To the extent that subscribers value increases in variety at a decreasing rate, we would generally expect any two networks to be substitutes for one another to some extent. When $\delta = 0$, we would normally refer to the networks as being "independent" and when $\delta = v$ we would normally refer to the networks as being "perfect substitutes" for one another. When δ is between these two extreme values, we would normally refer to the networks as being "partial substitutes" for one another.

To keep the example as simple as possible, assume that the programmer's cost of providing the network to the MVPD is zero so the joint gain if the MVPD carries the network is simply equal to the MVPD's profit.[32] Assume also that the MVPD and programmer have equal bargaining

[32]It is easy to see that the example described below continues to yield the same conclusion if we assume that there is a cost of delivering the programming or if the programmer earns additional advertising revenue when the MVPD shows the programming.

strength in the sense that they choose a price to evenly split the joint profit.[33]

First, suppose that two different programmers each own one of the two networks. Then, so long as the MVPD carries both networks in equilibrium, when the MVPD negotiates with either of the two programmers, the marginal profit of adding a network will be equal to $v-\delta$ per subscriber and the negotiated fee will therefore be equal to half this amount or $(v-\delta)/2$. Therefore the total fees paid for both networks will be double this amount or

$$v-\delta \tag{III.2}$$

Now suppose that the same programmer owns both networks. In this case the joint profit of adding both networks is equal to $2v-\delta$. Therefore, so long as the programmer sells both networks bundled together as a single item, the negotiated fee for the bundle will be half this amount or

$$v - \delta/2 \tag{III.3}$$

A comparison of (III.2) and (III.3) reveals that the programming fees rise by $\delta/2$ because of combined ownership. This shows that combined ownership will increase programming fees to the extent that the two networks are partial substitutes for one another and that the increase in programming fees will be larger to the extent that the degree of substitutability between the two networks grows larger.

Thus a single owner will be able to negotiate higher total fees than will two separate

[33]It is easy to see that the example described below continues to yield the same conclusion if we assume that the programmer receives some share α of the total surplus where α is between 0 and 1.

owners to the extent that the two networks are partial substitutes. The basic economic reason is simply that, when negotiations for each network occur separately, each programmer is only able to extract some share of the joint profit from adding the last network. However, when negotiations occur for a bundle of networks, the programmer is able to extract a share of the joint surplus from adding the entire bundle. So long as networks within the bundle are partial substitutes, the joint surplus from adding a bundle of both networks will be greater than twice the surplus from adding the last network.

Recall that the particular example I considered in my first report is the case where $v = \$1.00$ and $\delta = \$.50$. That is, the marginal value of the first network is equal to \$1.00 but the marginal value of the second network in only equal to half this amount, or \$.50. In this case, total programming fees are \$.50 under separate ownership and \$.75 under combined ownership. Note in particular that the fee increase due to combined ownership in this case is extremely significant even though the two networks are far from being perfect substitutes for one another. Combined ownership causes programming fees to rise from \$.50 to \$.75 which is a 50% increase. This illustrates a very important point that I will return to below. Namely, if the parameter δ is large, combined ownership of two networks will result in large increases in programming fees even if the networks are far from being perfect substitutes. To put this another way, it is NOT necessary for two networks to be perfect substitutes or to even be close to being perfect substitutes in order for combined ownership of the networks to significantly increase programming fees. Combined ownership of two networks may result in significant increases in programming fees even if the two networks are only partial substitutes. Combined ownership will have a large dollar impact on programming fees to the extent that the carriage of one network has a large dollar impact on the marginal value of carriage of the other network. There is absolutely no need for the two networks to be perfect substitutes in order for combined ownership to have a significant effect on programming fees.

3. DIFFERENT TYPES OF PROGRAMMING

Drs. Israel and Katz observe that local broadcast stations carry programming that, in at least some respects, is clearly quite different than the programming carried by RSNs.[34] They also note that the Commission itself has observed exactly the same thing.[35] They assert that the fact that these two different types of networks carry different types of programming should be viewed as evidence that these two types of networks are not partial substitutes for one another.

While I agree that local broadcast stations and RSNs carry different types of programming, I completely reject the assertion that this somehow implies that these two types of networks cannot be partial substitutes for one another. To the extent that substitutability between networks is caused simply by the fact that subscribers value increases in variety at a decreasing rate, it is perfectly possible and reasonable that two very different types of networks could be partial substitutes for one another in the sense that the value of adding one of the two networks decreases conditional on the other network already being carried.

Consider the numerical example I described in the previous section where the marginal value of carrying the first network is $1.00 and the marginal value of carrying the second network is $.50. It is perfectly reasonable to interpret this example as corresponding to the case where the two networks carry different types of programming. Suppose, for example that one of the

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[34] *See Israel Katz Report II* at para. 111.

[35] *See Israel Katz Report II* at para. 104.

networks is a movie network and one is a sports network. Suppose all subscribers are identical and like to watch some sports and some movies. It is perfectly reasonable and plausible to hypothesize that subscribers would be willing to pay an extra dollar to add either a movie or sports channel but, once one of the two had been added and they had more variety to choose from, that they would only be willing to pay an additional $.50 to add the second network.

4. PERFECT SUBSTITUTES

In addition to noting that the Commission has observed that local broadcast stations carry different types of programming than RSNs, Drs. Israel and Katz also quote the Commission as having noted that the "unique nature" of regional sports programming means that there are "no adequate substitutes" for this type of programming.[36] As I understand the argument of Drs. Israel and Katz, they would like us to conclude that the Commission's statement that there are "no adequate substitutes" for RSNs should be interpreted as meaning that the Commission is stating that local broadcast stations and RSNs cannot be partial substitutes for one another in the sense necessary for combined ownership to result in increased program fees. I completely disagree with this interpretation. The straightforward interpretation of the Commission's statement is that it is observing that there are no perfect substitutes or even near-perfect substitutes for RSNs. I have already explained why my theory of harm does NOT require networks to be perfect substitutes in order for combined ownership to result in increased program fees. It is sufficient that the networks be partial substitutes in order for my theory to apply.

5. DEMOGRAPHIC DIFFERENCES IN VIEWERS

[36]*See Israel Katz Report II* at para. 104 citing the *DirecTV-News Corp. Order* at para. 59-60.

Drs. Israel and Katz report that there are some demographic differences between viewers of local broadcast stations and viewers. In particular they note that RSNs tend to attract an audience that is somewhat more male and younger than the audience for local broadcast stations. They assert that these differences imply that the two types of networks cannot be partial substitutes for one another. Once again, it is not clear why the fact that two networks have somewhat different demographic profiles would necessarily imply that they cannot be partial substitutes for one another. First, even if the demographics of the networks are not identical, it may well still be the case that a large majority of individuals watch both types of networks. So long as most individuals watch both types of networks, it would be possible for most individuals to view the networks as partial substitutes. Furthermore, many households consist of multiple individuals with different demographic characteristics. Therefore even if not all individuals in a household watch both types of networks, it may well be that a much larger percentage of households watch both types of networks. Therefore households may view two networks as being partial substitutes even if individuals within the household do not. Of course, it is the entire household that must make the decision of what MVPD to subscribe to.

5. CONCENTRATION RATIOS

Drs. Israel and Katz define the concentration ratio for a programmer to be the share of total viewing hours that households devote to all networks produced by the programmer. They calculate concentration ratios for NBCU and Comcast prior to the transaction and the concentration ratio for the joint venture after the transaction and note that all of these concentration ratios are relatively low compared to the levels of concentration ratios that antitrust authorities would traditionally view as creating market power. As I understand their argument, they suggest that this provides evidence that neither NBCU, Comcast, nor the joint venture have market power over any programming and that no horizontal theory of harm could therefore be true. This completely ignores the Commission's own determination that calculating concentration ratios in this manner is not the correct way to assess the extent of market power in programming markets. In particular, Commission has repeatedly concluded that RSNs and local broadcast networks both create significant amounts of market power. [37]

6. EMPIRICAL ANALYSIS

In my initial report I described some empirical evidence that suggests that joint ownership or control of multiple Big 4 local broadcast stations in the same DMA results in higher retransmission consent fees. While this does not provide any direct evidence on the issue of whether combined ownership of an RSN and local broadcast station will result in increased programming fees, it does provide evidence on the somewhat more general point that combined control of multiple must have networks can result in higher programming fees. However, I certainly agree that the most direct evidence on my theory of horizontal harm as it applies to the combination of NBC O&Os and Comcast RSNs would be evidence on whether combined ownership of an RSN and local broadcast station results in increased programming fees, holding

[37] For example, in its evaluation of the DirecTV-News Corp. transaction, the Commission concluded that "News Corp. currently possesses significant market power in the DMAs in which it has the ability to negotiate retransmission consent agreements on behalf of local broadcast stations" and justified this conclusion in part by observing that "carriage of local television broadcast stations is critical to MVPD offerings." (*See DirecTV-News Corp. Order* at para. 201-202). It similarly concluded that "News Corp. currently possesses significant market power with respect to its RSNs within each of their specific geographic regions" (*See Adelphia-Time Warner-Comcast Order* at para. 147) based on similar observations.

all other factors constant. In my initial report I stated that no such evidence was available and that the evidence I presented on the effect of combined ownership or control of multiple Big 4 local broadcast stations in the same DMA was therefore the best available evidence.

