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November 16, 2010

Via Electronic Delivery

Ms. Marlene H. Dortch
Federal Communications Commission
The Portals, TW-A325
445 12th Street SW
Washington, DC 20554

Re: Ex Parte Presentation – MB Dkt. 10-56, *Application of Comcast Corporation, General Electric Company and NBC Universal, Inc. for Consent to Assign Licenses or Transfer Control of Licensees*

Dear Ms. Dortch:

Attached please find a letter from Dr. Simon Wilkie explaining in further detail the finding of his previously-filed Technical Addendum that the Comcast/NBCU merger will reduce consumer welfare by raising the price of Comcast's standalone broadband service.

Pursuant to the Commission's rules, a copy of this letter is being filed electronically in the above-referenced docket for inclusion in the public record.

Respectfully submitted,



Jennifer P. Bagg
Counsel for EarthLink, Inc.

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Re: MB Dkt. 10-56, *Applications of Comcast Corporation, General Electric Company and NBC Universal, Inc. for Consent to Assign Licenses or Transfer Control of Licensees.*

Dear Ms. Dortch:

On October 1, 2010, I filed a supplemental report containing a technical addendum (the “Technical Addendum”) to my initial report regarding the proposed transaction between Comcast and NBC Universal, *Consumer Sovereignty, Disintermediation and the Economic Impact of the Proposed Comcast/NBCU Transaction* (filed June 21, 2010 with the Petition to Condition or Deny of EarthLink, Inc.). My findings in the Technical Addendum, which have not been rebutted, prove that the Comcast/NBCU merger will reduce consumer welfare by raising the price of Comcast’s standalone broadband service. Herein, I explain the results contained in the Technical Addendum.

Why Will the Proposed Transaction Increase Comcast’s Incentive to Raise the Price of Standalone Broadband Service?

The Technical Addendum contains an economic analysis that compares two sets of profit-maximizing prices: (1) Comcast’s pre-merger, profit-maximizing prices for standalone broadband, standalone cable, and a broadband/cable bundle; and (2) Comcast’s post-merger, profit-maximizing prices for those three products. The key finding is that Comcast’s lower, post-merger NBCU programming costs cause Comcast to increase the profit-maximizing price of standalone broadband service.

Based on these profit-maximizing prices, the Technical Addendum demonstrates that following:

- (1) Post-merger, the cost to Comcast of acquiring programming from NBCU will decline. Thus, Comcast’s marginal costs of providing standalone cable and a broadband/cable bundle will decline.
- (2) The decrease in the marginal cost of providing the broadband/cable bundle leads to a decrease in Comcast’s post-merger, profit-maximizing price of

the broadband/cable bundle and an increase in the price of standalone broadband.

- (3) If post-merger Comcast increases the price of standalone broadband service above the pre-merger price, some customers will stop purchasing Comcast's standalone broadband service or some of those customers will, in response to the now lower price of the bundle, switch to Comcast's broadband/cable bundle.
- (4) Thus, the merger enables Comcast to capture the revenues from some of the customers who stop purchasing its standalone broadband service in response to the post-merger increase in price.
- (5) If the decrease in the price of the bundle is less than the decrease in the marginal cost of producing the bundle, then there will be a positive net change in profits from (1) decreasing the price of the broadband/cable bundle and (2) increasing the price of standalone broadband service.
- (6) Thus, given the lowered price of the broadband/cable bundle, the post-merger Comcast will continue to gradually increase the price of standalone broadband service until the net change in profits is zero.

What about the efficiencies of a vertical merger?

The traditional view of a vertical merger – that it reduces inefficiencies and may lead to a lower price for the consumer – breaks down when we move away from a simple market with only one type of consumer. In markets where there are diverse consumers and more than one type of good being offered to more than one type of consumer, the price-setting problem increases in complexity, and a vertical merger in the supply chain can have detrimental consequences.

Understanding the Bundle: One key to understanding the source of detrimental effects arising from certain vertical mergers is to understand the “bundle.” Consider a company that has two goods to sell to consumers: A and B. The company charges a “standalone” price for the purchase of A and a “standalone” price for the purchase of B. The company also charges a single price for the purchase of A and B together – the “bundle” price. The company typically will set a lower bundle price for the purchase of both A and B than the combination of the standalone prices for A and B. The company wants to set the “bundle” price lower than the two standalone prices to entice consumers to purchase both goods. The difference between the sum of the standalone prices and the bundle price is called the “bundle discount.” The seller will calculate the most profitable bundle discount – in other words, the seller will set the highest bundle price it thinks consumers will pay so that the seller makes the highest profit.

We can use Comcast's cable television service and broadband service to further illustrate bundle pricing. Comcast sells each service as a standalone service and sells a bundle of both services. Based on recent website information, Comcast sells the standalone cable television service at a non-promotional price of \$102.25 per month and sells the standalone broadband service for \$59.95 per month. Comcast also offers both services as a bundle, with the non-promotional bundle price set at \$127.05 per month. Thus, if a consumer bought the services separately, it would cost \$162.20 per month.

The bundle price of \$127.05 provides the consumer a savings of slightly more than \$35.00, which is the bundle discount.

The complexity of the problem increases where there are many goods and many possible compositions of bundles. For example, Comcast offers a variety of “double play” and “triple play” bundles consisting of some combination of broadband service, cable television service, and voice service. Comcast also offers various tiers and upgrades for each service, such as increased broadband speeds and premium cable television packages. These services may be purchased in a variety of combinations and each package is priced differently and will have a different bundle discount.

