Consumer Federation of America

BUYER AND BOTTLENECK MARKET POWER
MAKE THE COMCAST-TIME WARNER MERGER "UNAPPROVABLE"

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ASKING THE RIGHT QUESTION

In the two months since the proposal of a Comcast-Time Warner merger, Comcast has constantly claimed the merger is "approvable" largely because Comcast and Timer Warner do not compete head-to-head and Comcast agreed to conditions in the Comcast-NBC merger.[1] This is has triggered a back and forth in the mass media around a simple question.[2]

- If the Department of Justice and the Federal Communications Commission approved the Comcast-NBC merger, how can they turn this merger down, especially since Comcast and Time Warner engage in no direct competition?

The question is posed almost rhetorically and the answer is not supported with reference to the analyses that antitrust and communications law or practice routinely conduct in merger review. This paper shows that when the impact of the merger is examined through the lens of the standards that recognize a number of different competitive impacts of a merger, it becomes immediately apparent that the question should be flipped around.

- How can this merger possibly be approved?

Since Comcast and Time Warner do not compete head-to-head as cable operators, this is not a "horizontal" merger so the merger does not directly raise concerns about monopoly power. The merger does raise significant concerns about the market power of the huge firm that would result from the merger as a buyer of content (monopsony power) and as a seller of broadband access service that online video distributor need to compete (vertical leverage). By abusing these other forms of market power, Comcast could weaken competition and strengthen its dominant position. Indirectly, its monopoly market power is strengthened. The weakness of head-to-head competition actually intensifies the concerns about buyer and bottleneck market power. The anticompetitive harm that the buyer and bottleneck market power this merger creates in the broadband and video markets triggers severe antitrust and Communications Act concerns that are much more profound than the concerns triggered by Comcast NBC.

Far from excusing the merger from antitrust and Communications Act scrutiny, however, the fact that Comcast and Time Warner do not compete head-to-head merely reminds us of the sad state of horizontal competition in the video distribution markets that they dominate in their local areas – broadband Internet access and multichannel video. The failure of the cable operators to overbuild one another to compete head-to-head in the multichannel video market and the extension of the gentlemen's agreement not to compete in physical space into cyberspace with the "TV Everywhere" authentication model is one of the greatest failures of the Telecommunications Act of 1996.

This paper presents an initial empirical analysis of the impact of the merger as viewed through the general standards and preliminary screens that are used to evaluate the impact of mergers. It is based on publicly available data. A series of Appendices provides the legal and

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[1] Brian Roberts, the Comcast CEO, emphasized this from the announcement of the merge. David Cohen interview with Reid Hundt, former Chairman of the Federal Communications Commission, March 10, 2014.

[2] For example, James B. Stewart, "A Vision Beyond Cable for Comcast After Merger," *New York Times*, March 28, 2014; Chris Moran, "Let's Count the Ways in Which the NY Times Love Letter to the Comcast Merger is full of Bull," *Consumerist.com,* March 29, 2014.

analytical underpinnings for the empirical analysis as we have presented it in regulatory proceedings over the course of the last decade.

CONCERNS ABOUT MARKET POWER

Buyer Market Power

An important antitrust concern arises when a firm becomes so large a buyer of goods or services that it can use its market power to dictate prices, terms and conditions that hurt the firms from which it buys those goods and services. It might do so to increase its profits, even though the quality or diversity of the products available declines. The official term for this form market power is "monopsony" power. (See Appendix A)

If the firm with buyer market power also happens to also sell similar products, as Comcast does in the video market, it would be doubly glad to weaken potential competition in the market for those product. It could increase its profits by paying less for the goods and services it buys and charge more or gain market share for its own products by using its buyer power. The weaker horizontal competition is, the more likely it is for the firm with buyer market power to benefit from its abuse.

There is no doubt about the relevance of this concern. When Comcast announced the merger, it said it would divest enough cable subscribers to lower its market share to 30%. The 30% figure is the limit the Federal Communications Commission (FCC) proposed for video distribution firms based on the fear that by refusing to carry a cable network, the firm would be large enough to determine if the program will succeed or fail. Antitrust practice uses the same threshold and companies have been found guilty of violating the antitrust laws by abusing their market power with market shares at this level. Mergers have been blocked based on the existence of buyer market power.[3]

> Enhancement of market power by buyers, sometimes called "monopsony power," has adverse effects comparable to enhancement of market power by sellers. The Agencies employ an analogous framework to analyze mergers between rival purchasers that may enhance their market power as buyers.[4]

Bottleneck Market Power

When a firm has a large market share for an input that is necessary for other firms to compete with it, then it can use its control over that bottleneck to undermine competition in a number of ways. The official term for this form of market power is vertical leverage. (See Appendix B) Potential competitors who want to enter the market to compete the dominant incumbents, like over-the-top video distributors, need to have access to customers. If Comcast controls access to a large enough number of customer, it can make it hard for the competitor to succeed by raising its

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[3] The area of greatest activity has been health care (e.g. Henry, S. Allen, Jr., *Consolidating Health Insurer Markets: A Challenge Facing Antitrust Enforcement,* American Medical Association.

[4] Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines,* August 19, 2010, p. 2.

rival's cost, degrading its quality of service, or blocking the delivery of its product altogether. This preserves its market power in its core business of video distribution.

The importance of bottleneck power was affirmed in the Comcast-NBC merger. The Department of Justice (DOJ) made it clear that Comcast would have the incentive and the ability to undermine competition by leveraging its control over access to broadband customers. This would weaken online video distributors (OVDs). Both the DOJ and the FCC imposed conditions to prevent that abuse.

> 52. The impact of the JV [Joint Venture between Comcast and NBC] on emerging competition from the OVDs is extremely troubling given the nascent stage of OVDs' development and the potential of these distributors to significantly increase competition through the introduction of new and innovative features, packaging, pricing, and delivery methods…
>
> 54. Comcast has an incentive to encumber, through its control of the JV, the development of nascent distribution technologies and the business models that underlie them by denying OVDs access to NBCU content or substantially increasing the cost of obtaining such content. As a result, Comcast will face less competitive pressure to innovate, and the future evolution of OVDs will likely be muted.[5]
>
> [W]e find that Comcast's acquisition of additional programming content that may be delivered via the Internet, or for which other providers' Internet-delivered content may be a substitute, will increase Comcast's incentive to discriminate against unaffiliated content and distributors in its exercise of control over consumers' broadband connections.[6]

Coordinated Effects

Given the failure of cable operators to compete head-to-head in physical space and their efforts to extend that non-compete model into cyberspace, the impact of the proposed merger to enhance the ability of the industry to coordinate this campaign against OVD competitors must be considered. A dominant firm with a market share as large as Comcast-Time Warner would have would be well positioned to lead, signal and coordinate actions that would diminish competition.

> A merger also can enhance market power by increasing the risk of coordinated, accommodating, or interdependent behavior among rivals. Adverse competitive effects arising in this manner are referred to as "coordinated effects." In any given case, either or both types of effects may be present, and the distinction between them may be blurred…
>
> The Agencies are likely to challenge a merger if the following three conditions are all met: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct… and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability.[7]

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[5] United States Department of Justice, et al. v. Comcast, et. Al, Complaint, 2011, p. 21

[6] Federal Communications Commission, "Memorandum Opinion and Order," In the Matter of Applications of Comcast Corporation, General Electric Company and NBC Universal, Inc. For Consent to Assign Licenses and Transfer Control of Licensees, MB Docket No. 10-56, January 20, 2011, ¶91.

[7] DOJ/FTC, *Merger Guidelines*, 2010, pp. 2… 25.

ASSESSING THE IMPACT OF MERGERS

Thresholds

The Department of Justice and the Federal Trade Commission (FTC) have published *Merger Guidelines* for decades that lay out the broad framework that they apply in reviewing mergers. The goal is to give industry guidance on the general approach that will be taken. At the core of those *Guidelines* is statistical analysis of the market structure. Two aspects of the market are captured. How large is the post-merger firm and how much does the merger increase the concentration in the market. The *Guidelines* were recently revised, so the standards for review are quite fresh.

As described in Exhibit 1, the DOJ/FTC use three categories to identify markets – Unconcentrated, Moderately Concentrated and highly concentrated. The categories are defined by the HHI index, which is a measure of the degree of concentration that has been used throughout the history of the *Guidelines.* (See Appendix C) The merger is assessed in terms of its impact on market concentration.

EXHIBIT 1: MERGER GUIDELINE THRESHOLD ANALYSIS

Post-Merger Market Type	HHI Level	HHI Change	Impact on Competition
Unconcentrated	HHI <1500	NA	
Moderately Concentrated	1500 ≤ HHI< 2500	+100	Raise significant competitive concerns
Highly Concentrated	HHI ≥ 2500	+100-200	Raise significant competitive concerns
		+≥200	Presumed to be likely to enhance market power

Source: Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines,* August 19, 2010

- If the post-merger market is unconcentrated, it generally does not raise competitive concerns.
- If the post-merger market is either moderately concentrated or highly concentrated and the merger increases the HHI by a fairly small amount, more than 100 points, the merger "raises significant competitive concerns."
- If the post-merger market is highly concentrated and the merger raises the HHI by more than 200 points, the merger is "presumed to be likely to enhance market power."

These are only the initial screening thresholds and the results are greatly influenced by the way the geographic and products markets are defined, but this analysis sets the tone of the inquiry.

Qualitative Assessment of the Nature of the Merger

The proposed Comcast Time Warner poses much greater potential harm to competition and consumers than the Comcast-NBC merger did.

Comcast-NBC was the first merger between a cable Multiple System Operator (MSO) and a broadcast network. Comcast-Time Warner is only the second. It increases the incentive and ability of Comcast to abuse its vertical leverage, increasing market share at the key points of leverage in the vertical chain by 50%.

This is the largest merger in the history of the broadband access market, a merger between the #1 and #3 firms that dramatically increases the level of concentration in the market far in excess of the threshold of concern stated in the recently revised *Merger Guidelines*. It creates an industry leader that is twice the size of the next firm. It creates a dominant firm with a post-merger market share that exceeds the threshold for concerns about buyer market power by a substantial margin.

