accomplished without the transaction."[125] Applicants' understanding of this concept is not shared by the Commission. To be considered transaction-specific, a benefit must be "unlikely to be realized by other means that entail fewer anticompetitive effects,"[126] and must be one "that would not be achievable but for the proposed merger."[127] Thus, the Commission has found, for example, that a claimed benefit is not transaction-specific if it could be accomplished by a joint venture between the parties or other means that pose fewer competitive risks rather than merger.[128]

Using the Commission's definition, several claimed benefits of the proposed transaction are quite plainly *not* transaction-specific. For example, as DIRECTV pointed out, Comcast and NBCU could bid for sports rights as a joint venture, just as TNT and CBS did for the rights to the Men's NCAA Basketball Tournament.[129] Other examples are discussed in more detail below.

1. Common Sense Media. Applicants have committed to expand Comcast's existing partnership with Common Sense Media and to "look for more opportunities for

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[125] Opposition at 34 (emphasis in original).

[126] *See EchoStar Commc'n. Corp., General Motors Corp., and Hughes Electronics Corp.*, Hearing Designation Order, 17 FCC Rcd. 20559, ¶ 189 (2002) ("*EchoStar HDO*").

[127] *NYNEX Corp. and Bell Atlantic Corp.*, Memorandum Opinion and Order, 12 FCC Rcd. 19985, ¶ 158 (1997).

[128] *See, e.g., EchoStar HDO*, ¶ 230 (rejecting claimed benefit related to satellite broadband service because applicants failed to show that the "critical mass" of subscribers and facilities could not be achieved through a joint venture rather than merger); *News/Hughes*, ¶¶ 328, 337, 350, 357 (rejecting several claimed benefits because applicants had not explained why those benefits could not take place in the absence of the transaction); *Comcast Corp., AT&T Corp., and AT&T Comcast Corp.* Memorandum Opinion and Order, 17 FCC Rcd. 23246, ¶ 203 (2002) (rejecting claimed benefit where applicants had failed to show that it required special expertise that could not be duplicated absent the transaction).

[129] *See* DIRECTV Comments at 59.

[Common Sense] to work with NBCU."[130] Yet the Opposition reveals that Comcast "is now in the process of formalizing with Common Sense" the very undertakings made in the Application.[131] Given that DIRECTV has already integrated Common Sense Media ratings information into its on-screen guide,[132] this "commitment" is almost certainly driven by market forces rather than any imperative arising from the proposed transaction.

2. *Spanish-language programming.* Documents produced in this proceeding call into question the transaction-specificity of Applicants' commitments with respect to carriage of additional Spanish-language programming. For example, {{

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130 *See* Application at 46 (Commitment #5).

131 Opposition at 35.

132 *See* DIRECTV, *DIRECTV Is First to Deliver Easy-to-Understand On-Screen TV Ratings From Common Sense Media* (Feb. 24, 2010) (*available at* http://www.directv.com/DTVAPP/global/article.jsp?assetId=P6700131&_DARGS=/DTVAPP/global/component/cmpt_v.jsp&_requestid=1405345).

133 63-COM-728.

134 63-COM-733, -736.

}} there is no basis for Comcast to argue that this proffered commitment is transaction-specific.

3. VOD programming. In its Comments, DIRECTV compared the many sources of VOD content available to Comcast with the much smaller amount of VOD content actually made available to subscribers, and concluded that "something other than the availability of content — such as limitations in Comcast's own facilities — was responsible."[135] In response, Applicants assert instead that Comcast's ability to meet consumer demand for high-quality content across multiple platforms was delayed by the reluctance of content owners to embrace new and untested distribution platforms, such as VOD.[136] Similarly, Rosston and Topper assert that the launch and expansion of the VOD platform took longer than expected because of limits on the quantity, quality, and variety of content that was available to Comcast.[137]

Such assertions are {{

}}.[139] Moreover, with respect to NBCU specifically, {{

[135] DIRECTV Comments at 54.

[136] Opposition at 57.

[137] Rosston/Topper Opposition Report at 4.

[138] 63-COM-308; 63-COM-358; 63-COM-701.

[139] 63-COM-296; 63 COM-700.

