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The FCC distorted market realities to scuttle the Comcast-TWC merger
October 2, 2015
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Last week, FCC General Counsel Jonathan Sallet pulled back the curtain on the FCC staff's analysis behind its decision to block Comcast's acquisition of Time Warner Cable. As the FCC staff sets out on its reported Rainbow Tour to reassure regulated companies that it's not "hostile to the industries it regulates," Sallet's remarks suggest it will have an uphill climb. Unfortunately, the staff's analysis appears to have been unduly speculative, disconnected from critical market realities, and decidedly biased — not characteristics in a regulator that tend to offer much reassurance.

Merger analysis is inherently speculative, but, as courts have repeatedly had occasion to find, the FCC has a penchant for stretching speculation beyond the breaking point, adopting theories of harm that are vaguely possible, even if unlikely and inconsistent with past practice, and poorly supported by empirical evidence. The FCC's approach here seems to fit this description.

The FCC's fundamental theory of anticompetitive harm

To begin with, as he must, Sallet acknowledged that there was no direct competitive overlap in the areas served by Comcast and Time Warner Cable, and no consumer would have seen the number of providers available to her changed by the deal.

But the FCC staff viewed this critical fact as "not outcome determinative." Instead, Sallet explained that the staff's opposition was based primarily on a concern that the deal might enable Comcast to harm "nascent" OVD competitors in order to protect its video (MVPD) business:

> Simply put, the core concern came down to whether the merged firm would have an increased incentive and ability to safeguard its integrated Pay TV business model and video revenues by limiting the ability of OVDs to compete effectively, especially through the use of new business models.

The justification for the concern boiled down to an assumption that the addition of TWC's subscriber base would be sufficient to render an otherwise too-costly anticompetitive campaign against OVDs worthwhile:

> Without the merger, a company taking action against OVDs for the benefit of the Pay TV system as a whole would incur costs but gain additional sales – or protect existing sales — only within its footprint. But the combined entity, having a larger footprint, would internalize more of the external "benefits" provided to other industry members.

The FCC theorized that, by acquiring a larger footprint, Comcast would gain enough bargaining power and leverage, as well as the means to profit from an exclusionary strategy, leading it to employ a range of harmful tactics — such as impairing the quality/speed of OVD streams, imposing data caps, limiting OVD access to TV-connected devices, imposing higher interconnection fees, and saddling OVDs with higher programming costs. It's difficult to see how such conduct would be permitted under the FCC's Open Internet Order/Title II regime, but, nevertheless, the staff apparently believed that Comcast would possess a powerful "toolkit" with which to harm OVDs post-transaction.

Comcast's share of the MVPD market wouldn't have changed enough to justify the FCC's purported fears

First, the analysis turned on what Comcast could and would do if it were larger. But Comcast was already the largest ISP and MVPD (now second largest MVPD, post AT&T/DIRECTV) in the nation, and presumably it has approximately the same incentives and ability to disadvantage OVDs today.

In fact, there's no reason to believe that the growth of Comcast's MVPD business would cause any material change in its incentives with respect to OVDs. Whatever nefarious incentives the merger allegedly would have created by increasing Comcast's share of the MVPD market (which is where the purported benefits in the FCC staff's anticompetitive story would be realized), those incentives would be proportional to the size of increase in Comcast's national MVPD market share — which, here, would be about eight percentage points: from 22% to under 30% of the national market.

It's difficult to believe that Comcast would gain the wherewithal to engage in this costly strategy by adding such a relatively small fraction of the MVPD market (which would still leave other MVPDs serving *fully 70%* of the market to reap the purported benefits instead of Comcast), but wouldn't have it at its current size – and there's no evidence that it has ever employed such strategies with its current market share.

It bears highlighting that the D.C. Circuit has already *twice* rejected FCC efforts to impose a 30% market cap on MVPDs, based on the Commission's inability to demonstrate that a greater-than-30% share would create competitive problems, especially given the highly dynamic nature of the MVPD market. In vacating the FCC's most recent effort to do so in 2009, the D.C. Circuit was resolute in its condemnation of the agency, noting:

> In sum, the Commission has failed to demonstrate that allowing a cable operator to serve more than 30% of all [MVPD] subscribers would threaten to reduce either competition or diversity in programming.

The extent of competition and the amount of available programming (including original programming distributed by OVDs themselves) has increased substantially since 2009; this makes the FCC's competitive claims even less sustainable today.

It's damning enough to the FCC's case that there is no marketplace evidence of such conduct or its anticompetitive effects in today's market. But it's truly impossible to square the FCC's assertions about Comcast's anticompetitive incentives with the fact that, over the past decade, Comcast has made massive investments in broadband, steadily increased broadband speeds, and freely licensed its programming, among other things that have served to *enhance* OVDs' long-term viability and growth. Chalk it up to the threat of regulatory intervention or corporate incompetence if you can't believe that competition alone could be responsible for this largesse, but, whatever the reason, the FCC staff's fears appear completely unfounded in a marketplace not significantly different than the landscape that would have existed post-merger.