This is one of the largest mergers between Multichannel Video Program Distributors (MVPD) in U.S. history. It is a merger between the #1 and #5 MVPDs (the #1 and #2 cable MSOs) that increases the level of concentration in the market by much more than the threshold of concern stated in the recently revised *Merger Guidelines*. It creates an industry leader that is 1.5 times the size of the next firm, a dominant firm with a post-merger market share that exceeds the threshold for concerns about buyer and bottleneck anti-competitive conduct by a substantial margin.

Thus, by creating a huge firm with buyer and bottleneck market power, this merger poses a severe threat to competition, even though it is a geographic extension merger. Moreover, this is a unique geographic extension merger that magnifies the potential harm to competition.

Since the market power concern is about the ability of the dominant firm to harm competition by using leverage as a buyer or a bottleneck, control over the most important markets compounds the problem. The market power of the combined firm is magnified by the fact that post-merger, Comcast will have a strong, even dominant position in the most important video advertising markets in the U.S. – 19 of the top 20 markets and 30 of the top 50 markets.[8] Being denied access or placed at a disadvantage in access to customers in the markets where they are most valuable does particularly severe harm to potential content or OVD competitors. Advertisers covet access to audiences in these markets.

The regional sports and news networks that Comcast and Time Warner control would enhance the market power of the post-merger firms both as a bottleneck (withholding access to marquee content) and a buyer (reaching high value regional sports audiences). Comcast has used access to this marquee content to weaken competition in the past.

The Impact of the Merger on Market Concentration

Exhibit 2 presents the market structure analysis of the Comcast-Time Warner merger in terms of both the dominant firm market share analysis (30%) recognized by Comcast and antitrust practices and the HHI analysis from the *Guidelines*. It assumes the market is national and presents several alternative definitions of the product market that have been discussed in the press and would be examined by the oversight agencies.

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[8] MoffettNathanson, cited in Philadelphia Magazine-Online, March 17, 2014, David Carr, "The Media Equation," *New York Times*, April 7, 2014.

EXHIBIT 2: THE MERGER RAISES SEVERE CONCERNS MARKET POWER

	Post-Merger Market		DOJ/FTC Merger Guidelines	
	Dominant Firm Share	HHI Level	Change in HHI	Impact on Competition
DOJ/FTC Thresholds of market power concerns	30	1500-2500	100-200	
Internet Access Service				
True Broadband	**49**	**2835**	**1120**	**Likely to enhance market power**
High Speed Data	38	2045	670	Significant competitive concerns
Cable Television Service				
Wireline	**54**	**3249**	**1359**	**Likely to enhance market power**
MVPD	35	1778	552	Significant competitive concerns

Sources and Notes:
Thresholds: Dominant firm, see text, Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines,* August 19, 2010
Market shares: LRG March 17, 2014, Year-End subscriber counts for Broadband and Multichannel Video.
True Broadband includes AT&T U-Verse and Verizon FIOS, but excludes AT&T and Verizon DSL subscribers and all other telephone company DSL subscribers.
Wireline excludes satellite from the video count
Cable excludes satellite and telephone company from the video count.

The key to product market definition is the ability of products to provide similar service at similar prices. "A relevant product market consists of a group of substitute products."[9] If a product does not possess reasonably similar attributes or has a much higher price tag, it is not a good substitute. We believe that the most relevant product market are True Broadband access market and the Wireline MVPD market, identified in bold in the table.

The most important product market here is the True Broadband Market. We define the True Broadband Market to include cable modem service, Verizon FIOS and ATT U-verse. We do not include telephone company DSL in the product market. True broadband is the product that can deliver large amounts of high quality video to consumers, which makes ti the primary area for potential competition. Comcast's own advertising and executive statements make it clear that DSL is not a substitute.[10]

We do not include wireless broadband in this product definition. As deployed, it generally lacks the ability to deliver large quantities of high quality video that can compete with the MVPD product. Comparisons of speed and price make it clear that wireless broadband is not a good substitute when it comes to MVPD video. Compared to Verizon and AT&T, the dominant wireless broadband service providers, Comcast offers services at roughly the same fixed monthly charge but the speed is twice as fast and the cap is over 100 times higher. At the level of Comcast's cap, AT&T

[9] Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines,* August 19, 2010, p. 8.
[10] Allen P. Grunes and Maurice E. Stucke, *The Beneficent Monopolist,* March 26, 2014, p. 4, cite cable industry "veteran" John Malone who states that "In broadband, other an in the FiOS area, cable's pretty much a monopoly," a sentiment expressed by Comcast CEO Brian Roberts.

and Verizon wireless broadband is ten times as expensive. Streaming of HD video, which is the direction of video service, will overwhelm wireless broadband.

For similar reasons, we believe the wireline MVP market is the relevant video market. Satellite has never been able to discipline cable pricing power and is at a severe disadvantage vis-à-vis cable because of the emerging dominance of bundles. The bundled product is clearly the product that Comcast promotes, "According to Comcast 79 percent of its video customers at the end of 2013 subscribed to two services while 44 percent subscribed to all three. Satellite cannot provide bundles.

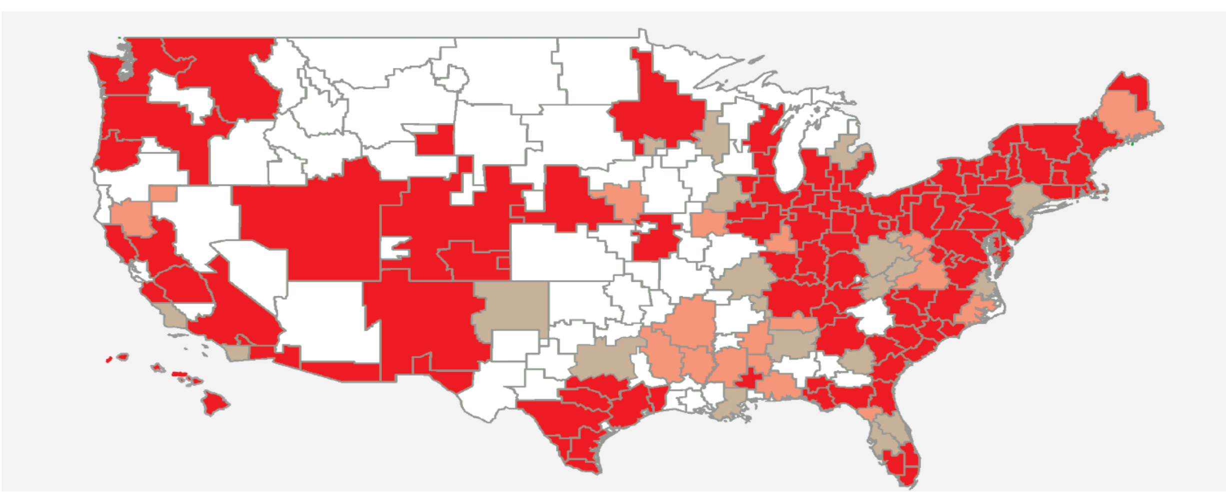
The definition of a true broadband product market gives Comcast-Time Warner a 49% market share of a 65 million subscriber True Broadband based on publicly available date. Free Press has estimated the market share of the post-merger Comcast at between 47% (true broadband), 49% (double play) and 55% (triple play) based on proprietary data. The somewhat dated FCC broadband statistics put the broadband market for services with speeds of greater than 10 mb at 60 million in December 2012. LRG reports an increase of 6.3 million cable and ATT/Verizon broadband subscribers. Hence, we believe our estimate of the size of the true broadband market and the Comcast-Time Warner market share is reasonable and accurate.

The market share and competitive impact that flows from the merger in the wireline MVPD market is similar to that in the True broadband product market. Even if broader market definitions are used, the merger violates the guidelines and standards by a substantial margin. If the unique value of subscribers in the large markets dominated by Comcast-Time Warner are taken into account, the anticompetitive effect of the merger would be seen as even greater.

Market Extension

Exhibit 3 show a map of the designated market areas in which Comcast-Time Warner would hold a cable franchise. The designated market area (DMA) is the unit of analysis in the video sector.

EXHIBIT 3: COMCAST-TIME WARNER DOMINATE KEY VIDEO MARKETS



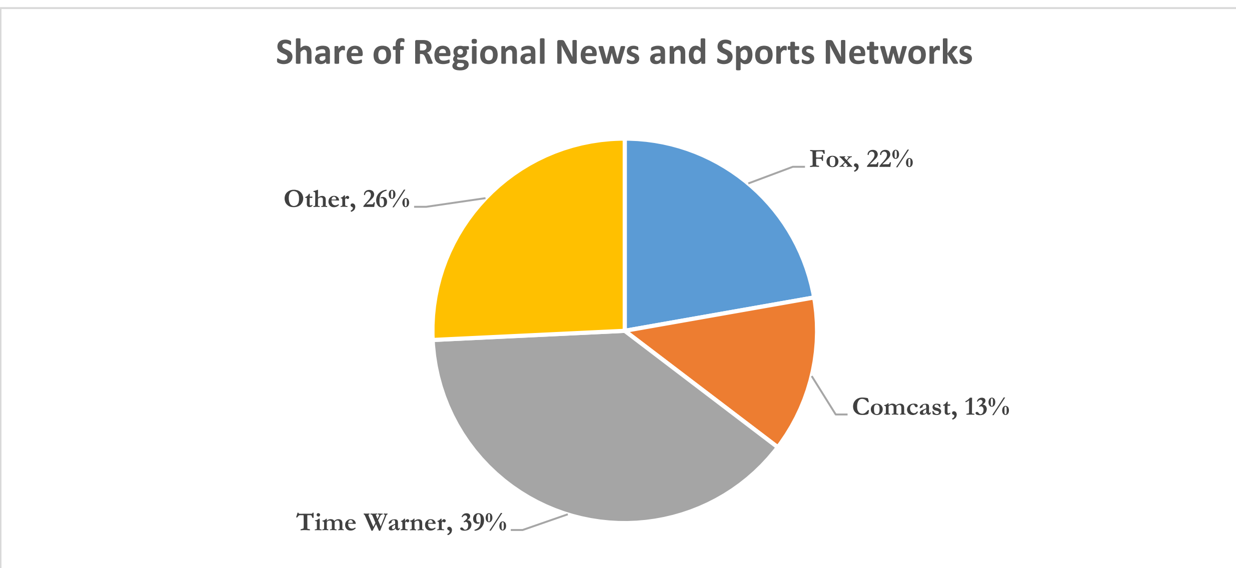
Source: Josh Stearns, "Four Infographics Reveal Why the Comcast Merger is Bad for You, Free Press, March 26, 2014.