There is, of course, some data that is potentially available on the issue of how combined ownership of an RSN and local broadcaster in the same region affects programming fees. This is because News Corp. owns a large number of Fox local broadcast stations and RSNs and has purchased and sold various Fox local broadcast stations and RSNs over the last decade. Consider any particular RSN. If News Corp. owns the RSN and also owns a Fox local broadcast station that operates in at least part of the region served by the RSN, I will say that the RSN is under "combined ownership." If Fox does not own the RSN or if Fox does own the RSN but does not own a Fox local broadcast station that overlaps with the RSN, I will say that the RSN is not under combined ownership. When News Corp. purchases or sells an RSN, it is possible that the transaction will affect the combined ownership status of the RSN. Similarly if News Corp. purchases or sells a Fox local broadcast station, it is possible that the transaction will affect the combined ownership status of RSNs owned by News Corp. that operate in the DMA served by the Fox local broadcast station. Therefore, if one were able to identify transactions that changed the combined ownership status of particular RSNs and gather fee data for each RSN for a period both before and after the transaction, it would in principle be possible to attempt to determine how the transaction affected programming fees. Drs. Israel and Katz conduct a study of this sort.

To the best of my knowledge, at the time that I wrote my initial report, no one had attempted to conduct such an exercise, and for good reason. Because of limitations in the amount and type of data available and the inherent impossibility of controlling for other factors that might affect RSN fees, it would be impossible or at least very difficult to draw any meaningful or useful conclusions from such a study. The two main, related problems are that: (1) there is only a handful of such events; and, (2) RSN fees can be dramatically affected by a variety of events that are difficult to control for. In particular, changes in which sports teams are carried by a particular RSN can dramatically change the attractiveness of an RSN to subscribers overnight. A compounding factor in this particular type of study is that many of the events involve a change in ownership of the RSN itself. When the ownership of an RSN changes, it is reasonable to expect that there may be large changes in the fees charged by the RSN, simply because the new management has a different type of strategy or management style or because changes in ownership are associated with changes in the teams carried by the RSN or changes in other important factors that might affect fees. Thus, a change in ownership of an RSN is inherently an event that we would expect to have potentially large and unpredictable effects on the RSN's pricing quite independent of any issue associated with combined ownership. If there were a very large number of such events, perhaps we could hope that these difficult-to-control-for variables would average out. However, when there is only a handful of such events to begin with, and there are inherently so many other factors that could affect RSN fees that are likely to be changing at the same time, an empirical analysis that simply ignores all of these issues would not be able to provide any useful information about the effect of combined ownership on RSN fees.

To be more specific about the flaws with the empirical analysis undertaken by Drs. Israel and Katz, it will be necessary for me to describe the data they consider in somewhat more detail. Drs. Israel and Katz have annual fee data on all RSNs for the period 1999-2009. Define a "transaction" to be an RSN/year pair where the combined ownership status of the RSN changed in the given year. As I understand their procedure, Drs. Israel and Katz made the judgment that having one year of data on each side of the transaction was sufficient to allow them to investigate for the presence or absence of pricing effects. Therefore, as I understand their procedure, Drs. Israel and Katz considered all transactions in the years 2000-2008.[38] Based on my interpretation of Table V.5 in *Israel Katz Report II*, it appears that Drs. Israel and Katz were able to identify eleven transactions to investigate. I list all of these transactions below in Table III.1 and describe the nature of each transaction.

[38]This guarantees that there will be at least one year of data before the event and at least one year of data after the event.

TABLE III.1
A LIST OF ALL TRANSACTIONS CONSIDERED BY DRS. ISRAEL AND KATZ IN THEIR EMPIRICAL ANALYSIS OF THE EFFECT OF COMBINED OWNERSHIP ON PROGRAM FEES

RSN*	DATE	DESCRIPTION OF THE TRANSACTION**
FSRM	2008	News Corp. sold a Fox station in the RSN’s region
FSM	2008	News Corp. sold a Fox station in the RSN’s region
FSU	2008	News Corp. sold a Fox O&O in the RSN’s region
FSM	2008	News Corp. sold a Fox O&O in the RSN’s region
FSW	2008	News Corp. sold a Fox O&O in the RSN’s region
FSO	2008	News Corp. sold a Fox O&O in the RSN’s region
SS	2006	News Corp. purchased the RSN; a Fox O&O
FSF	2005	News Corp. purchased the RSN and already owned a Fox station
FSO	2005	News Corp. purchased the RSN and already owned a Fox station
FSW	2001	News Corp. purchased the RSN and already owned a Fox station
FSN	2001	News Corp. purchased the RSN and already owned a Fox station

* The following abbreviations are used for RSNs.

FSRM	=	Fox Sports Rocky Mountain
FSM	=	Fox Sports Midwest
FSU	=	Fox Sports Utah
FSW	=	Fox Sports Wisconsin
FSN	=	Fox Sports North
FSO	=	Fox Sports Ohio
FSF	=	Fox Sports Florida
SS	=	Sports South

** “News Corp. sold a Fox station in the RSN’s region” means “Before the transaction, News Corp. owned the RSN and a Fox local broadcast station serving the RSN’s region. The transaction is that News Corp. sold the Fox station.”

“News Corp. purchased the RSN and already owned a Fox station” means “Before the transaction, News Corp. did not own the RSN but did own a Fox station that operated in the RSN’s region. The transaction is that News. Corp. purchased the RSN.”

The first thing to notice about this list of transactions is that six of the eleven listed transactions all occurred in 2008 when News Corp. sold a number of Fox O&Os. Since Drs. Israel and Katz have annual fee data from 1999-2009, this means that they only have one post-transaction year of data for RSN fees for these six transactions. Furthermore, it is typically the case that programmers and MVPDs sign multi-year agreements. Therefore it may well be the case that many of the RSN fees paid in 2009 were determined by contracts signed prior to News Corp.'s sale of the Fox affiliates. Therefore, in my judgment, these six transactions should not be included in the study. This leaves Drs. Israel and Katz with only five transactions.

Examination of these five transactions shows that all of them involve News Corp. purchasing the RSN. As I stated above, the inherent problem with looking at RSN fee data around the time of an ownership change is that we might expect there to be large changes in the RSN's fee structure at this point due to changes in ownership that are completely unrelated to any combined ownership effect. For example, just prior to News Corp. purchasing Turner South in 2006 from Turner Broadcasting, the network showed a variety of regionally-oriented programming and, in particular, did not restrict itself to showing only sports programming. However, after purchasing the network, News Corp. changed the network's name to SportSouth and changed its focus so that it exclusively showed regional sports programming.[39] This transformation in programming focus may well have resulted in significant changes in program fees quite unrelated to the combined ownership effect.

Finally, recall that another general problem I identified above is that RSN program fees can change dramatically and unpredictably due to changes in the sports teams that the network carries. If a team change occurs at the same time as an ownership change, it would be critical to control for

[39] *See* Mike Reynolds, "Network Reclaims Old Name," Multichannel News, October 7, 2008.

the team change. Drs. Israel and Katz make no attempt of any sort to control for changes in the teams that RSNs carry. In particular, note that one event that Drs. Israel and Katz include in their analysis is News Corp.'s acquisition of a controlling interest in Fox Sports Ohio in 2005. They attribute any subsequent changes in Fox Sports Ohio's fees to this change in ownership. However, during this same year Fox Sports Ohio experienced a major team loss, as reported in a declaration of the President of Massillon Cable TV that is another MVPD that operates in this area and carries Fox Sports Ohio.

> "In 2005, Massillon had an agreement with Fox Cable Networks, Inc. ("Fox") to carry Fox Sports Net Ohio ("FSNO"). The vast bulk of 'marquee' live sporting events carried on FSNO - more than two-thirds (2/3) of the professional sports content – was Cleveland Indians baseball games. On December 26, 2005, the Cleveland Indians announced that its was creating its own regional sports network, Sports Time Ohio, and moving all of its games from FSNO."[40]

This event may well have significantly reduced the level of program fees that Fox Sports Ohio was able to charge. Thus, even if the effect of combined ownership in 2005 was to raise programming fees, the loss of the Cleveland Indians may well have caused an even larger reduction in program fees. Thus it is certainly possible that the net effect on Fox Sports Ohio's fees from all of the events of 2005 was to reduce its program fees. Drs. Israel and Katz would interpret this as suggesting that combined ownership can reduce program fees. I think it would be more correct to interpret this an example of a uncontrolled-for events that invalidates their analysis.