Understanding the Standalone Price: A company selling a single good to a single type of consumer may be expected to lower its price when the cost of producing a unit of the good (the “marginal cost of production”) decreases. When there are many goods, however, there are different marginal costs of production for each good and it is reasonable to expect that a decrease in the marginal cost of production of a good (*i.e.*, A) decreases its standalone price. The impact that the decrease in the marginal cost of A has on the standalone price of another standalone product (*i.e.*, B) requires a more complex analysis. Using the most natural economic model available to answer this question demonstrates that, all else being equal, a decrease in the marginal cost of A will actually serve to *increase* the standalone price of good B.

Consider a hypothetical supply chain with one company selling two goods, A and B, either on a standalone basis or as a bundle. The company relies on and must pay for inputs from different providers in order to sell A. If the company and one of the input providers merge, the company’s marginal cost of producing A will decrease and, thus, the standalone price of A should decrease. According to the model presented in the Technical Addendum, the company now has an incentive to increase the standalone price of B in order to encourage buyers to purchase the bundle of A and B.

Now consider Comcast’s acquisition of NBCU. Currently, Comcast relies on and must pay NBCU for an input into its cable television service. Post-merger, Comcast will not have to pay NBCU for this input and, thus, Comcast’s marginal cost of its cable television service will decrease. This should decrease the standalone price of the cable television service. According to our model, after the merger, Comcast will have the incentive to increase the standalone price of its broadband service. This incentive is especially pronounced here because Comcast’s advertising revenues will increase based on an increase in consumers subscribing to its cable television service and broadcast station and because consumers can use the standalone broadband service to create their own synthetic broadband/cable bundle through online video viewing or through a competitive provider of video services (*e.g.*, DBS).

The analysis of this example requires an assumption that the consumer chooses from four possible options: buy only A, buy only B, buy the bundle of A and B, or buy nothing.¹ Consumers have valuations for each good. An important part of the model is

¹ Theoretical analysis of this problem requires us to make assumptions on the preferences of consumers, but we have been able to demonstrate that the analysis is robust by incorporating a large number of consumer preferences. Thus, by increasing the consumer preference options, we have even further evidence that the incentive to increase the standalone price of A is very likely to arise.

the distribution of consumer's valuations.² A valuation is simply the maximum price the consumer is willing and able to pay for the good and a consumer's valuation of a bundle is the sum of the valuations for each good. The consumer will choose the option which yields the highest "surplus" (*i.e.*, the difference between a consumer's valuation and expenses).

The merged company knows how valuations are distributed across the population. While it does not know exactly how much each consumer values A and B, given a range of dollar values, it knows how many consumers have valuations for A and B lying in that range. With this information, the company must set three prices - standalone prices for each good and a bundle price - to maximize profits. Thus, consumers and the company interact simultaneously (consumers making buying decisions and the company setting its prices) and we get a list of the three prices which maximize profits for the company as consumers make optimal buying decisions. Economic theory provides us with tools that enable us to evaluate the impact of a decrease in the marginal cost of good A on the standalone price of good B.

This sort of an exercise is called "comparative statics" and allows us to see how profit maximizing prices change as we lower the marginal cost of production of A. This exercise applied in the Technical Addendum demonstrates the conclusion that this vertical merger will have the detrimental consequences of raising the price of one of the standalone goods - broadband service.

Why is the Increase in Comcast's Incentive to Raise the Price of Standalone Broadband Service Significant?

My finding that the Comcast/NBCU Merger will increase the price of Comcast's standalone broadband service is significant because it will result in several harms to consumer welfare. These harms include forcing some existing standalone broadband subscribers to drop their broadband service and increasing the charges to subscribers who wish to "cut the cord" and acquire online video distribution services via standalone broadband, thereby avoiding Comcast's higher-priced bundled offerings.

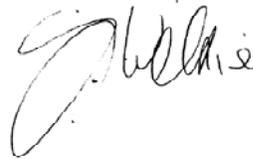
The structural solution proposed by EarthLink - wholesale standalone broadband access - will mitigate this harm to consumer welfare and ensure that consumers benefit from the Comcast/NBCU transaction. Competitive choices, such as an independent ISP like EarthLink could provide, would serve consumers who wish to remain with a standalone broadband provider at competitive prices. The availability of sufficient neutral provider choices would also serve to discipline Comcast's ability to raise prices and engage in anticompetitive conduct.

A condition requiring Comcast to sell wholesale standalone broadband access to independent ISPs has the added benefits of indirectly encouraging the further development of online video programming by leveling the playing field. By increasing the difficulty for content-integrated ISPs to discriminate against non-affiliated

² Preliminary investigations tell us that there is ample evidence to suggest that the result holds for an extremely large class of distributions, which includes many commonly used distributions in statistical analyses. These distributions are called *log-concave* distributions, and this class includes the Normal, Exponential, and Weibull distributions among others.

programming, this structural solution will promote the growth and health of these programmers, giving consumers more diversity in online content. This result will also increase pressure on Comcast to continue to invest in, and expand, their broadband network. The condition will also diminish the incentive of Comcast/NBCU to paralyze online video programming, as there would be a real marketplace “penalty” imposed upon them by upset customers who will switch to another ISP.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Simon J. Wilkie". The signature is fluid and cursive, with a large initial "S" and "W".

Simon J. Wilkie, Ph.D.
Professor and Chair, Department of
Economics
University of Southern California