There may be more than one cable franchise in a DMA, so it is important not to assume that just because Comcast-Time Warner is the dominant cable operator (darkest red color), it serves the entire DMA. On the other hand, where it is the dominant cable operator, it is likely to be the most important video distributor from the point of view of both competitive content and OVDs.

The merger brings the top two video and advertising markets – New York and Los Angeles – under Comcast control, giving in near total domination in the top 10 video market. Time Warner also brings dominance in several of the market that rank in next ten and the top 50. Our analysis shows that in terms of advertising revenue, the viewer in the markets that Comcast-Time Warner would dominate have a premium of 20%. (See Appendix D). Thus, as deeply concerning as the concentration analysis based on subscribership was, it underestimates the market power of a post-merger Comcast-Time Warner and the impact of the merger.

Exhibit 4 shows the impact of the merger in terms of regional news and sports, measured by the count of networks. Time Warner dominates regional news with two thirds of all the networks listed by the FCC. Sports is more evenly divided with both Comcast and Time Warner owning about one-fifth of the sports networks. The merger would make Comcast-Time Warner the dominant regional sports programmer and the dominant regional news programmer. Combining the companies and the two forms of marquee regional content, Comcast-Time Warner would have a majority of the total regional marquee networks.

EXHIBIT 4: COMCAST-TIME WARNER DOMINANCE OF MARQUEE REGIONAL CONTENT



Source: Federal Communications Commission, *Fifteenth Report, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* MB Docket No. 12-203

Given the markets in which Comcast-Time Warner dominate, an analysis based on subscribers and revenues would magnify their market shares. To the extent that regional programming can be used as a tool to weaken competition in the distribution market, the post-merger dominance raises significant concerns.

CONCLUSION

The opposition to the merger expressed by the *Economist,* hardly a "paranoid blogger,"[11] or wild-eyed populist enemy of capitalism,"[12] incorporated the market definitions and anticompetitive concerns demonstrated with basic antitrust concepts in this paper.

> The deal would create a Goliath far more fearsome than the latest ride at the Universal Studios theme park (also Comcast-owned). Comcast has said it would forfeit 3m subscribers, but even with that concession the combination of the two firms would have around 30m—more than 30% of all TV subscribers and around 33% of broadband customers. In the cable market alone (i.e., not counting suppliers of satellite services such as DirecTV), Comcast has as much as 55% of all TV and broadband subscribers.
>
> Comcast will argue that its share of customers in any individual market is not increasing. That is true only because cable companies decided years ago not to compete head-to-head, and divided the country among themselves. More than three-quarters of households have no choice other than their local cable monopoly for high-speed, high-capacity internet.
>
> If the takeover is approved, Comcast would control 20 of the top 25 cable markets, according to MoffettNathanson, a research firm. Antitrust officials will need to consider Comcast's status as a monopsony (a buyer with disproportionate power), when it comes to negotiations with programmers, whose channels it pays to carry. Comcast could refuse to carry certain channels, or use its clout to insist on even greater price discounts or to favour its own content over that of others.
>
> For consumers the deal would mean the union of two companies that are already reviled for their poor customer service and high prices. Greater size will fix neither problem…
>
> The biggest worry is Comcast's grip on the internet. Unlike Britain and France, America unwisely has no "common carriage", allowing for internet service providers to rent cable companies' pipes and compete on price and speed. Already Americans pay far more than people in other rich countries for slower internet. Comcast will have extraordinary power over what content is delivered to consumers, and at what speed.[13]

It is a gross understatement to say that the proposed Comcast-Time Warner raises competitive concerns. It fractures the *Guidelines* and standards of antitrust practice. If the Comcast had been the size of the firm that would be created by this merger **before** it acquired NBC, it is a very good bet that the Comcast-NBC merger would not have been approved because the anticompetitive threat of buyer and bottleneck market power would have been much more severe.

It is even better bet that the conditions placed on the Comcast NBC merger are grossly inadequate to deal with the likely enhancement of market power that would result from the Comcast-Time Warner merger. The leverage for the abuse of market power is dramatically increased by this merger. Every aspect of the consent decrees would have to be reviewed and we believe found grossly inadequate to prevent the abuse of the much more virulent market power created by the proposed Comcast-Time Warner merger. For example:

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[11] Doug Brake, "Ignore Paranoid Bloggers: The Comcast-Time Warner Merger Is Good for Consumers," *Forbes,* February, 27, 2014.

[12] Grabnetworks, "Comcast-TWC Merger Would Create a "Fearsome Goliath," Should be Shot Down, *IT Business Net,* March 18, 2014.

[13] Turn it off: American regulators should block Comcast's proposed deal with Time Warner Cable, *Economist,* March 15th 2014

First, the cornerstone of the consent decrees was a nondiscrimination obligation that relies on market benchmarks and pays deference to standard industry practices in things like most favor nation clauses or other contract provisions that reference third parties. With Comcast Time Warner representing half of the broadband access market by subscribers, and even more by subscriber value, there may simply be no effective market to point to. Especially when standard industry contracts refer to the rates, terms and conditions that others receive, Comcast can dictate industry wide practices that are anticompetitive and then point to them as market benchmarks.

Second, the Netflix dispute delivers a similar message. It took Netflix years to resolve its dispute with Comcast and it quickly made it clear that it was forced to agree to undesirable terms ("arbitrary tax") because the network neutrality conditions are too weak. It declares there is a need for "strong" network neutrality conditions.[14] This was before Comcast had proposed to acquire 50% more bargaining power by merging with Time Warner.

Third, in the video space, Comcast's treatment of Bloomberg is a blatant demonstration of bad faith and recalcitrance that calls into question the ability of the oversight agencies to enforce consent decree conditions.[15]

Fourth, even though the Netflix and Bloomberg disputes were or are likely to be resolved eventually, they raise a more fundamental question. These are two very large companies that could withstand years of foot dragging by Comcast. Smaller firms cannot, especially if Comcast is 50% larger. The entire approach to enforcement would have to be revamped with Comcast required to comply on an expedited basis (weeks, not years).

Fifth, the choke points over which Comcast would exercise bottleneck market power have also expanded beyond those considered in the consent decree. Set top box and WiFi hotspots are emerging as additional choke points where the industry is moving unilaterally or collectively to extend their agreement not to compete and their efforts to foreclose competition.[16] A review of the merger conditions would require a comprehensive review of all the choke points and would show that the Comcast-NBC consent decree is inadequate to address the multilayered vertical leverage that Comcast-Time Warner would have.

The Comcast-NBC consent decree is inadequate to deal with the buyer and bottleneck market power of a merged Comcast-Time Warner. In our Tunney Act comments supporting the consent decree in the Comcast-NBC merger, we cautioned that the benefits of the conditions would be contingent on two key developments. First, we noted that "enforcement would have to be vigilant and aggressive." [17] Second, we pointed out that

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[14] Peter Lauria, "The regulatory war between Comcast and opponents of its Time Warner Cable Deal has officially begun," Buzzfeed, March 23, 2014, for the reference to strong network neutrality; Reuters, "Netflix CEO calls for Free Interconnection, Criticizes Comcast," March 21, 2014.

[15] Grunes and Stucke, 2014, p. 9.

[16] Shalini Ramachandran, Daisuke Wakabayashi and Amol Sharma, "Apple in talks with Comcast about streaming-TV service," *Wall Street Journal,* March 23, 2014, refers to the new Comcast, cloud based set top box; Jea-Lois Gassee, "Comcast and Us," *Mondaynote.com,* February 16, 2014, notes that control of set top box preserves control over video customers; Kevin Fitchard, "Its not just cable: Comcast-time Warner would create a WiFi powerhouse," *gigaom.com.*

[17] Tunney Act Comments of The Consumer Federation of America And Consumers Union,United States District Court For The District Of Columbia, United States of America, et al., v. Comcast, et al., State of California, v. Comcast Corp., General Electric Co., and NBC Universal Inc., Case: 1:11-cv-00106, p. 5.

> the complaint lays the basis for broader Section I or Section II action against other operators… The Department has now established the product and geographic market definitions, the structural sources of horizontal market power and vertical leverage, and the behaviors that would constitute anticompetitive conduct that seeks to defend or extent the market power of the cable/ broadband access companies. The market structure analysis indicates that it is so likely to substantially enhance market power it should not be approved.[18]

The proposed merger is a clear violation of Sections 1 and 2 of the Sherman Act and Sections 7, 12, 15, and 16 of the Clayton Act.

The current state of competition in the two markets that are placed at risk by this mergr reinforces this conclusion. We have moved from potential competition to emerging competition.[19] It is clear that Internet distribution of video content has begun to dent the anticompetitive armor that cable operators have built around their abusive business model. Unfortunately, but not unexpectedly, it is also clear that cable operators are attempting to rebuild their defenses by extending their practices to cyberspace and leveraging their control over true broadband access.

This is a critical moment in the development of potential competition and allowing a merger that would create a broadband and MVPD giant would be a huge mistake. Allowing firms that have been at the forefront of the industry-wide efforts to undermine competition to become a "fearsome Goliath that towers over the rest of the industry would deal a severe, if not a death blow to emerging competition. When all is said and done, the merger is too large and the leverage points too numerous to try and repair the damage to competition with conditions. Competition, consumers and the public interest will be best served if the merger is blocked.

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[18] Tunney Act Comments of The Consumer Federation Of America, p. 5.
[19] The *Merger Guidelines* use the term potential competition and potential entrants 17 times.

APPENDIX A:
THE ECONOMIC THEORIES OF MONOPSONY AND MONOPOLY POWER

Excerpt From: Comments of Consumer Federation of America, et el.*, On Horizontal Limits,* pp. 85-88..*[20]*

Antitrust law and practice recognizes that monopoly and monopsony are flip sides of the same anticompetitive coin.