Therefore, of the five remaining transactions that might in principle be reasonable events

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[40]*Declaration of Robert Gessner*, Attached to *Reply Comments of the American Cable Association, In the Matter of Comcast Corporation, General Electric Company, and NBC Universal, Inc. To Assign and Transfer Control of FCC Licenses, MB Docket No. 10-56,* August 19, 2010 ("*Gessner Declaration"*) at para. 4.

for Drs. Israel and Katz to study, my own very limited search for uncontrolled for events has revealed that for at least two of the transactions, there were uncontrolled for events that likely had a significant effect on pricing. My search for uncontrolled for events was not exhaustive or complete. It is very possible that uncontrolled for events also occurred along with the other three transactions. Therefore I would view even these three remaining transactions as being suspect. Therefore, at best Drs. Israel and Katz are left with three suspect transactions to analyze.

In summary then, although Drs. Israel and Katz have conducted an empirical study that attempts to measure the effect of combined ownership of an RSN and local broadcaster serving the same region on program fees, there are simply too many flaws with the study and the data for these results to provide any useful information on the issue they claim to be studying. Therefore, the evidence I report on the effect of combined ownership of multiple Big 4 broadcasters in the same DMA on retransmission consent prices is still the best available evidence on this issue. While not directly addressing the issue of whether combined ownership of an RSN and local broadcast station in the same region will raise programming fees, it provides evidence on the more general point that combined ownership of multiple must have networks can result in higher programming fees.

IV. REMEDIES

1. INTRODUCTION

With my advice, the ACA has constructed a set of conditions that I believe would substantially address both the vertical and horizontal harms of the transaction that I have identified, while still allowing the transaction to proceed. A statement of the proposed ACA conditions is included in an attachment to the ACA reply comments.[41] In this section I will begin by briefly reviewing two important points relevant to the issue of conditions that I discussed in my initial paper. Then, I will describe the ACA conditions and explain why they will address the vertical and horizontal harms created by this transaction, both for larger MVPDs and their customers and for smaller MVPDs and their customers.

2. PROGRAM ACCESS RULES

Program access rules are in a general sense intended to prevent vertically integrated programmers from discriminating against unaffiliated MVPDs. Although they do not apply to retransmission consent agreements and it is not clear whether they apply to on-line programming, it would certainly be possible to extend their application to these types of programming as a condition of approving the transaction. Therefore, two natural first questions to consider are: (1) whether it would make sense to extend the application of program access rules to these types of programming as a condition of the transaction; and, (ii) whether this simple condition would be sufficient to address the vertical harm created by the transaction.

In my initial report, I described two significant problems with program access rules over and above the fact that they do not apply to some types of programming. The first problem is the "quantity discounts loophole." This problem occurs because program access rules have been interpreted as allowing a vertically integrated MVPD significant freedom to charge competing MVPDs higher rates for programming than it charges itself, so long as the competing MVPDs

[41] *See* "ACA's Proposed Comcast-NBCU License Transfer Conditions," Attachment C in *ACA Reply Comments, In the Matter of Applications of Comcast Corporation, General Electric Company, and NBC Universal, Inc., to Assign and Transfer Control of FCC Licenses,* MB Docket No. 10-56, August 19, 2010("*ACA Reply Comments")*

have a smaller number of subscribers than the vertically integrated MVPD. Since Comcast is the nation's largest MVPD, this means that program access rules would be particularly ineffectual in limiting the extent to which Comcast-NBCU will be able to discriminate against its rivals. The second problem is the "arbitrary transfer prices" problem. This problem occurs because vertically integrated firms who wish to charge high discriminatory prices to rival MVPDs may be able to do so without violating program access rules simply by raising the internal transfer price they charge themselves to the same high level and then instructing their downstream divisions to continue to purchase the integrated programming at artificially high internal transfer prices.

I believe that even given these problems, program access rules may have some impact on limiting the extent to which vertically integrated firms can discriminate against rival MVPDs. Furthermore, the non-exclusivity provisions of program access rules play the desirable role of preventing vertically integrated firms from simply announcing that they will not sell their programming to rival MVPDs at any price. Therefore, I believe that it would be desirable for the Commission to impose conditions on this transaction that require Comcast-NBCU's retransmission consent agreements and its carriage agreements for online programming to both be subject to the nondiscrimination requirements and non-exclusivity requirements of program access rules. However, these conditions alone will clearly not be sufficient to fully remedy the vertical harms of this transaction.

3. BINDING ARBITRATION

In previous transactions with vertical harms, such as the DirecTV-News Corp. and Adelphia-Time Warner-Comcast transactions, one remedy used by the Commission has been to give parties that purchase certain classes of programming from the combined entity the right to ask for binding baseball-style arbitration with mandatory interim carriage in the event that a dispute over program fees cannot be resolved. The purpose of the arbitration is to determine a fair market value for the programming in question. In this report I will refer to this arbitration process as the "regular arbitration process" to distinguish it from another arbitration process which the ACA conditions would also implement which I will refer to as the "special arbitration process for smaller MVPDs." The important point that I wish to make in this section of my report is that the regular arbitration process has turned out to be unaffordable for smaller MVPDs. I believe that making the regular arbitration process available to MVPDs would be a very reasonable condition for the Commission to consider in order to help protect larger MVPDs and their customers from the competitive harms of this transaction. However, the fact that it is not affordable for smaller MVPDs means that additional conditions still need to be adopted to protect smaller MVPDs and their customers.

The essential economic issue is that the costs of engaging in an arbitration are relatively fixed regardless of the number of subscribers that an MVPD has. However, the potential benefits of engaging in an arbitration - lower programming fees - are of course directly proportional to the number of subscribers that an MVPD has. Therefore, incurring the cost of engaging in a full-blown arbitration proceeding becomes progressively less attractive to an MVPD as its subscribership decreases.

For purposes of designing an appropriate set of conditions, the Commission will have to determine of the level of MVPD subscribership below which this type of arbitration becomes unaffordable. The key parameter in such a calculation is of course the total cost of engaging in such an arbitration. In my initial report, I noted that Colleen Abdoulah, the CEO of the cable system operator WOW! has testified that, when her company was faced with the decision of whether to undertake such an arbitration, it determined that the likely cost would exceed $1 million and that this estimate did not include the cost of the time that WOW!'s own management and employees would need to devote to the arbitration.[42] Since I wrote my original report, a declaration by Robert Gessner, President of Massillon Cable TV, Inc. has been filed with the Commission in which he describes his actual experience when he attempted to use the arbitration process to settle a dispute with Fox Cable Networks, Inc. He reports that his actual arbitration costs were approximately $1 million and that this cost estimate does not include the cost of the time that Massillon's own management and employees devoted to this issue.[43] Based on this evidence, I conclude that $1 million dollars is a reasonable estimate of the cost of participating in such an arbitration and may actually be somewhat conservative in the sense that it does not include

[42] "The FCC sought to tighten these loopholes in subsequent transactions between content providers and distributors, for instance, by permitting complainants to use third-party arbitration or collectively bargain for rights. But, here again, programmers affiliated with larger cable operators quickly found how to beat the system. WOW! considered using the arbitration process imposed on Comcast in the Adelphia decision but determined the cost of the process was likely to exceed $1 million, take one year or longer, and require key personnel to take large amounts of time from their regular jobs. In other words, the costs of using arbitration were going to be close enough to the extra price Comcast was going to charge us in the first place. Instead, we had no choice but to "eat" an enormous rate increase to carry Comcast's RSN. In effect, the program access process has essentially given us a right without a remedy. It would be a grave error to buy into the contention of Comcast and NBC Universal that these processes constitute a legitimate backstop for anticompetitive harms arising from the deal." *See Testimony of Colleen Abdoulah, President and CEO, WOW! Board Member ACA Before the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights,* February 4, 2010 at page 8.

[43]"When all costs of arbitration are considered, Massillon spent approximately $1,000,000 from the date of the arbitration request (October 2006) through the present day. The amount does not include the considerable out-of-pocket costs (including travel expenses) incurred by Massillon and substantial time and resources spent by Massillon management and employees to participate in the dispute and arbitration process." *See Gessner Declaration* at para. 15.

the cost of the time that an MVPD's own management and employees would need to devote to the arbitration.

I will now suggest one possible approach that the Commission could use to determine the level of MVPD subscribership below which this type of arbitration becomes unaffordable. In particular, I will describe a set of payoffs that could be interpreted as describing a "reasonably strong" case for which the Commission would hope that arbitration would be a feasible alternative for an MVPD and calculate the level of subscribership for an MVPD at which the MVPD would view the expected benefits of the arbitration as being exactly equal to the costs. This would mean that an MVPD with any lower level of subscribership would be unwilling to engage in arbitration.