}}[140] This internal evidence further undercuts Applicants' claims about the benefits of the proposed transaction.[141]

DIRECTV also pointed out that, while NBCU content may become more available in more ways to Comcast, it is likely to be more difficult for Comcast's MVPD rivals to access.[142] Applicants have not challenged this observation. As with their arguments related to double marginalization, it appears that Applicants believe that what is good for Comcast is good for the public at large. The Commission cannot take such a narrow view in its analysis.

4. Investment. Another benefit claimed by Applicants is the likelihood that Comcast will invest in NBCU programming, just as it has done with other networks it has acquired.[143] DIRECTV challenged this purported benefit, noting that there was no evidence that NBCU networks lacked for investment or were otherwise in a similar position as Comcast's other programming acquisitions.[144] In response, Rosston and

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140 11-COM-755, 803.

141 Perhaps then it should come as no surprise that the CEO of Comcast's wholly-owned online media management and publishing company, the Platform, opined that "'[m]edia companies are now wholeheartedly embracing multi-platform video distribution.'" *See Comcast Media Center and the Platform Announce Validation of Their Online Video Publishing Capabilities in Preserving Nielsen's Audio Watermarks*, THEPLATFORM (May 20, 2010) (*available at* http://theplatform.com/about/details/cmc_theplatform_nielsen_c3_announcement).

142 *See* DIRECTV Comments at 53-54.

143 *See, e.g.*, Application at 5-7; Rosston Report at 5-6.

144 *See* DIRECTV Comments at 58-59.

Topper point to NBC as an example of programming that is underperforming and would benefit from greater investment by Comcast.[145] Yet the evidence does not support this assertion.

For example, internal documents produced by NBCU show {{

}}[146] — a year when NBC was the top-ranked network.[147] Another presentation {{

}}.[148] Moreover, an exhibit provided by Rosston and Topper shows that {{

}}.[149] Such robust advertising results are not consistent with an "underperforming" network that lacks investment.

Significantly, Applicants did not even attempt to argue that NBCU's cable networks are underperforming or lack for investment. Indeed, an exhibit submitted by

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145 Rosston/Topper Opposition Report at 10.

146 21-NBCU-12998 at 9.

147 *See, e.g.*, Network Rankings (*available at* http://tviv.org/Nielsen_Ratings/Historic/Network_Television_by_Season/2000s).

148 29-NBCU-9370 at 9.

149 Rosston/Topper Reply Report, Third Party Exh. # 7. And as noted above, another document produced by Comcast in this proceeding states that {{

}}. 39-COM-12.

Katz/Israel shows that: (1) {{

}}.[151]

As for investment, {{

}}[153] Applicants themselves state that, after buying Telemundo for $2.7 billion in 2002, NBCU subsequently invested an additional $900 million to acquire stations and create Telemundo Studios (which currently produces more than 3000 hours of original content a year) and Telemundo International.[154] Conversely, there is evidence that Comcast may actually invest less in NBCU. For example, {{

150 Israel/Katz Reply Report, Confidential and Highly Confidential Supporting Data, Document 11.2.1.7 at NBCU-107, NBCU-110, NBCU-117 (July 22, 2010).

151 *Id.* at 129, 160.

152 *Id.* at 117.

153 *Id.* at 113.

154 Opposition at 235.

}}.[155]

As DIRECTV pointed out, there is no evidence that NBCU has under-invested in its broadcast network or cable channels. Moreover, the success of any content depends more upon developing programming that viewers want to watch than upon simply spending more money. NBC presents a vivid and recent example of this principle, having engaged in a high profile gambit to move Jay Leno to primetime and Conan O'Brien to The Tonight Show, only to reverse those decisions after less than five months — while absorbing a $45 million charge to buy out O'Brien's contract.

Thus, many of the benefits claimed by Applicants are not cognizable under the Commission's public interest analysis. In addition, it is worth noting that Applicants have not asserted that the procompetitive conditions proposed by DIRECTV in this proceeding would prevent them from achieving any of these purported benefits.

CONCLUSION

For the foregoing reasons, DIRECTV respectfully submits that the public interest would be served by approving the proposed transaction only if the Commission imposes the narrowly tailored conditions to safeguard competition and consumers. Accordingly, DIRECTV requests that the conditions set forth in Exhibit B hereto be included in any grant issued in this proceeding.

[155] 31-COM-1785.