OVDs aren't vulnerable, and don't need the FCC's "help"

After describing the "new entrants" in the market — such unfamiliar and powerless players as Dish, Sony, HBO, and CBS — Sallet claimed that the staff was principally animated by the understanding that

> Entrants are particularly vulnerable when competition is nascent. Thus, staff was particularly concerned that this transaction could damage competition in the video distribution industry.

Sallet's description of OVDs makes them sound like struggling entrepreneurs working in garages. But, in fact, OVDs have radically reshaped the media business and wield enormous clout in the marketplace.

Netflix, for example, describes itself as "the world's leading Internet television network with over 65 million members in over 50 countries." New services like Sony Vue and Sling TV are affiliated with giant, well-established media conglomerates. And whatever new offerings emerge from the FCC-approved AT&T/DIRECTV merger will be as well-positioned as any in the market.

In fact, we already know that the concerns of the FCC are off-base because they are of a piece with the misguided assumptions that underlie the Chairman's recent NPRM to rewrite the MVPD rules to "protect" just these sorts of companies. But the OVDs themselves — the ones with real money and their competitive futures on the line — don't see the world the way the FCC does, and they've [resolutely *rejected*] the Chairman's proposal. Notably, the proposed rules would "protect" these services from exactly the sort of conduct that Sallet claims would have been a consequence of the Comcast-TWC merger.

If they don't want or need broad protection from such "harms" in the form of revised industry-wide rules, there is surely no justification for the FCC to throttle a merger based on speculation that the same conduct could conceivably arise in the future.

The realities of the broadband market post-merger wouldn't have supported the FCC's argument, either

While a larger Comcast might be in a position to realize more of the benefits from the exclusionary strategy Sallet described, it would also incur more of the *costs* — likely in direct proportion to the increased size of its subscriber base.

Think of it this way: To the extent that an MVPD can possibly constrain an OVD's scope of distribution for programming, doing so also necessarily makes the MVPD's own broadband offering less attractive, forcing it to incur a cost that would increase in proportion to the size of the distributor's broadband market. In this case, as noted, Comcast would have gained MVPD subscribers — but it would have also gained broadband subscribers. In a world where cable is consistently losing video subscribers (as Sallet acknowledged), and where broadband offers higher margins and faster growth, it makes no economic sense that Comcast would have valued the trade-off the way the FCC claims it would have.

Moreover, in light of the existing conditions imposed on Comcast under the Comcast/NBCU merger order from 2011 (which last for a few more years) and the restrictions adopted in the Open Internet Order, Comcast's ability to engage in the sort of exclusionary conduct described by Sallet would be severely limited, if not non-existent. Nor, of course, is there any guarantee that former or would-be OVD subscribers would choose to subscribe to, or pay more for, *any* MVPD in lieu of OVDs. Meanwhile, many of the relevant substitutes in the MVPD market (like AT&T and Verizon FiOS) also offer broadband services – thereby increasing the costs that would be incurred in the broadband market *even more*, as many subscribers would shift not only their MVPD, but also their broadband service, in response to Comcast degrading OVDs.

And speaking of the Open Internet Order — wasn't that supposed to prevent ISPs like Comcast from acting on their alleged incentives to impede the quality of, or access to, edge providers like OVDs? Why is merger enforcement necessary to accomplish the same thing once Title II and the rest of the Open Internet Order are in place? And if the argument is that the Open Internet Order might be defeated, aside from the *completely* speculative nature of such a claim, why wouldn't a merger condition that imposed the same constraints on Comcast – as was done in the Comcast/NBCU merger order by imposing the former net neutrality rules on Comcast – be perfectly sufficient?

While the FCC staff analysis accepted as true (again, contrary to current marketplace evidence) that a bigger Comcast would have more incentive to harm OVDs post-merger, it *rejected* arguments that there could be countervailing *benefits* to OVDs and others from this same increase in scale. Thus, things like incremental broadband investments and speed increases, a larger Wi-Fi network, and greater business services market competition – things that Comcast is *already* doing and would have done on a greater and more-accelerated scale in the acquired territories post-transaction – were deemed insufficient to outweigh the expected costs of the staff's entirely speculative anticompetitive theory.