Suppose that Comcast-NBCU is raising the fee for a particular network above its fair market value by $.50 per subscriber per month.[44] Suppose that an MVPD believes that it has a 50% chance of winning an arbitration case on this issue, which would result in a fee decrease of $.50 per subscriber per month over the life of the contract. I will assume that the contract lasts 3 years (36 months) and that the MVPD uses a cost of capital of 10%. Straightforward calculation shows that the expected discounted gain to the MVPD from engaging in an arbitration is then equal to $7.80 per subscriber.[45] If the MVPD has s subscribers then its expected net benefit to participating in the arbitration is given by

$$7.80\, s \quad - 1{,}000{,}000 \qquad \text{(IV.1)}$$

[44]Recall that this is the approximate amount that I predict retransmission consent fees will rise by due to the vertical aspect of the transaction in the six DMAs with an NBC O&O where Comcast has a substantial presence as a cable provider.

[45]The present discounted value of $1 per month for 36 months using an annual interest rate of 10% is $31.20. Therefore the present discounted value of the expected fee increase from arbitration is equal to ½ x $.50 x 31.20 or $7.80.

The first term of Equation (IV.1) is the expected benefit from winning the arbitration and the second term is the cost of the arbitration. Let s* denote the level of subscribership at which the MVPD would just break even from participating in the arbitration. It is given by

$$s^* = 1{,}000{,}000/7.80 = 128{,}205. \qquad \text{(IV.2)}$$

Based on this calculation, it therefore appears that an MVPD with fewer than approximately 125,000 subscribers for any particular piece of programming would not find it affordable to enter into arbitration even when it had a reasonably strong case.

4. THE ACA CONDITIONS

In this section I will describe the conditions being suggested by the ACA and explain why they would substantially address the competitive harms of the transaction that I have identified for both large MVPDs as well as smaller MVPDs.[46] The set of conditions that the ACA is proposing can be divided into five main groups. I will consider each group of conditions separately and explain the economic role that each group plays in remedying the harms of the transaction. The section numbers in parentheses in each sub-title below refer to the numbering used in the formal statement of the conditions.

[46]Recall that a complete statement of the ACA proposed conditions is contained in attachment C to the *ACA Reply Comments*.

Program Access Conditions (Section II.A)

This group of conditions simply extends the applicability of the non-discrimination and non-exclusion requirements of program access rules to apply to Comcast-NBCU's retransmission consent agreements and its carriage agreements for online programming. As discussed above, while these conditions will likely place some additional restraint on Comcast-NBCU's ability to disadvantage rival MVPDs, they will clearly not be sufficient to fully address the problem.

The Regular Arbitration Process (Section II.C)

This condition allows MPVDs purchasing programming from Comcast-NBCU to request baseball-style binding arbitration and is the type of condition that the Commission used to remedy vertical competitive harms in both the DirecTV-News Corp. and Adelphia-Time Warner-Comcast transactions. As I noted above, I will refer to this type of arbitrations process as the "regular arbitration process" to distinguish it from another type of arbitration process which the ACA conditions also implement (and which will be described below) which will I will call the "special arbitration process for smaller MVPDs."

An important point to note about the regular arbitration process in the context of the Comcast-NBCU transaction is that it can remedy both the vertical and horizontal competitive harms of the transaction. That is, to the extent that the arbitration process allows MVPDs to obtain programming from Comcast-NBCU at fair market value, it will prevent Comcast-NBCU from charging fees higher than fair market value regardless of whether the problem originates with the horizontal or vertical aspect of the transaction. The fact that the condition remedies both vertical and horizontal competitive harms is one of the rationales for applying it to all types of

Comcast-NBCU programming and not just to programming that was owned by NBCU prior to the transaction. In particular, it provides a rationale for applying the binding arbitration condition to Comcast RSNs.

Note that the ACA condition makes binding arbitration available for MVPDs purchasing any type of programming from Comcast-NBCU, including NBC O&Os, Comcast RSNs, and national cable networks. In past transactions the Commission has limited the availability of binding arbitration to carriage agreements for local broadcast stations and RSNs. I argued in my initial report that the block of popular NBCU national cable networks has ratings as high or higher than most of the Big 4 broadcast networks and that it is plausible that withdrawal of this block of programming might have as large an effect on an MVPDs subscribership as withdrawal of the signal of an NBC O&O or RSN.[47] To the extent that this is true, the rationale for making the binding arbitration remedy available to MVPDs that purchase carriage of NBC O&Os or RSNs applies equally well to MVPDs that purchase carriage of national cable networks.

As I explained above, the main problem with this type of condition is that smaller MVPDs have found this type of arbitration to be unaffordable. Thus, while it may remedy the harms of the transaction for larger MVPDs and their customers, it provides little relief for smaller MVPDs and their customers. The remaining conditions are largely focused on providing the same relief for smaller MVPDs that the regular arbitration process will provide for larger MVPDs.

Stand-Alone Agreements for NBC O&Os and Comcast RSNs (Section II.B)

This group of conditions requires that when Comcast-NBCU enters into carriage agreements for NBC O&Os or RSNs with any MVPD, that it sign a separate agreement for each

[47] *See Rogerson Report I* at pages 9-10.

NBC O&O and a separate agreement for each RSN.

The purpose of this group of conditions is to dramatically increase the transparency of Comcast-NBCUs pricing arrangements for its RSNs and NBC O&Os in order to reduce the cost of arbitration over the pricing of these types of programming. When multiple different types of programming are bundled together in a single carriage agreement, there is no simple way to determine the rate that each individual item of programming is being sold for. Thus the issue of determining the fair market value of any particular type of programming becomes much more difficult and complex. The fact that Comcast-NBCU will be required to use stand-alone agreements for carriage of each of its NBC O&Os and RSNs means that the it will be relatively straightforward for an arbitrator to determine the rates that Comcast charges other MVPDs for NBC O&Os and RSNs. Of course a complete determination of fair market value may still require consideration of the rates that other programmers charge for similar type of programming as well as factors such as the advertising revenue that the programming generates. Thus the determination of fair market value in the regular arbitration process may still be somewhat complex and costly. However, even a moderate reduction in the cost of the regular arbitration process would be of benefit. Furthermore, as will be described below, the increased transparency of Comcast-NBCUs pricing for carriage of NBC O&Os and RSNS will have an even more dramatic effect on reducing the costs of the new special arbitration process for smaller MVPDs.

Special Rules for Smaller MVPDs (Sections III.A and III.B)

This group of conditions requires that Comcast-NBCU make carriage of its NBC O&Os and RSNs available to smaller MVPDs at rates no more than 5% higher than the best rates that

Comcast-NBCU offers any MVPD. The purpose of this group of conditions is to provide smaller MVPDs with the same protection from programming fee increases for carriage of NBC O&Os and RSNs that larger MVPDs will receive from the regular arbitration process already described above. A special commercial arbitration process for smaller MVPDs is established that allows an MVPD to file a complaint if it believes this condition is not being met. If an MVPD files a complaint, Comcast-NBCU will be obliged to formally make the MVPD a final offer and to provide an arbitrator with both the final offer and with access to all of its contracts so that the arbitrator can make an independent interpretation of whether the rate in the final offer is no more than 5% higher than the best rate that Comcast-NBCU offers any MVPD for the programming in question. If the offer meets the condition, this becomes the carriage agreement. If it does not meet the condition, the arbitrator adjusts the rate appropriately so that the condition is met and then this adjusted offer becomes the carriage agreement.

The key point to notice is that, because of the conditions described above that require stand-alone contracting for NBC O&Os and RSNs, the arbitration process required to determine whether the 5% condition is being met will be extremely simple and therefore very inexpensive. In particular, it should be affordable my most smaller MVPDs. Since the stand-alone contracting condition already will result in a completely transparent price for each carriage agreement that Comcast-NBCU signs for NBC O&Os and RSNs, and the arbitrator will have access to all of these contracts, the only issue of any substance to deal with will be that the particular terms and conditions under which carriage of a given NBC O&O or RSN is provided may vary somewhat from MVPD to MVPD. However, it is a standard commercial practice in the programming industry, for purposes of enforcing MFN agreements, to calculate dollar equivalents for variations in terms and conditions. Such calculations produce a so-called "Net Effective Rate" for each contract that provides the effective rate corrected for differences in terms and conditions. The condition instructs the arbitrator to follow this standard commercial practice. Namely the arbitrator is instructed to deal with variations in terms and conditions by calculating the net effective rate of each agreement and then simply checking if the net effective rate being offered to the MVPD no more than 5% higher than the lowest net effective rate received by any MVPD for the programming in question.

Three additional points to note about this group of conditions are as follows.