Respectfully submitted,

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By: /s/

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August 19, 2010

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I hereby certify that, on this 19th day of August, 2010, a copy of the foregoing Reply of DIRECTV, Inc. was sent by overnight delivery to:

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EXHIBIT A

RESPONSE OF PROFESSOR KEVIN M. MURPHY TO REPLY REPORT OF MARK ISRAEL AND MICHAEL L. KATZ

August 19, 2010

Kevin M. Murphy*

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Table of Contents

I. Introduction

1. On June 21, 2010, I submitted a report[1] in which I explained why the analysis presented in the submission to the Federal Communications Commission ("FCC") by Mark Israel and Michael L. Katz on behalf of the Applicants[2] failed to address the likely impact of the proposed transaction on the cost of licensing NBCU programming. In my report, I presented an economic model that provided a framework for understanding how the acquisition by Comcast of NBCU's owned and operated ("O&O") broadcast stations and national cable programming would create conditions that make higher carriage rates likely.

2. On July 20, 2010, Israel and Katz submitted a new report in which they comment on my submission, as well as on submissions on behalf of other parties.[3] Israel and Katz criticize my framework and conclusions, and reiterate their opinion that there is no basis in economic theory or empirical observations to expect the proposed transaction to harm consumers. Indeed, Israel and Katz claim that efficiencies generated by the transaction likely will result in lower consumer prices.

3. In this submission, I reply to Israel and Katz' critique of my model. I provide empirical analysis that, in DMAs served by Comcast, a substantial portion of the subscribers that would leave a DBS firm in response to a loss of attractive programming would move to Comcast. My model predicts substantial increases in carriage rates based on a reasonable estimate of this diversion rate. I also explain that Israel and Katz' other critiques of my analysis are unfounded, and that the evidence they offer to support their claims that diversion to Comcast from DBS is "near zero" and that the transaction is likely to reduce consumer prices is flawed.

[1] *Economic Analysis of the Impact of the Proposed Comcast/NBCU Transaction on the Cost to MVPDs of Obtaining Access to NBCU Programming*. ("Initial Report")

[2] Mark Israel & Michael L. Katz, *Application of the Commission Staff Model of Vertical Foreclosure to the Proposed Comcast-NBCU Transaction* (February 26, 2010).

[3] Mark Israel & Michael L. Katz, *Economic Analysis of the Proposed Comcast-NBCU-GE Transaction* (July 20, 2010) ("Israel and Katz Opposition Report").

II. My Bargaining Framework for Analyzing Negotiations Over Retransmission Fees Is Appropriate and Informative

4. Israel and Katz claim that the model that I presented to evaluate the effect on retransmission fees of the proposed transaction is "inappropriate for analyzing pricing in this industry and, in any event, fail[s] to yield precise, reliable predictions."[4] They claim that my model is "too stylized" to yield accurate predictions about the outcome of retransmission negotiations.[5] In particular, they question the appropriateness of the standard Nash bargaining assumption about the split of the gains from trade, and my analysis of how firms' bargaining positions change with integration.

A. Katz' Previous Use of a Nash Bargaining Framework To Analyze Negotiations Over Retransmission Fees is Inconsistent with His Current Claim That This Framework Is Inappropriate For Analyzing Retransmission Negotiations

5. Israel and Katz claim that the "theoretical" bargaining model that I present – a Nash bargaining model – is "inappropriate" for analyzing pricing in this industry. However, as I discussed in my Initial Report, Professor Katz endorsed the equivalent framework in his submission to the FCC at the end of 2009.[6] In that report, Professor Katz and his coauthors apply a Nash bargaining model to analyze the outcome of retransmission consent negotiations. The fundamental features of Professor Katz' model in his prior report are the same as those in my model.

6. In a footnote to their Opposition Report, Israel and Katz attempt to distinguish the application of the bargaining model in Katz' earlier report from my application in this context. They claim that the earlier report "is not directly relevant" because (1) it "discussed only departure rates from MVPDs, not switching rates to any particular alternative MVPD" such as Comcast; and (2) "its discussions of departure rates was not informed by the results of our studies of the various retransmission disputes or local-into-local events."[7] But their explanation

[4] Israel and Katz Opposition Report ¶5.
[5] Israel and Katz Opposition Report ¶43.
[6] Initial Report ¶¶64-66, discussing Michael L. Katz, Jonathan Orszag, & Theresa Sullivan, *An Economic Analysis of Consumer Harm from the Current Retransmission Consent Regime*, GN Docket No. 09-47 (Nov. 12, 2009) ("Katz 2009 RTC Report")
[7] Israel and Katz Opposition Report ¶244 & fn 552.

provides no justification for rejecting application of the bargaining framework in this proceeding, while endorsing it in connection with the FCC's retransmission consent proceeding. The two factors they identify relate only to their empirical findings (and thus choices of values for the parameters used in the model), and not to the applicability of the Nash bargaining model in this setting.