> The mirror image of monopoly is "monopsony." A monopsonist is a monopoly buyer rather than seller. Although most antitrust litigation of market power offenses has involved monopoly sellers rather than buyers, monopsony can impose social costs on society similar to those caused by monopoly.[21]
>
> Monopsony is often thought of as the flip side of monopoly. A monopolist is a seller with no rivals; a monopsonist is a buyer with no rivals. A monopolist has power over price exercised by limiting output. A monopsonist also has power over price, but this power is exercised by limiting aggregate purchases. Monopsony injures efficient allocation by reducing the quantity of the input product or service below the efficient level.[22]

Monopsony power has received less attention in antitrust practice for a variety of reasons. Monopoly and monopsony frequently occur together and monopoly is the more inviting antitrust target.[23] The impact of this exercise of market power, in the first instance, may be to lower prices paid by monopsonist buyers, which poses a conundrum for antitrust law, which usually focuses on price increases.[24]

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[20] Comments of Consumer Federation of America, et el*.,* In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992, Implementation of Cable Act Reform Provisions of the Telecommunications Act of1996, The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules, Review of the Commission's Regulations Governing Attribution, Of Broadcast and Cable/MDS Interests, Review of the Commission's Regulations and Policies Affecting Investment, In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy, Federal Communications Commission, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002,

[21] Hovenkamp, p. 13-14.

[22] Lawrence Sullivan and Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook,* Hornbook Series (West Group, St. Paul, 2000) at 138-139.

[23] Id. at 138-139, Antitrust law has been slow to develop a coherent set of principles for assessing monopsony power. One reason for this is that many firms possessing monopsony power in the purchase of goods or services also possess monopoly power when the goods or services are resold. For example, the monopsony power that a cable TV franchise possesses in purchasing television programming becomes monopoly power when that programming is distributed to the franchise's cable subscribers. When a monopsonist is also a monopolist, attacking the monopoly conduct may be the politically more popular enforcement option because the monopoly conduct has a direct impact on the price paid by consumers. Although there is no theoretical basis for assuming that monopsony power is less injurious to consumer welfare than monopoly power, the direct injury that monopsony occasions is to the seller of goods and services, not to the end consumer. To the extent antitrust chooses politically popular enforcement initiatives, it is understandable that it would focus on a monopoly that raises prices to consumers rather than a monopsony that depresses prices to sellers.

[24] Hovenkamp, at 14.By reducing its demand for a product, a monopsonist can force suppliers to sell to it at a lower price than would prevail in a competitive market... If the price is suppressed they will reduce output to a level that once again equals their marginal costs. In any event, both price and output will fall below the competitive level when the buyer is a monopsonist. Some productive assets will be assigned to products that would have been the supplier's second choice in a competitive market. As a result, monopsony allocates resources inefficiently just as monopoly

However, the leading antitrust texts recognize that a careful economic analysis of the abuse of monopsony power leads to the more traditional and typical anticompetitive effects.[25]

> The monopsonist reduces its buying price by reducing the amount of some input that it purchases. If the input is used in the output in fixed proportions, then the output must be reduced is well. This suggests two things: (1) the monopsony buyer that resells in a competitive market will charge the same price, but its output will be lower than if it were a competitive purchaser; (2) the monopsony buyer (or cartel) that resells in a monopolized (or cartelized) market will actually charge a higher price than if it were a competitive purchaser.[26]

But antitrust attacks on monopsony abuses do occur and enforcement efforts can lead to a potentially wider interest in market power abuses of powerful buyers.

> For example, in addressing vertical restraints, the theoretical literature has increasingly recognized that some restraints are a product of market power in the hands of downstream dealers that buy from their suppliers. Increased public interest also followed the Federal Trade Commission's pursuit of a vertical restraints case against Toys "R" Us alleging that the powerful retail chain exercised monopsony power in preventing suppliers from selling on equal terms to other retailers.[27]

In fact, not only is monopsony power the object of traditional antitrust practice,[28] but also it has a very long-standing presence in seminal cases.

> Although the Court did not use the term "monopsony," it has not hesitated in a number of cases to apply Section 2 of the Sherman Act to monopsony power. An early example of this was the 1911 Standard Oil case, involving allegations that Standard Oil used its monopsony power over the railroads to dictate the terms by which the railroads would deal with rivals of Standard Oil. Standard Oil was by no means the sole purchaser of railroad transportation, but its substantial position in the oil industry and the relative importance of a railroad maintaining its petroleum business probably gave Standard Oil a substantial measure of monopsony power. The Justice Department directed another Section 2 attack on monopsony power at movie theater owners in United States v. Griffith. In Griffith, the defendants owned movie theaters in towns in Oklahoma, Texas and New Mexico, some of them in competition with rival theaters in the same town, others operating as the sole theater in town. The Justice Department successfully invoked Section 2 in condemning the defendants use of their buying power to gain favorable terms from movie distributors...

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does. The important policy implication of monopsony is that it reduces rather than increases output in the monopsonized market. Many federal judges have failed to see this. The consumer welfare principle in antitrust, or the notion that the central goal of antitrust policy should be low prices, has often suggested to courts that monopsony is not all that important an antitrust policy concern.

25 Roger D. Blair and Jeffrey L. Harrison, "Antitrust Policy and Monopsony," *Cornell L. Rev.* 1991.

26 Id. at 15.

27 Sullivan and Grimes, at 139.

28 John Lauck, "Toward an Agrarian Antitrust: New Direction for Agricultural Law," *N.Dak. L. Rev* 499, 1999; John J. Curtin, Daniel L. Goldberg and Daniel S. Savrin, "The EC's Rejection of the Kesko/Tuko Merger: Leading the Way to the Application of a 'Gatekeeper' Analysis of Retailer Market Power Under U.S. Antitrust Law," 40 *B.C. L. Rev.* 537 (1999).

> The unspoken premise of Griffith is that the Court will apply the same standards of proof to a monopsony claim under Section 2 that it would apply to a monopolization claim.[29]

Sullivan and Grimes note that the exercise of monopsony power is more likely in specialized products. They specifically include cable TV programming in the list of markets likely to be afflicted with the exercise of monopsony power.

> Monopsony is thought to be more likely when there are buyers of specialized products or services. For example, a sports league may exercise monopsony (or oligopsony) power in purchasing the services of professional athletes. An owner of a chain of movie theaters, some of which are the sole theaters in small towns, may have monopsony power in the purchase or lease of movies. Cable TV franchises may exercise monopsony power in purchasing television channels that will be offered to their subscribers.[30]

At the same time, the abuse of monopsony power is more likely when the product is undifferentiated. Where products are relatively undifferentiated and capacity primarily distinguishes firms and shapes the nature of their competition, the merged firm may find it profitable unilaterally to raise price and suppress output. The merger provides the merged firm a larger base of sales on which to enjoy the resulting price rise and also eliminates a competitor to which customers otherwise would have diverted their sales. Where the merging firms have a combined market share of at least <u>thirty-five percent</u>, merged firms may find it profitable to raise price and reduce joint output below the sum of their premerger outputs because the lost markups on the foregone sales may be outweighed by the resulting price increase on the merged base of sales.[31]

In some respects, video programming is differentiated, in others it may not be. The NPRM recognizes this when it discusses the question of entry by imitation in genres.[32] The development of marquis shows and strong brands suggests differentiation. The development of look-a-likes suggests a lack of differentiation.

The 35 percent figure, given for routine monopsony power concerns, is well grounded in antitrust practice in the sense that mergers have been successfully challenged at this level.[33] Similarly, a 30% limit is well grounded in monopsony complaints. For example, in the Toys R Us case noted above, the market controlled was "20% of the national wholesale market and up to 49% of some local markets."[34]

This review of theoretical and practical literature on horizontal market structure leads to a clear conclusion that is reflected in much public policy. Based on decades of analysis, the expectation is that certain types of market structures are sufficiently conducive to anticompetitive outcomes to be a source of concern. The 30 percent figure used by the FCC is well grounded in this literature and practice.

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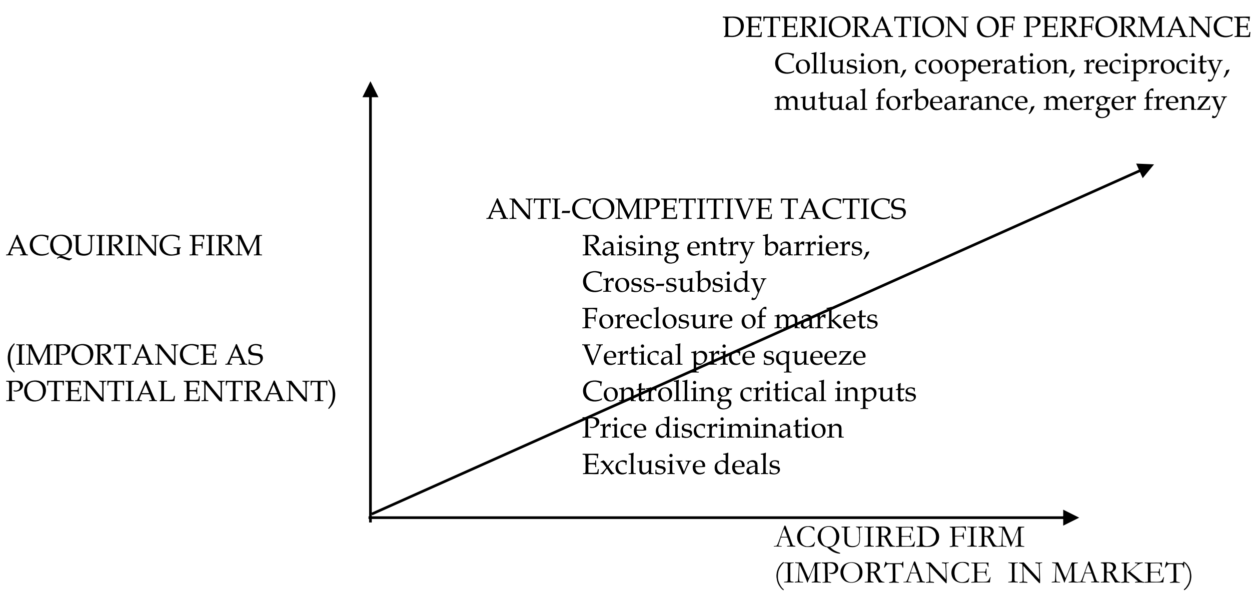
[29] Id. at 139.
[30] Sullivan and Grimes, p. 138.
[31] Merger Guidelines, Section 2.22.
[32] ¶ 17
[33] Peter Asch, *Industrial Organization and Antitrust Policy* (John Wiley, New York; 1983), Chapter 14.
[34] *In re Toys "R" Us, Inc.,* FTC No. 9278 (October 13, 1998).