First, the provision that rates for smaller MVPDs may be 5% higher than the best rates that Comcast-NBCU offers any MVPD is meant to allow for the fact that there may be some cost savings associated with contracting with larger MVPDs in the sense that the fixed cost of contracting can be spread over a larger number of subscribers. I believe that 5% is likely a very generous over-estimate of the extent to which programmers' per subscriber costs of dealing with smaller MVPDs are higher than their per subscriber costs of dealing with larger MVPDs. In the course of reviewing this transaction, the Commission may consider assessing for itself the magnitude of such cost differences and use this to determine the appropriate percentage.

Second, the rationale for defining "smaller MVPDs" as being MVPDs with 125,000 or less subscribers for the programming in question was developed in Section IV.3 above.

Third, note that the arbitration process is this case is not baseball-style arbitration where both parties make offers and the arbitrator selects the offer that most closely meets the condition specified in the arbitration rules. Instead, only Comcast-NBCU makes a final offer and then the arbitrator directly determines if this offer meets the 5% condition or not.[48] The rationale for using

[48]Under baseball-style arbitration, both Comcast-NBCU and the MVPD would make final offers

this simpler type of arbitration is that, since Comcast-NBCU and the arbitrator will both have access to all of Comcast's contracts and the MVPD will not, Comcast-NBCU and the arbitrator will both have vastly superior information about the value of the correct rate than will the MVPD. Furthermore under the specified arbitration process Comcast-NBCU will know that it has to choose a rate that meets the 5% condition because the arbitrator will find it very easy to determine if the condition is met. Therefore there will be no need (or advantage) to try to involve the MVPD in a more active way. That is, the arbitrator is the appropriate actor to discipline Comcast-NBCU because it will have access to the same information that Comcast-NBCU has access to and it will be simple and inexpensive for the arbitrator to directly determine if the 5% condition is met.

Special Rules for Bargaining Agents (Section III.C)

The previous group of conditions is designed to protect smaller MVPDs from programming fee increases for carriage of NBC O&O's and Comcast RSNs due to the transaction. This group of conditions is designed to provide smaller MVPDs with protection from programming fee increases for national cable networks due to the transaction. This turns out to be a simpler problem to address because of the fact that the National Cable Television Cooperative (NCTC) already acts as a bargaining agent on behalf of most smaller MVPDs and collectively represents all of them in negotiations over fees for national cable networks.

The manner in which the NCTC negotiates agreements on behalf of its members is as follows. The NCTC begins by negotiating the terms and conditions of a carriage agreement for a particular network or group of networks with a programmer. At the time the agreement is

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and the arbitrator would choose the offer that is closest to being 5% higher than the best rate that Comcast-NBCU offers any MVPD for the programming in question.

negotiated, the NCTC has no authority to commit any of its members to accept the agreement. Rather, after the agreement is negotiated, members of the NCTC have the option to opt into the agreement if they wish. In the terms of the formal language of the ACA conditions, the NCTC is a bargaining agent whose members "are not bound by the prices, terms, and conditions entered into by the bargaining agent."[49]

It is generally the case in the programming industry that, holding all other factors constant, that an entity purchasing carriage rights for programming will be able to negotiate a lower per subscriber programming fee as the number of subscribers it is purchasing programming for increases. The main purpose of the NCTC is to attempt to obtain lower rates for its members by collectively negotiating on their behalf. Programmers and the NCTC deal with the fact that the NCTC is not able to commit its members in advance by negotiating different rates depending on the actual number of subscribers that end up receiving the programming under the agreement. Higher numbers of subscribers generally result in lower per subscriber rates. I will refer to a rate schedule that specifies the actual per subscriber rate that will be paid as a function of the total number of subscribers that actually end up being served under the agreement as a "conditional rate schedule."

This group of conditions takes two different approaches to strengthening the NCTC's ability to negotiate better programming fees on behalf of its members. The first approach, described by the conditions listed in Section III.C.1, is to more clearly require Comcast-NBCU to allow NCTC to negotiate contracts on behalf of all of its members, including its largest members. In particular, programmers sometimes inform the NCTC that some of its members will not be

[49]*See ACA's Proposed Comcast-NBCU License Transfer Conditions*, Appendix B of this report, Sections III.C. 1.b and III.C.2.a.

eligible to opt into particular agreements. Other programmers simply refuse to negotiate conditional rate schedules for large subscriber levels corresponding to the case where most NCTC members, including its largest members, opt into a deal. Finally, it may be that some programmers pressure particular MVPDs that are members of the NCTC to agree to separate carriage agreements that contain the provision that they are not able to opt into deals negotiated by the NCTC even if these deals contain better terms. The conditions in Section III.C,1 prohibit these types of behaviors. In a sense these are relatively weak conditions, since nothing would prevent a programmer subject to them from simply announcing a rate schedule that specifies the same high rate regardless of the total number of subscribers that end up being covered by agreement. Similarly, nothing would prevent larger NCTC members from accepting individual programming agreements that committed them not to opt into NCTC deals so long as they found these deals more attractive than deals that did not require this commitment. However, based on my discussions with NCTC staff and with other industry participants, there is a general belief that requiring Comcast-NBCU to agree to these "good faith" conditions might well result in NCTC being able to negotiate deals that more of its members would opt into and that result in all of them paying lower programming fees. I certainly see no harm in the Commission adopting this type of condition. At minimum, it might provide useful information on the efficacy of this type of "good faith" condition that could inform the Commission's decision-making in future transactions that it considers.

The second approach, described in Section III.C.2 of the conditions, provides a much more tangible mechanism that will increase the ability of the NCTC to achieve lower program rates more commensurate with the aggregate subscribership of its members. This approach gives

NCTC the same rights as any individual MVPD to request that the regular binding arbitration process be used to determine the fair market value for programming. Furthermore the binding arbitration process is used to determine an entire conditional rate schedule over the entire range of subscribership levels that the NCTCs membership could provide.[50] The condition instructs the arbitrator that the fair market value of the programming at any subscribership level is defined to be the fair market value of the programming for an MVPD with this number of subscribers.

By allowing smaller MVPDs to collectively engage in a single arbitration to determine a fee that they all pay, this approach completely finesses the problem that individual smaller MVPDs are not able to afford the arbitration process. Thus, through this approach, the regular arbitration process would essentially become available to smaller MVPDs for the case of national cable networks.

V. CONCLUSION

In my initial report (*Rogerson Report I*), I described and estimated the magnitude of two significant competitive harms that will result from this transaction. The Applicants for this transaction subsequently submitted an economic report by Drs. Mark Israel and Michael L. Katz (*Israel Katz Report II*) meant to refute the analysis in my initial report. In this follow-up report, I have presented my own analysis of *Israel Katz Report II*. In particular, I have explained why this report fails to successfully refute any of the arguments that I advanced in my initial report. I

[50]Specifically, it allows the MVPD to select a set of different subscribership levels, where each subscribership level can be any number less than or equal to the aggregate number of subscribers of its entire membership, and ask for binding arbitration to determine a rate for each subscribership level. Baseball-style arbitration is used to set the rate for each subscribership level. That is, both firms announce a rate for each subscribership level and the arbitrator chooses the rate closest to the fair market value of the programming for each subscribership level.

have also described a set of conditions proposed by the American Cable Association (that they developed with my advice) and explained why I believe that this set of conditions would substantially address the harms that I have identified, while still allowing the transaction to proceed.

APPENDIX
CORRECTLY CALCULATING THE MAGNITUDE OF THE REDUCED DOUBLE MARGINALIZATION EFFECT

The purpose of this Appendix is to provide a more formal demonstration of the economic reasoning presented in Section II.2 of this paper. It explains the correct method for calculating the magnitude of Comcast's cost reduction due to the reduced double marginalization effect. In particular, it shows that the method for calculating this cost reduction suggested by Drs. Israel and Katz dramatically overestimates the true value of the cost reduction because it fails to properly account for the opportunity cost of lost programming profits that the vertically integrated firm will experience when it attracts new customers that switch from other MVPDs.

To do this, I will consider a model where there is initially an unintegrated programmer that sells programming to n different MVPDs at some given programming fee. I will calculate the equilibrium subscription prices in the downstream MVPD market conditional on the given programming fee. Then I will assume that the programmer merges with one of the MVPDs. As explained in section II.2, Drs. Israel and Katz claim that one effect of the vertical transaction, completely independent of any effects associated with whether or not the vertically integrated firm will have an ability to raise programming prices for rivals, is that the vertically integrated firm will now view its own marginal cost as being reduced by an amount equal to the programming fees of the programmer it purchased. I will investigate this claim by calculating the new downstream pricing equilibrium in the MVPD market after the vertical transaction, holding the programming fee constant at the pre-transaction level. This will allow me to isolate the effects of the vertical transaction on firms' downstream pricing decisions independent of any effect of the transaction on the programmer's ability or incentive to raise programming fees. What I will show is that, while there is an effect, it is trivially small compared to the effect that Drs. Israel and Katz assert will exist. This is because Drs. Israel and Katz fail to take account of the opportunity cost of lost programming profits that the vertically integrated firm will experience when it attracts new customers from other MVPDs.