7. Israel and Katz claim that, although my "stylized" model "provides useful insights in academic settings, it relies on strong assumptions that very likely are not satisfied in actual negotiations between content owners and MVPDs."[8] Even without regard to Katz' own application of this framework in analyzing and offering opinions on real-world negotiations over retransmission rates, however, Israel and Katz ignore empirical application of this framework in other contexts. In particular, the FCC applied a bargaining framework in supporting its conclusions in the News/Hughes and Adelphia/Comcast/TWC transaction.[9]

8. Thus, Israel and Katz' assertion that my model is purely an academic construct that is not useful for analyzing retransmission negotiations is contradicted both by Katz' recent use of a Nash bargaining model to analyze the outcome of retransmission negotiations and by the application of bargaining models more generally. Importantly, the questions in this matter hinge critically on the magnitude of the loss of subscribers an MVPD would incur if it lost access to particular programming (such as NBCU O&O stations). This value, together with the incremental value of adding a subscriber, determines the amount MVPDs are willing to pay for retransmission rights. Thus, as an economic matter, the level of negotiated retransmission fees is the natural place to look for evidence on this parameter. That is exactly what the Nash bargaining model permits.

[8] Israel and Katz Opposition Report ¶44.
[9] *General Motors Corp., Hughes Electronics Corp. and The News Corporation Ltd.*, 19 FCC Rcd. 473 (see, e.g., "[a]s commenters have correctly observed, the *ability* of a television broadcast station to threaten to withhold its signal, even if it does not actually do so, changes its bargaining position with respect to MVPDs, and could allow it to extract higher prices, which ultimately are passed on to consumers" (¶204); see, also, ¶¶ 4 and 151); *Adelphia Communications Corp., Time Warner Cable Inc., and Comcast Corp.*, 21 FCC Rcd. 8203, Appendix D (2006).

B. Israel and Katz' Criticism of the Specific Implementation of My Framework Ignores that Estimates of Departure Rates Associated with Broadcast Stations Derived From My Framework Are Consistent With Other Evidence on Departure Rates

9. Israel and Katz claim that "using the bargaining model to derive precise predictions about pricing effects from the proposed transaction pushes the model beyond what [it] can reasonably do."[10] They question whether the framework, combined with the specific assumptions that I make (in particular, the "equal sharing assumption"), can generate reliable predictions. Their critique is unfounded for two reasons.

10. First, Israel and Katz misinterpret the conclusion that I derive from my parameterization of the bargaining model. I did not conclude that the estimated increases in retransmission fees obtained from application of the model reflect the precise actual increase in rates that would result from unconditional approval of the merger. Rather, my calculations indicate what market forces would imply for the change in rates if other forces (such as potential regulatory restraints) did not intervene. I use the model to demonstrate the incompleteness of the theoretical and empirical analysis provided by Israel and Katz in their initial report, which ignored completely the potential impact on retransmission fees from vertical integration. Nothing in Israel and Katz' critique of my framework refutes my fundamental conclusion, which is that their exclusive focus on the likelihood of foreclosure is improper and that the merger would create conditions that make higher retransmission rates likely.

11. Second, Israel and Katz ignore my use of empirical evidence to support the predictions of my theoretical model. The first step of my analysis uses the model and a common assumption about firms' "bargaining skill"– combined with empirical evidence on outcomes of retransmission negotiations, broadcast advertising revenues, MVPD margins and other economic variables – to predict departure rates associated with the elimination of NBCU O&O broadcast stations from an MVPD's lineup. But my analysis has a second step, in which I compare these predicted departure rates to empirical evidence on how MVPDs' subscribership changed historically when broadcast networks were added to or removed from MVPDs' channel lineups.

[10] Israel and Katz Opposition Report ¶44.

This empirical evidence comes from (a) DIRECTV's addition of local broadcast stations (local into local ("LIL")) to its lineup and (b) the elimination of local broadcast stations from DISH's lineup during the Fisher dispute. My predicted departure rate from parameterizing the bargaining model was broadly consistent with the empirical evidence on departure rates from historical experience.