APPENDIX B:
VERTICAL MARKET POWER

Excerpt From: Comments of Consumer Federation of America, et el. , *Horizontal Limits Proceeding*, 2002, pp. 93-98.[35]

Vertical issues are also a concern in this proceeding because cable operators have integrated into programming. Vertical integration can raise concerns, especially when dominant firms become integrated across markets for critical inputs. Exhibit 5 summarizes the anticompetitive conduct and negative market performance that can emerge from the weakened market structures that result from the particular type of concentration caused by these mergers.

EXHIBIT 5: THE SPECIAL PROBLEM OF CONGLOMERATES



Shepherd, William G., *The Economics of Industrial Organization,* (Prentice Hall, Englewood Cliffs, NJ, 1985), pp. 289-304.

Vertical integration can create barriers to entry. By integrating across stages of production, incumbents may force potential competitors to enter at both stages, making competition much less likely.

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[35] In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992, Implementation of Cable Act Reform Provisions of the Telecommunications Act of1996, The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules, Review of the Commission's Regulations Governing Attribution, Of Broadcast and Cable/MDS Interests, Review of the Commission's Regulations and Policies Affecting Investment, In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy, Federal Communications Commission, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002.

> [V]ertical mergers may enhance barriers to entry into the primary industry if entrants must operate at both stages in order to be competitive with existing firms and if entry at both stages is substantially more difficult than entry at one stage.[36]

> Bain popularized the concept of barriers to entry and also discussed the importance of potential competition. Bain argued that vertical integration creates a capital barrier to entry by forcing potential entrant to contemplate entry at two stages of production rather than just one.[37]
>
> To avoid these hazards, firms entering either of the markets in question might feel compelled to enter both, increasing the amount of capital investment required for entry.[38]

Capital market hurdles are only one of the barriers to entry that vertical integration and conglomeration can create. Such mergers can also foreclose input markets to competitors.

> When all production at a level of an industry is "in-house," no market at all exists from which independent firms can buy inputs. If they face impediments or delays in setting up a new supplier, competition at their level will be reduced. The clearest form of this is the rise in capital a new entrant needs to set up at both levels.[39]
>
> Ores, special locations, or other indispensable inputs may be held by the integrated firm and withheld from others. The integration prevents the inputs from being offered in a market, and so outsiders are excluded. A rational integrated firm might choose to sell them at a sufficiently high price.[40]

Exclusive and preferential deals for the use of facilities and products compound the problem.

> The first firms to integrate into neighboring stages reduce the number of alternative sources for other firms at either stage. This "thinning" of the market can increase the costs of market or contractual exchange. Subsequent integration by other firms then becomes more likely.[41]
>
> Restrictions may be set on areas, prices or other dimension … Only when they are done by small-share firms may competition be increased. When done by leading firms with market shares above 20 percent, the restrictions do *reduce* competition.[42]
>
> Similarly, a dominant firm may also use vertical integration to raise the costs of its competitors … By leaving the open market thin, competitors may be unable to expand without significantly driving up the input price, they may be subject to higher prices set by the fewer remaining suppliers, or they may incur higher transaction costs for having to negotiate contracts with suppliers…[43]

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[36] Perry, p. 247.
[37] Perry, p. 197.
[38] Scherer and Ross, p. 526.
[39] Shepherd, pp. 289-290.
[40] Shepherd, p. 290.
[41] Perry, p. 247.
[42] Shepherd, p. 294.
[43] Perry, p. 197.

The market structural conditions that result from the concentration and integration of the industry make behavioral abuse more easily effective. Cross-subsidization becomes possible,[44] although this is by no means the only available instrument of anti-competitive conduct. Vertical integration facilitates price squeezes and enhances price discrimination.[45] Cable firms can impose higher costs on their rivals or degrade their quality of service (withholding flagship programming) to gain an advantage.

> This could happen, if, for example, the conduct of vertically integrated firms increased risks for nonintegrated firms by exposing downstream specialists to regular or occasional price squeezes or made it difficult for upstream specialists to find a market for their output in times of depressed demand.[46]

There is a growing body of theoretical and empirical analysis that has reinvigorated concerns about the anti-competitive impacts of vertical integration, particularly in the cable industry.[47] Concerns arise that not only will the dominant firm in the industry gain the leverage to profitably engage in anti-competitive conduct, but also the dynamic processes in the industry will clearly shift toward cooperation and coordination rather than competition. The issue is not simply collusion, although that is clearly a concern.

> The *Guidelines* do recognize three major competitive problems of vertical mergers in concentrated industries. First, forward mergers into retailing may facilitate collusion at the manufacturing stage by making it easier to monitor prices or by eliminating a "disruptive buyer." [48]

Beyond collusion, a mutual forbearance and reciprocity occurs as spheres of influence are recognized and honored between and among the small number of interrelated entities in the industry.

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[44] Asch, Peter and Rosalind Senaca, *Government and the Marketplace* (Dryden Press, Chicago: 1985), p. 248. Subsidization: The conglomerate firm can choose to behave in a predatory fashion in one market, subsidizing its predation from profits earned elsewhere. The simple concept involved in cross subsidizing is that conglomerates can use profits from branch A to support deep, "unfair" price cuts by branch B …

Shepherd, p. 302. If all branches of a diversified firm are dominant in their markets, their pooled resources are likely to increase their dominance through greater price discrimination, threats of punitive actions, and so forth. By contrast, a string of small-share branches is more likely to promote competition than to reduce it, if it can help its members at all

[45] Scherer and Ross, p. 524. Substitution elasticities of unity and less normally imply that inputs are indispensable, that is, that no output can be produced until at least some use is made of each relevant input. When the monopolist of an input indispensable in this sense integrates downstream, it can make life difficult for remaining downstream competitors. It can refuse to sell the input to them, driving them out of business. Or it can sell it to them at a monopoly price, meanwhile transferring input at marginal cost to its affiliated downstream units, which, with their lower costs, can set product prices at levels sufficiently low to squeeze the rivals out of the market.

[46] Scherer and Ross, p. 526.

[47] On the cable industry see Ordover and Braunstein, op. cit. or more general arguments see Krattenmaker, T.G. and S. C. Salop, "Anti-competitive Exclusion: Raising Rivals' Costs to Achieve Power Over Prices," The Yale Law Journal, 92:2 (1986); Ordover, J., A. O. Sykes and R.D. Willig, "Non-price Anti-Competitive Behavior by Dominant Firms Toward the Producers of Complementary Products," in F. M. Fisher (Ed.), Antitrust and Regulation (Cambridge: MIT Press, 1985).

[48] Perry, p. 247.

> Now we consider the big picture, rather than market-by-market effects. Imagine an extreme situation, with five big diversified firms extending into all major sectors. They coexist in parallel, touching one another in hundreds of markets. Whatever their effects on each market might be, they pose a larger problem of spheres of interest, or diplomatic behavior replacing competition …
>
> Reciprocity is an exchange of favors. Reciprocal buying is one form of it. At its simplest, firm A buys from firm B because of some purchase that B makes from A …
>
> Reciprocity: The large conglomerate may have numerous opportunities for reciprocal buying arrangements.
>
> Mutual forbearance: More generally (it is sometimes claimed) large firms treat each other with deference, avoiding competitive confrontation whenever possible.[49]

The final behavioral effect is to trigger a rush to integrate and concentrate. Being a small independent firm at any stage renders a company extremely vulnerable to a variety of attacks.

> It is possible that business firms undertake vertical integration mergers not to enhance the level of monopoly power at some stage, but to redistribute it. Oligopolies often settle down into behavioral patterns in which price competition atrophies, even though some or all sellers suffer from excess capacity. Non-price rivalry then becomes crucial to the distribution of sales. One form of nonprice competition is the acquisition of downstream enterprises which, all else (such as prices) being equal, will purchase from their upstream affiliates. If acquisition of this sort deflects significant amounts of sales, disadvantaged rivals are apt to acquire other potential customers in self-defense, and reciprocal fear of foreclosure precipitates a bandwagon effect in which the remaining independent downstream enterprises are feverishly sought.[50]
>
> Triggering: If there are 10 nonintegrated firms and only one of them integrates, then little effect on competition might occur. But if this action induces the other 9 to do the same, the ultimate impact of the first "triggering" move may be large. Any increase in market power is magnified.[51]

The model that has emerged in this industry is one in which only the facility owner with a dominant technology that is a critical input for service delivery can leverage control of transmission facilities to achieve domination of content services. With proprietary control over the network for which there is a lack of adequate alternatives, such an owner can lock in consumers and squeeze competitors out of the broader market. Whether we call them essential facilities,[52] choke points,[53] or anchor points,[54] the key leverage point is controlling access facilities.

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[49] Asch and Senaca, p. 248.

[50] Scherer and Ross, pp. 526-527.

[51] Shepherd, p. 290.

[52] Langlois, p. 194.

[53] Mark Cooper, "Open Access to the Broadband Internet: Technical and Economic Discrimination in Closed Proprietary Networks," *University of Colorado Law Review,* Fall 2000).

[54] Sanford C. Bernstein and McKinsey and Company, *Broadband!*, January, 2000 (hereafter Bernstein), pp. 18…21, Broadband access platforms are the anchor points for much of the value at stake and vehicles for accessing new revenue streams. However, the current set of alternatives for reaching customers with broadband connections is inadequate. At least for the time being, cable is closed, meaning that much of the value is, in effect, ceded to the platform rather than captured by the content/applications providers…Furthermore, access is currently a bottleneck, and access winners have the potential to leverage their privilege positioned to ensure long-term value creation.