Suppose that there is a programmer that sells its programming to n different MVPDs indexed by $i \in \{1, \ldots, n\}$. For the purposes of simplicity, assume that the programmer charges the same fee to all MVPDs. Let w denote this fee. Suppose that the MVPDs also purchase programming from a number of other programmers. Once again, for purposes of simplicity, assume that all MVPDs purchase the same block of other programming from other programmers at the same fee. Let c denote the fee of all other programming that the MVPDs purchase. Let p_i denote the subscription price that MVPD i charges to its customers and let $\mathbf{p} = (p_1, \ldots, p_n)$ denote the vector of all subscription prices. Let $q_i(\mathbf{p})$ denote the demand function for MPVD i and let $q_{ij}(\mathbf{p})$ denote the derivative of q_i with respect to p_j. Assume that $q_{ii}(\mathbf{p})$ is negative (i.e., if an MPVD raises its own price, it will lose subscribers) and $q_{ij}(\mathbf{p})$ is positive for all $j \neq i$ (i.e., if an MVPD raises its own price, all other MVPDs will gain subscribers.)

When MVPD i slightly lowers its price to attract new customers, it will attract two different types of subscribers - people who previously subscribed to a different MVPD and switch to MVPD i, and people who previously subscribed to no MVPD. Let θ_i denote the fraction of new customers that are switchers. I will refer to θ_i as the "switcher share" for MVPD i. As I discuss in the main body of the paper, it is likely that the switcher share for most MVPDs is very close to 1. This simply reflects the fact that most people already subscribe to an MVPD. Therefore when an MVPD lowers its price to attract new subscribers, most of the subscribers must necessarily be switchers.

Prior to analyzing the model, it will be useful to derive an expression for θ_i based on the derivatives of the demand curves. Suppose that MVPD i slightly lowers its price. The number of new customers that arrive is given by

$$-q_{ii}(\mathbf{p}) \tag{A.1}$$

and the number of customers that leave other firms is given by

$$\sum_{j \neq i} q_{ij}(\mathbf{p}) \tag{A.2}$$

This means that θ_i is given by (A.1) divided by (A.2) or

$$\theta_i = \frac{\sum_{j \neq i} q_{ij}(\mathbf{p})}{-q_{ii}(\mathbf{p})} \tag{A.3}$$

For later use, note that we can rewrite equation (A.3) as

$$\sum_{i \neq j} q_{ij}(\mathbf{p}) = -\theta_i \, q_{ii}(\mathbf{p}). \tag{A.4}$$

First consider the case where the programmer and each of the MVPDs are separately owned. MVPD i chooses p_i to maximize its profits, given by

$$q_i(\mathbf{p})p_i - q_i(\mathbf{p})(w + c) \qquad \text{(A.5).}$$

The first order condition for this problem is given by

$$q_{ii}(\mathbf{p})p_i + q_i(\mathbf{p}) = (w + c)\, q_{ii}(\mathbf{p}) \qquad \text{(A.6).}$$

A Nash equilibrium to the downstream pricing game occurs when all of the first order conditions are satisfied.

Now suppose that the programmer merges with MVPD 1 to form a vertically integrated firm. The objective functions and first order conditions for MVPDs 2 through n remain unchanged as described above in equations (A.5) and (A.6). The question of interest is to determine the objective function of the vertically integrated firm and compare it to the objective function of MPVD 1 before the transaction. This will determine how the incentives for choosing p_1 are changed by the transaction. The vertically integrated firm's profit now consists of two separate terms. The first term is its downstream profit given by

$$q_1(\mathbf{p})\,(p_1 - w - c). \tag{A.7}$$

The second term is its upstream profit given by

$$\sum_{j=1}^{n} q_j(\mathbf{p})w \tag{A.8}$$

The vertically integrated firm's total profit is given by the sum of these two expressions or

$$q_1(\mathbf{p})p_1 \quad - \quad q_1(\mathbf{p})c \quad + \quad \sum_{j\neq 1} q_i(\mathbf{p})w. \tag{A.9}$$

The first term of equation (A.9) is the vertically integrated firm's downstream revenue. The second term is its downstream costs ignoring the transfer payment from the downstream division to the upstream division. The third term is its upstream profit, once again ignoring the transfer payment from the downstream firm to the upstream firm.

If the third term of (A.9) did not exist, Drs. Israel and Katz would be correct in their assertion that the vertically integrated firm chooses p_1 to maximize the downstream division's profits ignoring the transfer payment to the upstream division. However, the third term of (A.9) does exist, and the vertically integrated firm will most surely take account of this term when it chooses a profit maximizing level of p_1. In particular, the third term is the programming profit that the vertically integrated firm earns from selling programming to other MVPDs. If the vertically integrated firm lowers price slightly in an attempt to attract more customers, it will lose w dollars of profit for every subscriber that switches from some other MVPD to MVPD 1. This is the effect that Drs. Israel and Katz ignore.

The first order condition for maximization of (A.9) is given by

$$q_{11}(\mathbf{p})p_1 + q_1(\mathbf{p}) \quad = \quad cq_{11}(\mathbf{p}) \; - \; \sum_{i\neq 1} q_{i1}(p)w \tag{A.10}$$

Substitute i = 1 into equation (A.5) and substitute the result into equation (A.10) to yield

$$q_{11}(\mathbf{p})p_1 + q_1(\mathbf{p}) \quad = \quad (c + \theta w)\, q_{11}(\mathbf{p}) \tag{A.11}$$

Equation (A.11) is the first order condition determining p_1 under vertical integration. Substitute i = 1 into equation (A.5) to yield the FOC determining p_1 under no vertical integration.

$$q_{11}(\mathbf{p})p_1 + q_1(\mathbf{p}) \quad = \quad (c + w)q_{11}(\mathbf{p}) \tag{A.12}$$

A comparison of (A.11) and (A.12) shows that the only difference is that the term "c+w" in (A.12) is replaced by the term "$c + \theta w$" in (A.11). That is, with no vertical integration p_1 is chosen to maximize downstream profits viewing the marginal cost of providing service to an additional subscriber as c+w. With vertical integration, p_1 is chosen to maximize downstream profits viewing the marginal cost of providing service to an additional subscriber as $c + \theta w$. In particular, marginal cost is NOT reduced by w. Rather it is only reduced by $(1-\theta)w$. Therefore if θ is close to 1, the cost reduction due to vertical integration will be very small.

This is of course very intuitive. Drs. Israel and Katz are correct in their observation that the vertically integrated firm will not view its payment of w between divisions to be a cost of providing MVPD service. What they fail to recognize is that, when the vertically integrated firm lowers p_1 in an attempt to attract more customers, it will lose w dollars of programming profit on every customer that switches from some other MVPD. When this counteracting effect is taken into account, we conclude that vertical integration will only lower the vertically integrated firm's downstream cost to the extent that the new customers that it attracts are not simply customers that switch from some other MVPD but are instead entirely new subscribers to any MVPD service.

<u>ATTACHMENT B</u>

DECLARATION OF ROBERT GESSNER

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

In the Matter of	)	
	)	
Applications of Comcast Corporation,	)	
General Electric Company, and NBC	)	MB Docket No. 10-56
Universal, Inc. to Assign and Transfer	)	
Control of FCC Licenses	)	

DECLARATION OF ROBERT GESSNER

1. My name is Robert Gessner. I am President of Massillon Cable TV, Inc. ("Massillon"). My business address is 814 Cable Court NW, Massillon, OH 44647.

2. Massillon is a family-owned and operated telecommunications provider delivering advanced video, data, and voice services to more than 45,000 homes in Stark and Wayne Counties in Ohio.

3. As a cable television service provider, Massillon must contract with broadcast and cable programming providers to obtain the programming its subscribers desire.

4. In 2005, Massillon had an agreement with Fox Cable Networks, Inc. ("Fox") to carry Fox Sports Net Ohio ("FSNO").[1] The vast bulk of the "marquee" live sporting events carried on FSNO – more than two-thirds (2/3) of the professional sports content -- was Cleveland Indians baseball games. On December 26, 2005, the Cleveland Indians announced that it was creating its own regional sports network, SportsTime Ohio, and moving all of its games from FSNO.

[1] Fox and FSNO refer to the same entity throughout this declaration.