12. Thus, my analysis did not rely on economic theory alone, but provided a framework for deriving testable implications, which I supported with empirical evidence from related historical events. These comparisons provided evidence that my bargaining model, combined with the parameter assumptions that I make, provides a useful framework for understanding the outcomes of real-world retransmission negotiations and for predicting how market forces would affect retransmission rates after the proposed transaction.

C. Other Evidence Supports the Use of the Equal-Sharing Assumption In this Context

13. Israel and Katz challenge my assumption that the gains from trade resulting from reaching agreement on retransmission consent will be shared equally by the parties. Rather, they suggest that a more complex assumption is appropriate, in which the division of gains from trade reflects differences in the parties' "degrees of risk aversion or different discount rates."[11] They argue that the price prediction resulting from an assumption of equal sharing cannot be characterized as "a natural summary of the range of possibilities," because, they claim, it is inconsistent with empirical evidence from previous vertical integration events.[12]

14. Israel and Katz correctly note that, if NBC possesses virtually all the bargaining skill and the MVPD possesses virtually none, then the bargaining model implies that integration would have little or no effect on the outcome of retransmission negotiations.[13] However, they provide no basis for the kind of extreme sharing assumption needed for my model to generate the conclusion that the proposed transaction would not tend to increase retransmission rates. While extreme deviations from equal sharing would generate predictions that differ from the estimates I

[11] Israel and Katz Opposition Report ¶45
[12] Israel and Katz Opposition Report ¶52.
[13] Israel and Katz Opposition Report ¶51.

presented in my Initial Report, more moderate changes (e.g., assuming that the gains are split 1/3:2/3, rather than 50:50) still predict large changes in retransmission rates.

15. It is straightforward to derive a more general version of the model in my Initial Report, which allows NBCU and the MVPD to differ in their bargaining skill. Let s index NBCU's bargaining skill, where s is between zero and one, so $(1-s)$ represents the MVPD's bargaining skill. Then the expression for the departure rate (equation (14) in my Initial Report) becomes:

$$d = \frac{r^* + (1-s)(1-a)b}{(1-s)\left[\left(r_C a + r_2(1-a)\right) + (1-a)b\right] + sP_1(N=1)k}$$

and the expression for the increase in retransmission fees associated with integration (equation (18) in my Initial Report) becomes:

$$r_I^* - r^* = (1-s)da\left(P_C(N=0) - r_C\right)$$

Note that if $s = ½$ (meaning the parties have equal bargaining skill), I obtain the expressions in my Initial Report.

16. Using this expression, Exhibit 1 shows that {{

}} Israel and Katz provide no basis for assuming that either one of these alternative assumptions is better or worse than adopting the typical assumption of equal bargaining skill.

17. In my Initial Report, I supported the reasonableness of my assumption of equal sharing by comparing departure rates predicted by my model to historical evidence. This comparison provided empirical support for my conclusion that the combination of the equal-sharing assumption with other parameter assumptions was reasonable. The reasonableness of the equal-sharing assumption also is supported by Professor Katz himself, who adopted this assumption

without questioning its reasonableness, or even suggesting that it was speculative or controversial, in his previous report to the FCC on retransmission consent negotiations.[14] Indeed, his conclusion in his RTC report that increased competition among MVPDs explains increases in retransmission rates is inconsistent with a claim (which he suggests here) that networks' bargaining skill (or, more generally, their share parameter) is extremely high relative to that of MVPDs. Katz assumed in his RTC Report that, independent of the extent of competition between MVPDs, equal sharing of gains from trade was a reasonable assumption.[15]

D. Israel and Katz Wrongly Claim That My Assumption about Firms' Bargaining Positions is Inconsistent With the Rest of My Model

18. Israel and Katz claim that empirical evidence from "events involving non-integrated networks," by which I presume they mean the Fisher episode and LIL introduction, "very likely overstate the departure rate that a vertically integrated Comcast could induce by withholding NBCU networks from rival MVPDs."[16] They claim that "by the logic of the model, an MVPD negotiating with a vertically integrated NBCU would have an incentive to reduce the extent to which it would lose subscribers, say by committing itself to reducing its subscription charges conditional on losing access to NBCU content."[17] However, this critique is invalid. I properly incorporated both price and quantity effects into my model and into my predictions of the effect of the merger on retransmission rates.