It is hard to imagine private entities that possess this market power would refrain from using it to their advantage. Theoretical claims that monopolists have little motivation to engage in anticompetitive activity across layers of the platform or product markets have been refuted. There is ample evidence that these anti-competitive behaviors may be attractive to a new economy monopolist for static and dynamic reasons.[55]

Companies can exercise market power in the core product by conquering neighboring markets, erecting cross-platform incompatibilities, raising rivals' costs, and preventing rivals from achieving economies of scale. Companies can increase profits by enhancing their ability to engage in price discrimination. By driving competitors out of neighboring markets, new monopolies may be created, and the ability to preserve market power across generations of a product may be enhanced by diminishing the pool of potential competitors.

The dominant players in the physical layer can readily distort the architecture of the platform to protect their market power.[56] They have a variety of tools to create barriers to entry [57] such as exclusive deals,[58] retaliation,[59] manipulation of standards,[60] and strategies that freeze customers.[61] Firms can leverage their access to customers to reinforce their market dominance[62] by creating ever larger bundles of complementary assets.[63] As the elasticity of demand declines over the course of the product life cycle, market power lodged in the physical layer results in excessive bundling[64] and

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55 Langlois, pp. 195 –202; Lansuz A. Ordover and Robert D. Willig, Access and Bundling in High Technology Markets, in *Competition, Innovation And The Microsoft Monopoly: Antitrust And The Digital Marketplace* (Jeffrey A. Eisenbach & Thomas M. Lenard eds., 1999) ; Rubinfeld, *supra* note, in *Competition, Innovation And The Microsoft Monopoly: Antitrust And The Digital Marketplace* (Jeffrey A. Eisenbach & Thomas M. Lenard eds., 1999)at 877-81; Steven C. Salop, *Using Leverage to Preserve Monopoly*, in *Competition, Innovation And The Microsoft Monopoly: Antitrust And The Digital Marketplace* (Jeffrey A. Eisenbach & Thomas M. Lenard eds., 1999).

56Langlois, Franklin M. Fisher, Innovation and Monopoly Leveraging, ," in Jerry Ellig (Ed.), *Dynamic Competition and Public Policy: Technology, Innovations, and Antitrust Issues* (Cambridge: Cambridge University Press, 2001).

57. Joseph Farrell & Garth Saloner, Installed Base and Compatibility: Innovation, Product Preannouncements and Predation, 76 AM. ECON. REV. 940, 948-51 (1986); Richard Makadok, Can First-Mover and Early Mover Advantages Be Sustained in an Industry with Low Barriers to Entry/Imitation?, 19 STRATEGIC MGMT. J. 683, 685 (1996).; Ulrich Witt, "Lock-in" vs. "Critical Masses"–Industrial Change Under Network Externalities, 15 INT'L J. INDUS. ORG., 753, 768-69 (1997). Robin Mansell, Strategies for Maintaining Market Power in the Face of Rapidly Changing Technologies, 31 J. ECON. ISSUES 969, 970 (1997).

58. Melissa A. Schilling, Technological Lockout: An Integrative Model of the Economic and Strategic Factors Driving Technology Success and Failure, 23 Acad. Mgmt. Rev. 267, 270 (1998), at 276.

59. Willow A. Sheremata, New Issues in Competition Policy Raised by Information Technology Industries, 43 Antitrust Bull. 547, 573-74 (1998) Robert A. Woroch et al., Exclusionary Behavior in the Market for Operating System Software: The Case of Microsoft, in Opening Networks to Competition: The Regulation of Price and Access (David Gabel & David Weiman eds., 1997).

60. See Sheremata, New Issues in Competition, , at 560; see also Charles H. Ferguson, High StAkes No Prisoners: A Winner's Tale of Greed and Glory in the Internet Wars 309 (Three Rivers Press ed., 1999), p. 307; Mark A. Lemley & David McGowan, Could Java Change Everything? The Competitive Propriety of a Proprietary Standard, 43 Antitrust Bull. 715 (1998), p. 732.

61. Sheremata, New Issues in Competition,

62. Makadok, at 693.

63. David B. Office, "CHESS and Competing in the Age of Digital Convergence," in Competing in the Age of Digital Convergence 27 (Harvard Business School ed., 1997), p. 26; see also Robert E. Daisy & Cecilia Conrad, Commodity Bundling, 74 Am. Econ. Rev. 377 (1984).

64. Carmen Mattes and Pierre Regime, Compatibility and Bundling of Complementary Goods in a Duopoly, 50 J. Indus. Econ. 46 (1992);

overpricing of products under a variety of market conditions.[65] Control over the product cycle can impose immense costs by creating incompatibilities,[66] forcing upgrades,[67] and by spreading the cost increases across layers of the platform[68] to extract consumer surplus.[69] In information markets, creating incompatibilities or blocking the flow of information undermines consumer value.[70]

Excerpt from: Declaration of Dr. Mark Cooper, Consumer Federation of America and Adam Lynn, Free Press, Comcast-NBC Petition, pp. 9-12.[71]

[C]ontent and distribution are located at different points in a supply chain; however, that does not mean that there are no competitive concerns about their integration into one firm. Vertical integration can have significant effects on horizontal competition, particularly when there is strong complementarity between the upstream (content) and the downstream (distribution) stage of the supply chain. For example, if the seller of downstream services has market power, it can use that power to distort competition in the upstream market. Conversely, if the seller of content has market power, it can use that power to distort competition in the distribution market. In other words, leverage that results from vertical integration can be used to reduce horizontal competition.

Moreover, while vertical integration, as a general proposition, has received less attention from antitrust officials in recent years, there is a growing belief that this lack of attention has been a mistake -- especially in light of the growth of the digital economy.[72] In any event, in the video and film sector vertical integration has always received closer scrutiny than in other sectors. This is due in part because content and distribution are such strong complementary parts of the supply chain in this sector. It is also because this part of the media sector has important non-economic impacts that are deeply affected by vertical integration. The integration of content production and distribution has long been a concern in the video market. The ability of the owners of the distribution network, whether it is movie theaters, broadcast networks, cable television, or Internet access service raises antitrust and communications policy concerns. Because distribution is a bottleneck that controls

65. Joseph P. Guilt Nan, The Price Bundling of Services: A Normative Framework, 51 J. Mktg. 74 (1987); Carmen Mattes and Pierre Regime, Compatibility and Bundling of Complementary Goods in a Duopoly, 50 J. Indus. Econ. 46 (1992). Lester Teller, A Theory of Monopoly of Complementary Goods, 52 J. Bus. 211-30 (1979); Richard Schmalensee, Gaussian Demand and Commodity Bundling, 57 J. Bus. 211-30.

66. Jay Pil Choi, Network Externalities, Compatibility Choice and Planned Obsolescence, 42 J. Indus. Econ. 167 (1994), pp 171-73.

67. See Glenn Ellison & Drew Fudenberg, "The Neo-Luddite's Lament: Excessive Upgrades in the Software Industry," 30 Rand J. Econ. 253, 272 (2000); Drew Fudenberg & Jean Tirole, Upgrades, Trade-ins, and Buybacks, 28 Rand J. Econ. 235, 236 (1998).

68. See Ferguson, 309-10.

69. Id. at 176-77. K. Sridhar Moorthy, "Market Segmentation, Self Selection, and Product Lines Design," 3 Mktg. Sci. 303 (1984); Marcel Thum, "Network Externalities, Technological Progress, and the Competition of Market Contracts," 94 Int. J. Indus. Org. 280, 285-86 (1997).

70. Langlois, p. 221, The owner of a dominant standard may thus want to manipulate the standard in ways that close off the possibilities for a competitor to achieve compatibility. This has a tendency to retard the generational advance of the system.

71 Prepared in Support of the Petition to Deny of Consumer Federation of America, Consumers Union, Free Press and Media Access Project, In the Matter of Applications of Comcast Corporation, General Electric Company and NBC Universal, Inc. For Consent to Assign Licenses or Transfer Control of, Licenses, Federal Communications Commission, MB Docket No. 10-56, June 21, 2010,

72 See e.g. Robert Pitofsky, How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust, pp. 148-149, 2008: Oxford University Press. Daniel L. Rubinfeld & Hal. J. Singer, Open Access to Broadband Networks: A Case Study of the AOL/Time Warner Merger, 16 Berkeley Tech. L.J. 631 (2001).

access to the public, distributors can restrict competition and diversity in the production of content. They can determine which content succeeds or fails by controlling access to audiences. The symbiotic relationship of these complements makes the vertical integration important and potentially troubling.

Modern economic analysis has drawn the logical linkage between vertical foreclosure and market power. In particular, vertical mergers can lead to real foreclosure that increases market power in either the upstream or downstream market under certain identifiable circumstances. The circumstances under which competitive harm can result from vertical mergers fit the Comcast-NBCU merger quite precisely, as suggested by Salop's contribution to a recent volume on antitrust practice.

> A vertical merger can lead to market power in the downstream market...In these circumstances, the merged firm may have the incentive to raise prices or refuse to deal, and that conduct will raise the cost of their integrated rivals. If there is insufficient remaining competition in the downstream market among integrated firms or other un-integrated firms that have cost-effective alternative sources of supply, then the downstream price may increase leading to consumer injury....
>
> A vertical merger also can lead to make power in the upstream market. Suppose that after the merger, the downstream division of the integrated firm were to refuse to purchase from un-integrated input suppliers and instead began to purchase all of its input needs from the upstream division. If the downstream division of the integrated firm represents a large share of the market, withholding its purchases might drive one or more upstream competitors to exit from the market or be forced into a higher cost niche position. Either way, that might give the upstream division of the integrated firm the power and incentive to raise the prices it charges its other competitors...
>
> This vertical merger could also be anticompetitive by reducing or eliminating the potential for entry. Before the merger, each firm would have the incentive to cooperate with firms who were trying to enter the market of the other firm. Competition in the other market would lead to lower prices in the market and, therefore, higher demand and profits for the complementary product. Indeed, each firm might be a potential entrant into the market of the other firm. In contrast, this incentive to facilitate independent entry would disappear. As a result, entrants would need to enter both markets simultaneously. This requirement of two level entry may raise barriers to entry and lead to higher prices, even after taking the elimination of double marginalization benefit into account.[73]

One of the key weapons that facilitate the use of leverage is the opportunity to raise rivals' costs (RRC). This reduces the pressure on the entity exercising market power. This is precisely what a post-merger Comcast could do by bundling its large portfolio of programming and raising its cost. Competitors are squeezed, while Comcast profits. Again, Salop is instructive here:

> RRC conduct is more likely to harm consumers than is traditional deep-pocket predatory pricing for several reasons. First, unlike predatory pricing, or at least the paradigmatic view of predatory pricing, successful RRC does not require a risky investment or associated profit sacrificing during an initial predatory period that may only be recouped at some later point in the future. Instead, recoupment often occurs simultaneously. Second, unlike predatory

[73] Steven Salop, Economic Analysis of Exclusionary Vertical Conduct: Where Chicago Has Overshot the Mark in Robert Pitofsky, *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust*, pp. 148-149, 2008: Oxford University Press.