5. The loss of the Cleveland Indians baseball games caused a significant reduction in the value of FSNO programming, so Massillon contacted Fox to seek a rate reduction for carriage of FSNO. In effect, Massillon viewed the loss of the Indians' games as a constructive rate increase, effectively changing the balance of equities in the carriage agreement, since FSNO's carriage fees remained constant at the same time that the value of the network's content markedly decreased. Fox refused. Over the next ten months, Massillon continued to seek a negotiated solution with Fox but to no avail.

6. With the carriage negotiations with Fox at a standstill, Massillon examined whether it should seek relief pursuant to the commercial arbitration process established by the Federal Communications Commission's ("FCC") in its 2004 News Corp.-Hughes Order. From Massillon's perspective, the process set forth in this order was intended to be relatively straightforward and to have the potential to be expeditious and low-cost. However, as described below, the process turned out to be significantly more unwieldy and costly than expected.

7. On September 27, 2006, Massillon requested the dispute be resolved by commercial arbitration. Fox refused to recognize the legitimacy of the arbitration process and instead filed procedural motions contesting Massillon's right to invoke arbitration pursuant to the FCC's order. The following paragraphs describe the tortured path of the proceeding and the resources Massillon had to expend to obtain relief.

8. From the outset, Fox tried to drag out the process through procedural tactics. Eventually, Fox refused to cooperate or participate in the arbitration. For example, Fox agreed to a Joint Stipulation of Facts on February 5, 2007, but it simultaneously filed a motion to dismiss the case. Defending against this motion required Massillon to research and fully brief its opposition to this motion and to prepare and participate in a lengthy oral hearing on the matter.

9. In April 2007, the arbitrator denied Fox's motion to dismiss, and Fox immediately sought a stay of her decision from both the arbitrator and the Commission. Massillon again had to oppose these further attempts by Fox to derail the arbitration. To further increase the delay and cost, Fox wrote numerous letters to the arbitrator to which Massillon had to respond. In further gamesmanship, Fox then withdrew its FCC stay request without any explanation. The arbitrator denied Fox's request for a stay.

10. With the matter of whether Massillon had properly invoked the arbitration remedy squarely resolved in Massillon's favor, the arbitrator ordered the parties to submit their final offers in June 2007. Massillon timely produced its offer. In addition, to accommodate Fox's purported concerns, Massillon agreed that by participating in the arbitration Fox would not forfeit or compromise any of its rights to challenge the legitimacy of the proceedings. Even so, while all of the rights it purported to defend would have been fully preserved, Fox refused to provide a final offer or participate in discovery. In the absence of Fox's offer, which would have enabled the arbitrator to chose which of the two final offers was more appropriate, as the arbitration procedure was designed to achieve, Massillon had no choice but to commission its expert witness to engage in significant additional work to estimate FSNO's costs and demonstrate that Massillon's offer was reasonable on that basis, all without supporting justification or discovery opportunity. This resulted in substantially increased costs for Massillon. Moreover, due to Fox's unwillingness to participate in the process, even at no risk to its ability to pursue further its claim that the dispute was not properly before the arbitrator, Massillon was burdened with paying the entire cost of the arbitration proceedings, rather than sharing that expense with Fox.

11. In preparation for the arbitration hearing in support of its final offer, Massillon worked with its expert witness to quantify the reduction in the fair market value to carry FSNO and to prove that its proposed value was not below the cost of producing the programming. Much of this extensive economic analysis and research regarding program costs would normally have been an obligation of Fox.

12. On August 9, 2007, the arbitration hearing began. Fox did not participate in the hearing. The hearing consisted of testimony by Massillon's expert witness who delivered a prepared statement and responded to questions from the arbitrator during the two-day proceeding.

13. On September 12, 2007, the arbitrator issued a final award in favor of Massillon. The award required Fox to pay Massillon for the overpayment in carriage fees from the time the Cleveland Indians games were longer carried plus interest on this amount. The award also required Fox to pay Massillon for attorneys' fees, the fees of its expert witness, and the fees it paid to the arbitrator.

14. On September 21, 2007, Fox filed with the FCC for de novo review. In response, Massillon had to again research and file an extensive opposition to Fox's contentions. Expenses related to the de novo review of this arbitration proceeding continue to be incurred. The FCC has yet to reach a decision on review.

15. When all costs of the arbitration are considered, Massillon spent approximately $1,000,000 from the date of the arbitration request (October 2006) through the present day. This amount does not include the considerable out-of-pocket costs (including travel expenses) incurred by Massillon and substantial time and resources spent by Massillon management and employees to participate in the dispute and arbitration process.

16. Massillon continued to carry FSNO while the dispute was pending and after the arbitrator's decision. After the arbitrator's decision, Fox continued to invoice Massillon at the pre-arbitration carriage fee. In light of the arbitrator's decision in favor of Massillon, the company deducted the amount of the award from the amount due Fox for carriage of FSNO. Due to the size of the award, the agreement instituted by the arbitrator expired before the full amount of the award was exhausted. As a result, Massillon was forced to forfeit a portion of the arbitrator's award.

17. On January 1, 2010, Massillon and Fox entered into a new agreement to carry Fox Sports Net Ohio. As a result of these actions, Massillon has asked the FCC to dismiss the case and not undertake the de novo review. Massillon's request remains pending.

18. On its face, the arbitration process proposed in the News Corp.-Hughes Order looked straightforward and seemed to anticipate an efficient procedure and an expeditious decision, but, the reality was very different. Massillon's experience shows that a large, well-funded party in an arbitration proceeding can essentially raise any issue, force filings, and compel delay. All of these actions "stop the clock" and force parties in need of relief to expend resources, above and beyond the already significant cost of arbitration on the fair market value of the programming. The "no jurisdiction" argument pursued by Fox and the resources and time taken to deal with it provides just one example. When all of Fox's procedural tactics ultimately were rejected by the arbitrator (to whose determination of jurisdiction, it must be reemphasized, Fox had agreed to submit), Fox simply refused to appear or to submit the required materials. From Massillon's viewpoint, Fox was intent on employing any argument and using its "deep pockets" to make a small cable operator "cry uncle" by using the very process the FCC had created with the intent of preventing such behavior by the vertically integrated programamer.

19. Finally, even if Fox had chosen to offer no procedural arguments and simply argue about the fair market value of the programming, Massillon is convinced that the arbitration process would still have been very costly. Fox would almost certainly have employed an extensive and expensive discovery process to drag out the proceeding and add to Massillon's costs.

20. In the final analysis, the arbitration process was far different than my expectations. It was not a relatively straightforward process. It did not live up to its potential as an expeditious and low-cost dispute resolution mechanism. Rather, it proved that one party can frustrate the process to the point where it is not feasible for a smaller entity to remain engaged either for lack of financial resources or personal time. Large program entities may say Massillon has "learned its lesson" because it would not be inclined to commit to binding arbitration again.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct to the best of my information and belief.

Executed on August 6, 2010.

Robert Gessner

Robert Gessner

ATTACHMENT C

ACA'S PROPOSED COMCAST-NBCU LICENSE TRANSFER CONDITIONS

ACA's Proposed Comcast-NBCU License Transfer Conditions

I. Definitions

For purposes of the conditions set forth below, the following definitions apply:

"Bargaining Agent" means any entity that negotiates retransmission consent or carriage agreements on behalf of one or more of its principals or members, regardless of whether they are bound by the prices, terms and conditions entered into by the Bargaining Agent.[1]

"Comcast-NBCU" shall include Comcast Corporation ("Comcast") and the joint venture, composed of assets of Comcast and NBC Universal, Inc., ("NBCU"), and each of the companies' subsidiaries, affiliates, parents, successors, and assigns.

"Covered NBC Stations" means all NBC broadcast television stations currently or in the future owned, controlled or managed by Comcast-NBCU and all independent NBC affiliates on whose behalf Comcast-NBCU currently or in the future negotiates retransmission consent agreements.

"Covered RSNs" means all regional sports networks ("RSNs") that are currently or in the future owned, controlled or managed by Comcast-NBCU.[2]

"Covered National Cable Networks" means all national cable programming networks that are currently or in the future owned, controlled, or managed by Comcast-NBCU.

"Covered Programming" means all Covered NBC Stations, Covered RSNs, and Covered National Cable Networks.

"Net Effective Rate" means the net cash consideration charged under a retransmission consent agreement or an RSN carriage agreement, adjusted to reflect the value of: (1) all other economic consideration exchanged, including marketing or launch support, penetration or other discounts, advertising availabilities, channel positioning, and payment terms; and (2) any other rights or obligations related to such agreement, including the packaging of the Covered NBC Station or Covered RSN, and other distribution rights or obligations, which may include digitization, streaming, and/or dual feeds, and the distribution of the Covered NBC Station or Covered RSN on a video-on-demand basis or via a high-definition format or interactive version or broadband technology.

"Smaller MVPD" means a multichannel video programming distributor ("MVPD") that serves 125,000 MVPD subscribers or less in either the DMA served by a Covered NBC Station, or the region commonly served by a Covered RSN.