19. I explained in my Initial Report that an MVPD that loses the right to retransmit a broadcast station will in general earn lower profits because of both reduced subscribership (lower quantity from "departures") and lower prices (i.e., discounts made to reduce the loss of subscribers). The split between lower quantity and lower price reflects the MVPD's new choice of price given its changed channel lineup. {{

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[14] Katz 2009 RTC Report ¶26. I infer that he viewed this as reasonable because he keeps this assumption unchanged when he compares the outcome implied by the bargaining model in the scenarios of less and then more MVPD competition.

[15] In its Order in the Adelphia matter, the FCC stated that "[t]hroughout our analysis, we adopt a standard solution to bargaining games by assuming that the parties split the gains from trade ($\gamma_n = \gamma_1 = 0.5$)," where γ is the sharing parameter (*see*, *Adelphia Communications Corp., Time Warner Cable Inc. and Comcast Corp.*, 21 FCC Rcd. 8203, Appendix D (¶24) (2006), citing D. Fudenberg and J. Tirole, *Game Theory* 117 (1991)).

[16] Israel and Katz Opposition Report ¶59.

[17] Israel and Katz Opposition Report ¶59 (footnote omitted).

}} Ex-ante, a firm might want to "commit" to cutting price more than would be profit maximizing in an attempt to negotiate a better deal, but it is unclear why such a commitment would be credible.

20. Israel and Katz appear to claim that the MVPD's optimal subscriber price in the absence of an agreement would be lower if it is negotiating with an integrated firm than if it were negotiating with an unintegrated broadcast station. They argue that the MVPD has a strategic incentive to reduce its price in order to reduce its loss of subscribership, and thus the subscribership gain by the integrated firm, and thereby to worsen the integrated firm's bargaining position. They claim that it is inconsistent with the logic of my model to ignore the parties' expectation that a breakdown in negotiations would cause the MVPD to price strategically in this way.[18]

21. Israel and Katz' argument is invalid. First, even if there were some basis to make such an adjustment, they provide no evidence of how it would affect the model's conclusions. A substantial fraction of the effect of the MVPD's lower price would prevent departures to the parties' MVPD competitors. This means that the lower the share of departures gained by the integrated firm, the higher the cost to the MVPD from adjusting price strategically. If Comcast would gain 40 percent of the subscribers that leave a DBS firm for another MVPD if the DBS firm lost retransmission rights to NBC, then lowering its subscription rate would cause the DBS firm to reduce price to the 60 percent of subscribers that would choose other MVPDs, even though by assumption it would not be in the DBS firm's interest to do so (given that it was not in its interest before the vertical integration).

22. Second, Israel and Katz ignore a symmetric incentive on the part of the vertically integrated firm (in this case Comcast-NBCU) to commit to reduce price in order to increase the MVPD's loss of subscribers (and thus improve Comcast-NBCU's bargaining position). They provide no reason why, if such strategic actions were part of firms' equilibrium response, the only strategic pricing effect is for the MVPD to adjust price, and not for the integrated firm to do so. In general, whether firms' bargaining positions incorporate these strategic considerations in

[18] Israel and Katz Opposition Report ¶¶267-9.

the "no trade" outcome depends on assumptions about MVPDs' and networks' beliefs about each other's actions (and about each other's beliefs) should they reach such a point. These assumptions, in turn, affect whether an MVPD could commit to lower price strategically during an impasse. Israel and Katz imply that, "say by committing itself to reducing its subscription charges conditional on losing access to NBCU content," the MVPD could limit its loss of subscribers, but they provide no arguments or evidence beyond this.[19]

23. My assumption that firms would lower prices in the "no trade outcome" in a way consistent with past behavior (and thus presumably with their profit-maximizing choices historically) does not imply that they can commit to lower price strategically even more. Israel and Katz provide no evidence that such strategic commitments have been an important part of past negotiations.