> pricing, successful RRC does not require the exit of rivals, or even the permanent reduction in competitors' productive capacity. If the marginal costs of established competitors are raised, those rivals will have the incentive to raise their prices and reduce their output, even if they remain viable. Third, unlike paradigmatic predatory pricing, RRC is not necessarily more costly in the short run to the defendant than its victims. For a threat may not be very costly to the predator but could substantially raise the target firm's costs. This clearly could occur with respect to exclusionary vertical conduct. Fourth, unlike predatory pricing, successful RRC does not always involve a short-term consumer benefit that must be balanced against longer-term consumer harm, if any harm occurs during the recoupment period. The consumer harm would occur immediately.[74]

To conclude, Applicants' efforts to avoid close scrutiny by claiming this is just a vertical merger is wrong because there are major horizontal elements. Moreover, the merger dramatically increases the possibility of the use of vertical leverage that can be brought to bear on horizontal competition, which is a perennial concern in the media sector. The merger will also have a major impact on the incipient competition between cable and the Internet as a platform for MVPD service.

[74] Ibid at 143.

APPENDIX C:
MEASUREMENT OF MARKET STRUCTURE IN MERGER REVIEW

Excerpt From: Comments of Consumer Federation of America, et el., *Horizontal Limits Proceeding,* 2002, pp. 80-85.[75]

We now turn to the central question: "Under what circumstances is market power a problem?" In this chapter we discuss the third of the indices of market power on which the Notice seeks comment – the Herfindahl-Hirschman Index – because it has been widely used to set thresholds for concern and scrutiny of market power (see Exhibit 6).

EXHIBIT 6: DESCRIBING MARKET CONCENTRATION FOR PURPOSES OF PUBLIC POLICY

DEPARTMENT OF JUSTICE MERGER GUIDELINES	TYPE OF MARKET	EQUIVALENTS IN TERMS OF EQUAL SIZED FIRMS	HHI	4-FIRM SHARE (%)
	Monopoly	1	4250<	100
		Firm with 65% or more		
	Duopoly	2	5000<	100
HIGHLY CONCENTRATED		4	2500 or more	100
	Tight Oligopoly	6	1667	67
MODERATELY CONCENTRATED				
UNCONCENTRATED		6.67	1500	60
	Loose Oligopoly	10	1000	40
	Atomistic Competition	50	200	8

Sources: U.S. Department of Justice, *Horizontal Merger* Guidelines, revised April 8, 1997, for a discussion of the HHI thresholds; Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Englewood Cliffs, N.J., 1985), for a discussion of 4 firm concentration ratios.

In this discussion, market shares, and therefore market concentration, are the starting point for measuring market power. Measuring concentration for purposes of market structure analysis has received a great deal of attention. We describe the Department of Justice (DOJ) Merger Guidelines which are based on the HHI and relate these to the four-firm concentration ratio. More

[75] The discussion of thresholds is updated to the current revision of the *Merger Guidelines*. In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992, Implementation of Cable Act Reform Provisions of the Telecommunications Act of1996, The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules, Review of the Commission's Regulations Governing Attribution, Of Broadcast and Cable/MDS Interests, Review of the Commission's Regulations and Policies Affecting Investment, In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy, Federal Communications Commission, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002.

importantly, we describe a number of market structures that have played a role in the discussion of the horizontal limits – monopoly, duopoly, oligopoly, etc.

This chapter also discusses the concept of monopsony power – the power of a large purchaser – which is the focal point of this proceeding. We demonstrate that increased consolidation in cable leads to tremendous monopsony power, one of the main concerns of Congress in directing the Commission to enact the horizontal ownership cap. Based on a theory of monopsony power, we show that the rule is properly set at 30 percent.

DOJ's Merger Guidelines

The DOJ defines market levels of concentration to determine the extent of review of mergers.[76] These guidelines were defined in terms of the Herfindahl-Hirschman Index (HHI). This measure takes the market share of each firm, squares it, sums the result, and multiplies by 10,000.[77] A second method to quantify market concentration is to calculate the market share of the largest 4 firms (4 firm concentration ratio or CR4).

Under its Merger Guidelines, the DOJ considers a market with an HHI of 1000 or less to be unconcentrated. Such a market would have the equivalent of ten equal sized competitors. In such a market, the 4-firm concentration ratio would be 40 percent. Any market with a concentration above this level is deemed to be a source of concern.

The DOJ/FTC consider a market with an HHI above 1500 to be concentrated. This is the equivalent of a market with fewer than the equivalent of 7-equal sized firms. It considers a market with fewer than the equivalent of approximately 4-equal sized firms (HHI = 2500) to be highly concentrated. Markets with an HHI between 1500 and 2500 are considered moderately concentrated.

Many economists also describe markets in terms of the market share of the top four firms and Shepherd describes these thresholds in terms of four-firm concentration ratios as follows:[78]

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[76] U.S. Department of Justice, Merger Guideline, revised, 1997.

[77] Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1997, Fourth edition), p. 389, gives the following formulas for the Herfindahl-Hirschman Index (HHI) and the Concentration Ratio (CR):

n2
H = ∑ S_i
i=1 i

m
CR = ∑ S_i
i=1 i

m i = 1
where : n = the number of firms
m= the market share of the largest firms (4 for the 4 firm concentration ratio)
S_i = the share of the ith firm.

[78] Shepherd, p. 4.

Tight Oligopoly: The leading four firms combined have 60-100 percent of the market; collusion among them is relatively easy.

Loose Oligopoly: The leading four firms, combined, have 40 percent or less of the market; collusion among them to fix prices is virtually impossible.

Although the overlap is not perfect, there is a close correspondence between these two approaches. A highly concentrated market is called a tight oligopoly…there are two types of markets that are even more concentrated and therefore a source of additional concern. A duopoly is composed of two firms. Although the expression 'monopoly' technically refers to one firm, antitrust practice refers to monopoly power when the market share of a firm rises to the level of 60 to 70 percent.

The Link between Market Structure, Collusion, and Market Power

It is critical to keep in mind that merger policy is probabilistic and predictive. The DOJ Guidelines are oriented toward conditions under which certain types of anticompetitive behaviors are sufficiently likely to occur to require regulatory action.

> The rule of thumb reflected in all iterations of the Merger Guidelines is that the more concentrated an industry, the more likely is oligopolistic behavior by that industry.... Still, the inference that higher concentration increases the risks of oligopolistic conduct seems well grounded. As the number of industry participants becomes smaller, the task of coordinating industry behavior becomes easier. For example, a ten-firm industry is more likely to require some sort of coordination to maintain prices at an oligopoly level, whereas the three-firm industry might more easily maintain prices through parallel behavior without express coordination.

Shepherd refers to collusion in his discussion, but that is not the only concern of market power analysis or the Merger Guidelines. The Merger Guidelines recognize that market power can be exercised with coordinated, or parallel, activities and even unilateral actions.

> Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time.*/ In some circumstances, a sole seller (a "monopolist") of a product with no good substitutes can maintain a selling price that is above the level that would prevail if the market were competitive. Similarly, in some circumstances, where only a few firms account for most of the sales of a product, those firms can exercise market power, perhaps even approximating the performance of a monopolist, by either explicitly or implicitly coordinating their actions. Circumstances also may permit a single firm, not a monopolist, to exercise market power through unilateral or non-coordinated conduct -- conduct the success of which does not rely on the concurrence of other firms in the market or on coordinated responses by those firms. In any case, the result of the exercise of market power is a transfer of wealth from buyers to sellers or a misallocation of resources.
>
> */ Sellers with market power also may lessen competition on dimensions other than price, such as product quality, service or innovation.[79]

Lawrence Sullivan and Warren S. Grimes, describe the DOJ approach as follows:

[79] Horizontal Merger Guidelines, at section 0.1.

> The coordination that can produce adverse effects can be either tacit or express. And such coordination need not be unlawful in and of itself. According to the 1992 Guidelines, to coordinate successfully, firms must reach terms of interaction that are profitable to the firms involved and
>
> (2) be able to detect and punish deviations. The conditions likely to facilitate these two elements are discussed separately, although they frequently overlap.
>
> In discussing how firms might reach terms for profitable coordination, the Guidelines avoid using the term "agreement," probably because no agreement or conspiracy within the meaning of Section 1 of the Sherman Act is necessary for the profitable interaction to occur. As examples of such profitable coordination, the Guidelines list "common price, fixed price differentials, stable market shares, or customer or territorial restrictions." Sometimes the facilitating device may be as simple as a tradition or convention in an industry.

They go on to note the mechanisms that might be used and the usefulness of the HHI in this regard.

> Oligopoly conditions may or may not require collusion that would independently violate Section 1 of the Sherman Act. A supracompetitive price level may be maintained through price leadership (usually the leader is the largest firm), through observance of a well-established trade rule (e.g., a convention of a 50 percent markup in price among competing retailers), or through strategic discipline of nonconforming members of the industry…
>
> To the extent that one or very few members of a concentrated industry have much higher market shares than other members, the opportunities for strategic disciplining may expand… The expanded ability of the larger firm to coerce price discipline is reflected in the Herfindahl-Hirschman Index (HHI), which will assign a high concentration index to an industry with a very large participant. An industry with the same number of participants, each of them roughly equal in size, will have a lower index.[80]
>
> The area of noncollusive, oligopoly behavior has received a great deal of attention. A variety of models have been developed in which it is demonstrated that small numbers of market participants interacting in the market, especially on a repeated basis, can learn to signal, anticipate, and parallel one another to achieve outcomes that capture a substantial share of the potential monopoly profits

[80] Herbert Hovenkamp, *The Law of Antitrust: An Integrated Handbook,* Hornbook Series (West Group, St. Paul, 2000), pp. 596-597.