"Stand-Alone Retransmission Consent Agreement" means a retransmission consent agreement that does not include any provision to carry any video programming networks, other services, or other items unrelated to the carriage of a broadcast station signal, other than the primary and multicast streams of a single broadcast station, and any ancillary programming or service.

"Stand-Alone RSN Carriage Agreement" means a carriage agreement that does not include any provision to carry any video programming networks, other services, or other items unrelated to the carriage of a RSN, other than a single RSN, and any ancillary programming or service.

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[1] It is intended that the National Cable Television Cooperative (NCTC), as currently organized and as it operates, would be considered a Bargaining Agent for purposes of these conditions.
[2] "Regional Sports Network" shall have the same meaning as in the Adelphia-Time Warner-Comcast Order.

II. General Conditions Applicable to all MVPDs

A. Program Access Conditions

1. The program access rules will apply to Covered NBC stations and all other broadcast television stations currently or in the future owned, controlled or managed by Comcast-NBCU and all independent broadcast television stations on whose behalf Comcast-NBCU currently or in the future negotiates retransmission consent agreements.

2. The program access rules will apply to Covered RSNs and Covered National Cable Networks, regardless of its means of delivery to MVPDs, including terrestrially delivered programming.

3. The program access rules will apply to all programming discussed in Conditions II.A.1 and II.A.2., which shall include all means by which such programming is offered, in whole or in part, to consumers by Comcast-NBCU through any platform, including online and mobile platforms.

B. Requirements for Stand-Alone Agreements for Covered NBC Stations and Covered RSNs

1. All retransmission consent agreements entered into by Comcast-NBCU for Covered NBC Stations must be Stand-Alone Retransmission Consent Agreements.

2. All RSN carriage agreements entered into by Comcast-NBCU for Covered RSNs must be Stand-Alone RSN Carriage Agreements.

C. Commercial Arbitration Remedy

1. When negotiations fail to produce a mutually acceptable set of prices, terms and conditions for (i) Covered NBC Stations; (ii) Covered RSNs; or (iii) Covered National Cable Networks, an aggrieved MVPD may submit a dispute over the prices, terms and conditions of retransmission consent or carriage agreements for Covered Programming to commercial arbitration, subject to the arbitration rules outlined in the Adelphia-Time Warner-Comcast Order.[3]

[3] The ACA would not object to the Commission enhancing the terms and conditions of this commercial arbitration remedy to make it more efficient and effective.

III. Special Conditions Applicable to Smaller MVPDs

A. Special Requirements for Stand-Alone Agreements for Covered NBC Stations and Covered RSNs for Smaller MVPDs

1. Upon entering into a Stand-Alone Retransmission Consent Agreement for a Covered NBC Station with an MVPD that serves 125,000 MVPD subscribers or less in the DMA served by the Covered NBC Station, and throughout the life of the agreement, Comcast-NBCU may neither require nor accept fees, terms, and conditions from the MVPD that result in a Net Effective Rate more than 5% higher than the lowest Net Effective Rate of any retransmission consent agreement for the Covered NBC Station with any MVPD including itself, that is currently in force. Moreover, Comcast-NBCU may neither withhold terms and conditions related to carriage of the Covered NBC Station that are made available to other MVPDs, including itself, nor require terms and conditions related to carriage of the Covered NBC Station that are technically infeasible or commercially prohibitive for the MVPD.

2. Upon entering into a Stand-Alone RSN Carriage Agreement for a Covered RSN with an MVPD that serves 125,000 MVPD subscribers or less in the region commonly served by the Covered RSN, and throughout the life of the agreement, Comcast-NBCU may neither require nor accept fees, terms, and conditions from the MVPD that result in a Net Effective Rate more than 5% higher than the lowest Net Effective Rate of any carriage agreement for the Covered RSN with any MVPD including itself, that is currently in force. Moreover, Comcast-NBCU may neither withhold terms and conditions related to carriage of the Covered RSN that are made available to other MVPDs, including itself, nor require terms and conditions related to carriage of the Covered RSN that are technically infeasible or commercially prohibitive for the MVPD.

3. Each principal executive and financial officer of Comcast-NBCU will certify to the Commission on an annual basis that Comcast-NBCU, based on his or her knowledge, has calculated the Net Effective Rate for each retransmission consent agreement for Covered NBC Stations and for each carriage agreement for Covered RSNs currently in force, and is not in violation of Conditions III.A.1. or III.A.2.

B. Special Commercial Arbitration Remedy for Smaller MVPDs

1. An MVPD that serves 125,000 MVPD subscribers or less in either the DMA served by a Covered NBC Station, or the region commonly served by a Covered RSN, may submit a dispute over the terms and conditions of carriage of a Covered NBC Station or a Covered RSN subject to a special commercial arbitration remedy for Smaller MVPDs designed to affordably resolve disputes related to Conditions III.A.1. or III.A.2.

2. The special commercial arbitration remedy for Smaller MVPDs shall be a traditional arbitration conducted in accordance with the Rules for the Special Commercial Arbitration Remedy for Smaller MVPDs contained in Appendix A, different from the “final offer” or “baseball” arbitration outlined in Condition II.C.1.

3. An aggrieved MVPD shall be granted an automatic right to continued carriage of the Covered NBC Station or Covered RSN until resolution of the special commercial arbitration remedy for smaller MVPDs.

C. Special Rules for Bargaining Agents

1. Comcast-NBCU shall negotiate in good faith with Bargaining Agents. The following actions by Comcast-NBCU would violate this duty to negotiate in good faith:

   a. Refusal to negotiate with a Bargaining Agent on behalf of all its principals or members.

   b. Refusal to enter into a retransmission consent or carriage agreement with an MVPD unless it contains a restriction on either being represented by a Bargaining Agent, or opting into an agreement subsequently reached by a Bargaining Agent.

   c. Refusal to put forth an offer to a Bargaining Agent with members who are not bound by the prices, terms, and conditions entered into by the Bargaining Agent, for any set of different subscriber levels specified by the Bargaining Agent so long as none of the subscriber levels are greater than the aggregate number of MVPD subscribers served by the entire membership of the Bargaining Agent.

2. When negotiations involving Bargaining Agents fail to produce a mutually acceptable set of prices, terms, and conditions for Covered Programming, an aggrieved Bargaining Agent shall have the same rights to submit a dispute over the prices, terms and conditions for Covered Programming to commercial arbitration as an MVPD, pursuant to the rules outlined in Condition II.C.1, with the following additional rules:

   a. An aggrieved Bargaining Agent with members who are not bound by the prices, terms and conditions entered into by the Bargaining Agent and Comcast-NBCU, shall present final offers to the arbitrator based on each disputed set of subscriber levels specified by the Bargaining Agent so long as none of the subscriber levels are greater than the aggregate number of MVPD subscribers served by the entire membership of the Bargaining Agent. For each set of different subscriber levels, the arbitrator will choose the final offer of the party that most closely approximates the fair market value of the Covered Programming.[4]

IV. Duration of Conditions

A. These conditions shall apply to Comcast-NBCU for nine years, regardless of whether, during this period, any statute or regulation referenced in any condition, including the program access rules, are not extended by the Commission or are overturned by the Courts.

[4] The actual prices, terms and conditions of the agreement entered into by the Bargaining Agent's members will then be determined by the aggregate number of MVPD subscribers of the Bargaining Agent's members that subsequently opt into the agreement.

Appendix A

Rules for the Special Commercial Arbitration Remedy for Smaller MVPDs:

A. Upon receiving timely notice of a Smaller MVPD's intent to arbitrate, Comcast-NBCU shall submit to the arbitrator in writing its last offer to the MVPD, and may include, at its discretion, an explanation of why its offer complies with Conditions III.A.1. or III.A.2.

B. Comcast-NBCU shall be obligated to make available to the arbitrator all relevant contracts and other data and information, including its calculations of the Net Effective Rate for all retransmission consent agreements for the Covered NBC Station or for all carriage agreements for the Covered RSN currently in force, as the arbitrator deems necessary to resolve the dispute.

C. The Smaller MVPD may submit to the arbitrator in writing an explanation for why it believes Comcast-NBCU's last offer does not comply with Conditions III.A.1. or III.A.2.

D. Comcast-NBC may respond in writing to the Smaller MVPD's filing.

E. After receiving the written briefs of both parties and all relevant contracts and other data and information, the arbitrator shall determine whether Comcast-NBCU's last offer complies with Conditions III.A.1. or III.A.2. If the arbitrator finds that Comcast-NBCU's offer does not comply, then the arbitrator, after informal consultation with the parties, shall adjust the Comcast-NBCU offer to bring it into compliance. The MVPD and Comcast-NBCU shall be bound to accept the arbitrator's modified terms and conditions.