III. Economic Evidence Indicates That Israel and Katz' Newly Adopted Estimate of the Share of MVPD Subscribers That Switch From a DBS Firm to Comcast Is Too Low

24. Israel and Katz correctly state that my model implies that retransmission fees will increase after integration "*only if* Comcast would gain subscribers when other MVPDs lost access to NBCU networks."[20] They claim that "no one has presented any evidence in this proceeding to establish that Comcast would gain significant numbers of subscribers in such a circumstance."[21] {{ }}[22] They criticize me for adopting their assumption (which they made in their initial report) that the diversion rate to Comcast from an MVPD that loses programming is proportional to Comcast's market share among the MVPDs that did not lose programming. They now claim that the assumption in their initial report is "contradicted by the evidence."[23]

[19] Israel and Katz Opposition Report ¶59.
[20] Israel and Katz Opposition Report ¶54 (emphasis in the original).
[21] Israel and Katz Opposition Report ¶34.
[22] Israel and Katz Opposition Report ¶34.
[23] Israel and Katz Opposition Report ¶56.

25. In their implementation of a version of my pricing model, in which they claim to incorporate "efficiencies into the analysis,"[24] Israel and Katz assume that "diversion from a DBS provider to Comcast is equal to 1/3 of the value that would be implied by proportional diversion based on market shares."[25] They now claim that even this assumption is conservative given that, they claim, their empirical results imply a {{ }} diversion rate.[26] However, Israel and Katz' claim about diversion to Comcast requires extreme assumptions about substitutability between Comcast's offerings and those of the DBS suppliers that is not supported by other empirical evidence.

26. Below, I examine evidence on substitution between DBS firms and cable, none of which supports Israel and Katz' claim of {{ }} diversion between a DBS provider and Comcast (or cable more generally). Rather, it supports an assumption of a diversion rate from DBS to cable greater than "1/3 of what would be implied by proportional diversion based on market shares."[27] Based on this evidence, I conclude that Israel and Katz' assumption is not conservative. Although Israel and Katz' original assumption of proportionate substitution (which I also adopted in my Initial Report) likely overstates the degree of switching to cable, the evidence I report below, taken together, indicates that a reasonable assumption is a substitution rate of between {{ }} of that implied by proportionate substitution.

A. DIRECTV Surveys of Lost and Gained Subscribers Show Substantial Switching to Cable

27. DIRECTV conducts surveys to identify which MVPD, if any, its former subscribers choose after they cancel their subscription to DIRECTV. Results from surveys in the first quarter of 2010 indicate that {{

[24] Israel and Katz Opposition Report ¶64.
[25] Israel and Katz Opposition Report ¶67.
[26] Israel and Katz Opposition Report ¶67. It is not clear how this {{ }} assumption is grounded empirically, although, as I show below, it is more reasonable than {{ }} diversion.
[27] Israel and Katz Opposition Report ¶16.
[28] {{ }} of lost subscribers report that they have not subscribed to a new MVPD. I understand, based on my Staff's discussions with DIRECTV, that a significant portion of these usually subscribes to another MVPD in

}}

28. Nationally, cable's share of all MVPD subscribers {{ }}[29] This means that, according to the survey, subscribers leaving DIRECTV move to a cable provider at a rate equal to {{ }} percent of cable's national share of non-DIRECTV subscribers. Although less than proportionate substitution, this exceeds substantially the diversion rate that Israel and Katz now claim is conservative.

29. Moreover, these calculations likely provide an underestimate of diversion to cable, because they focus exclusively on the *existing* subscribers that DIRECTV likely would lose if it became less attractive (such as by losing access to some programming) and ignore the corresponding decline in *new* subscribers to DIRECTV that would result if DIRECTV's programming became less attractive. It also ignores the fact that telco is growing rapidly, so exit rates to telco likely overstate telco's steady-state representation among the new MVPD selected by DIRECTV subscribers. For both of these reasons, the distribution of prior MVPDs for new DIRECTV subscribers, also tracked by DIRECTV, provides useful additional evidence on substitution.

30. In the first quarter of 2010, {{ }} of new DIRECTV subscribers that indicated they switched from another MVPD had switched from cable. If the decline in DIRECTV subscribers from a loss of particular programming were due equally to a reduction in the number of new subscribers and an increase in the number of lost subscribers, then the simple

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a short period of time. The switching identified in the report accounts for only 98 percent of those responding to the survey. I understand from my Staff's discussions with DIRECTV that the remaining two percent did not respond to this survey question. *See*, DIRECTV Marketing Research. "Past & Current TV Service Trends Q2 2009 to Q1 2010."

[29] {{

}} DIRECTV Marketing Research. "Past & Current TV Service Trends Q2 2009 to Q1 2010."