APPENDIX D
THE ANTICOMPETITIVE IMPACT OF GEOGRAPHIC EXTENSION TO HIGH-VALUE MARKET ON COMPETITION CROSS THE SUPPLY-CHAIN

Excerpt from: Reply Comments of Consumer Federation of America and Consumers Union in Opposition to the Transfer of Licenses Applications of Adelphia Communications Corporation,[81] pp. 6-8… 19-20… 21…22.

At every level this merger makes things substantially worse. The anticompetitive effect is felt in both upstream and downstream markets.

1. Upstream - programming

National: Upstream in the national market, it is quite clear that post-merger, Comcast and Time Warner will have unilateral make-or-break power over programming. Independent producers of video programming, who do not have guaranteed access rights, through either ownership or Congressionally legislated carriage rights, simply cannot succeed without securing carriage on both Comcast and Time Warner systems. Comcast has that power today, but it will be substantially enhanced at the national and regional levels by these transactions, removing one of the largest cable operators not integrated into programming.

The anticompetitive conduct that is alleged and documented in the record of this proceeding includes favoring of affiliated programming and foreclosing of unaffiliated programming. The net effect as demonstrated in carriage rates is a huge disadvantage for unaffiliated programming.

Empirically, independent programmers cannot succeed without getting carriage on the systems operated by **both** of the dominant firms. Post-merger, there will not be sufficient market not controlled by these two giants to succeed without their support. This merger pushes the industry past an important tipping point. There are not enough homes to pass to succeed without securing carriage on one of these systems. As a practical matter, no one can succeed without securing it on both.

The new wrinkle added by this merger is the extensive domination of critical urban markets by these two firms. National advertisers value certain markets more highly for general programming. Programmers not only need to be in 60 million homes to survive as a national linear network, they need to be in a substantial number of the top 25 markets.

This merger increases the market share of the two dominant firms in 11 of the top 25 markets and brings the total number dominated to more than half (30) of the top 50 markets. This merger pushes the industry past a crucial tipping point. With these mergers, the firms dominate a majority of the most important markets.

[81] Comments of Consumer Federation of America and Consumers Union in Opposition to the Transfer of Licenses Applications of Adelphia Communications Corporation, Comcast Corporation and Time Warner Cable Inc., For Authority to Assign and/or Transfer Control of Various Licenses, Federal Communications Commission, MM Docket No. 05-192, August 8, 2005, pp. 6-8… 19-20… 21…22.

Regional: Another relatively new and important issue is the upstream market for regional programming, as opposed to national programming. There is an identifiable market for regional/local video programming. Certainly sports and news fit this category.

This programming tends to be monopolistic. Exclusive deals are made for the right to distribute the programming. Failing to get distribution dooms a producer or places that producer at a severe disadvantage.

2. Downstream – distribution

The impact of the monopolization of regional programming is also felt in the downstream market… because some of this regional programming is sufficiently "must have" or marquee to pose a threat to competition in the downstream, or distribution market. Marquee programming (sports and non-sports) is monopolized through the terrestrial loophole. Denying this programming to competitors reduces their ability to gain audience. Even when competitors get access, they are overcharged and placed at a competitive disadvantage.

The downstream threat is reinforced by other sources of market power. The large footprint of the increasingly regionally clustered systems also allows dominant regional firms to demand and receive exclusives on non-affiliated programming, further undermining competition. These regional giants also engage in selective regulatory arbitrage, delaying entry, and selective predatory pricing against new entrants, weakening their ability to attract customers.

The ultimate effect of the increase in concentration and market power on the consumer is higher prices. The growth in the size of the dominant firms and the increase in regional clustering will result in higher prices charged to consumers.…

In the cable TV industry, market power has been expanded and reinforced by control and distribution of regional programming, especially sports. Regional market power through clustering plays a critical role particularly for advertising markets. Dominating specific programming categories generates both high profits and provides leverage to undermine competitors.

The reasons offered for the importance of the large designated market areas include the attractiveness to advertisers of a high-income trend setting population, as well as the presence of the major media.

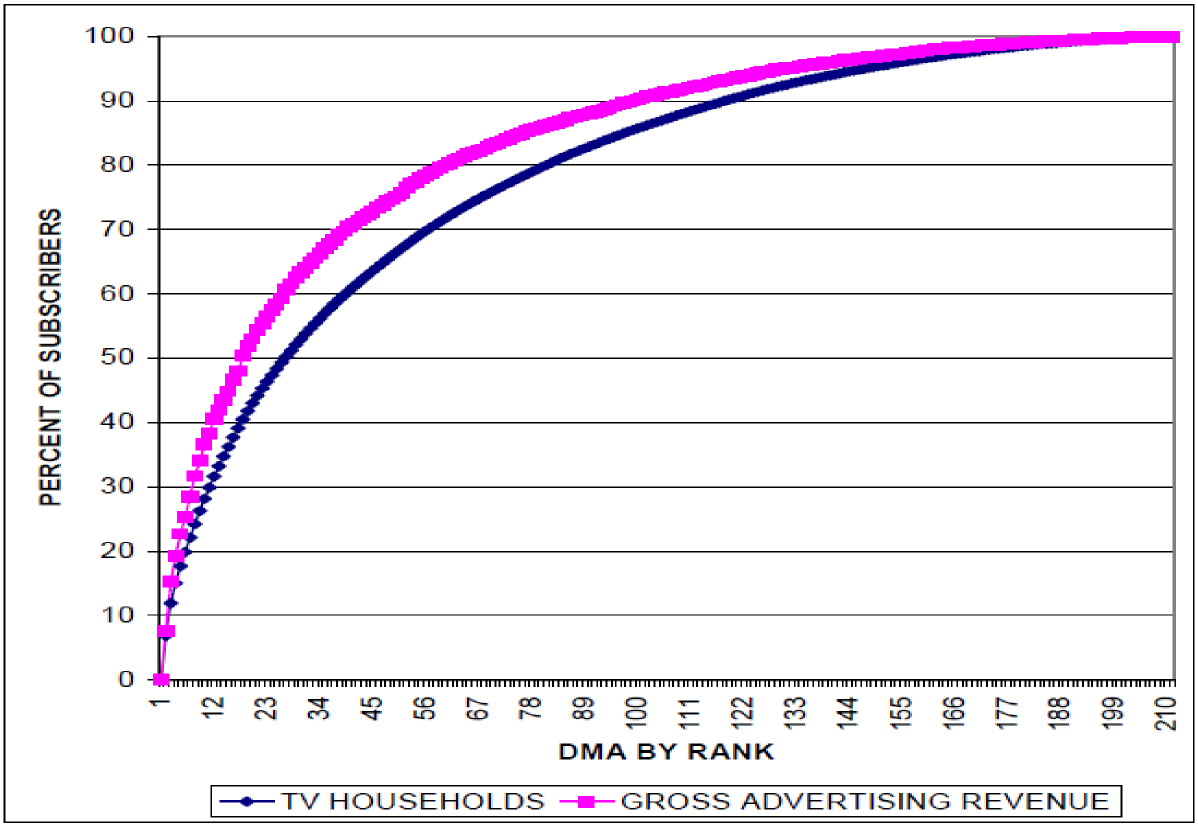
> In addition to the number of viewers, advertisers consider the markets to be important (indeed even disproportionately to their subscriber numbers) for a number of reasons including product trend-setting, higher per capita disposable income, and the presence of major press. Networks that do not substantially penetrate the top markets are at a severe disadvantage in the competition for advertising dollars relative to similar networks which do.[82]

While there are many intangible elements to this characteristic of the industry, there is one area in which it should be visible. Advertising revenue should be higher in the more highly valued markets. Exhibit 7 plots the distribution of TV households and TV ad revenue across the designated market areas, which are the standard definition of TV markets used in the industry. There is no doubt that the top markets account for a larger share of revenues than households. To

[82] TAC, Comment, p. 28.

assess the importance of this phenomenon, we have calculated the ratio of revenue to population – essentially the market-wide power ratio.

EXHIBIT 7: AD REVENUE IS SKEWED TOWARD THE TOP 25 DMA



The top eleven markets all have a substantial premium of ad revenues above TV households. These markets account for 31 percent of the TV households, but 41 percent TV ad revenue, a premium of over 33 percent. Six of the next 14 markets have a premium, but the overall premium is about the same. That is, the top 25 markets have 49 percent of TV households and 59 percent of the ad revenue. …

THE IMPACT OF THE MERGER ON KEY MARKETS

The importance of large urban markets and the weakness of satellite as a competitor, both at the point of sale and as a means of distribution for independent programming, converge in the case of Comcast. These two factors are extremely important in evaluating the market power of Comcast…

Comcast has clustered its systems in the dominant designated market areas. About 60 percent of its subscribers reside in the top 11 DMAs. Eighty percent of its subscribers reside in the top 25 DMAs. Thus, it has a heavy premium in terms of advertising clout. This gives it greater leverage over programmers than its subscriber count would indicate.

One interesting comparison is between Comcast and the total of satellite subscribers. Comcast owns systems that pass approximately 21.5 million subscribers. Weighted by advantage of advertising revenue in the top 11 markets, those subscribers are equal to 24.8 million. DBS serves approximately 21.3 million subscribers, but they are underrepresented in the top 11 DMAs. This disadvantage, *vis-à-vis* cable, would lower the DBS effective count to just over 17 million. In other words, instead of being equal to Comcast in simple subscriber count, DBS would be about two-thirds the size of Comcast on an ad revenue weighted basis, if the premium on viewers in the top 11 DMAs is included.

Time Warner's pattern of holdings is somewhat different. It has an important holding in New York (Manhattan) and Houston in the top eleven and Cleveland and Minneapolis among the top 25 markets. It is quite prominent in the second 25 markets, however.