In reality, however, not only OVDs, but consumers – and especially TWC subscribers – would have benefitted from the merger by access to Comcast's faster broadband speeds, its new investments, and its superior video offerings on the X1 platform, among other things. Many low-income families would have benefitted from expansion of Comcast's Internet Essentials program, and many businesses would have benefited from the addition of a more effective competitor to the incumbent providers that currently dominate the business services market. Yet these and other verifiable benefits were given short shrift in the agency's analysis because they "were viewed by staff as incapable of outweighing the potential harms."

The assumptions underlying the FCC staff's analysis of the broadband market are arbitrary and unsupportable

Sallet's claim that the combined firm would have 60% of all high-speed broadband subscribers in the U.S. necessarily assumes a national broadband market measured at 25 Mbps or higher, which is a red herring.

The FCC has not explained why 25 Mbps is a meaningful benchmark for antitrust analysis. The FCC itself endorsed a 10 Mbps baseline for its Connect America fund last December, noting that over 70% of current broadband users subscribe to speeds less than 25 Mbps, *even in areas where faster speeds are available*. And streaming online video, the most oft-cited reason for needing high bandwidth, doesn't require 25 Mbps: Netflix says that 5 Mbps is the most that's required for an HD stream, and the same goes for Amazon (3.5 Mbps) and Hulu (1.5 Mbps).

What's more, by choosing an arbitrary, faster speed to define the scope of the broadband market (in an effort to assert the non-competitiveness of the market, and thereby justify its broadband regulations), the agency has – without proper analysis or grounding, in my view – unjustifiably shrunk the size of the relevant market. But, as it happens, doing so also shrinks the size of the *increase* in "national market share" that the merger would have brought about.

Recall that the staff's theory was premised on the idea that the merger would give Comcast control over enough of the broadband market that it could unilaterally impose costs on OVDs sufficient to impair their ability to reach or sustain minimum viable scale. But Comcast would have added only one percent of this invented "market" as a result of the merger. It strains credulity to assert that there could be any *transaction-specific* harm from an increase in market share equivalent to a rounding error.

In any case, basing its rejection of the merger on a manufactured 25 Mbps relevant market creates perverse incentives and will likely do far more to harm OVDs than realization of even the staff's worst fears about the merger ever could have.

The FCC says it wants higher speeds, and it wants firms to invest in faster broadband. But here Comcast did just that, and then was punished for it. Rather than acknowledging Comcast's ongoing broadband investments as strong indication that the FCC staff's analysis might be on the wrong track, the FCC leadership simply sidestepped that inconvenient truth by redefining the market.

The lesson is that if you make your product too good, you'll end up with an impermissibly high share of the market you create and be punished for it. This can't possibly promote the public interest.

Furthermore, the staff's analysis of competitive effects even in this ersatz market aren't likely supportable. As noted, most subscribers access OVDs on connections that deliver content at speeds well below the invented 25 Mbps benchmark, and they pay the same prices for OVD subscriptions as subscribers who receive their content at 25 Mbps. Confronted with the choice to consume content at 25 Mbps or 10 Mbps (or less), the majority of consumers voluntarily opt for slower speeds — and they purchase service from Netflix and other OVDs in droves, nonetheless.

The upshot? Contrary to the implications on which the staff's analysis rests, if Comcast were to somehow "degrade" OVD content on the 25 Mbps networks so that it was delivered with characteristics of video content delivered over a 10-Mbps network, real-world, observed consumer preferences suggest it wouldn't harm OVDs' access to consumers at all. This is especially true given that OVDs often have a *global* focus and reach (again, Netflix has 65 million subscribers *in over 50 countries*), making any claims that Comcast could successfully foreclose them from the relevant market even more suspect.

At the same time, while the staff apparently viewed the broadband alternatives as "limited," the reality is that Comcast, as well as other broadband providers, are surrounded by capable competitors, including, among others, AT&T, Verizon, CenturyLink, Google Fiber, many advanced VDSL and fiber-based Internet service providers, and high-speed mobile wireless providers. The FCC understated the complex impact of this robust, dynamic, and ever-increasing competition, and its analysis entirely ignored rapidly growing mobile wireless broadband competition.

Finally, as noted, Sallet claimed that the staff determined that merger conditions would be insufficient to remedy its concerns, without any further explanation. Yet the Commission identified similar concerns about OVDs in both the Comcast/NBCUniversal and AT&T/DIRECTV transactions, and adopted remedies to address those concerns. We know the agency is capable of drafting behavioral conditions, and we know they have teeth, as demonstrated by prior FCC enforcement actions. It's hard to understand why similar, adequate conditions could not have been fashioned for this transaction.

In the end, while I appreciate Sallet's attempt to explain the FCC's decision to reject the Comcast/TWC merger, based on the foregoing I'm not sure that Comcast could have made *any* argument or showing that would have dissuaded the FCC from challenging the merger. Comcast presented a strong economic analysis answering the staff's concerns discussed above, all to no avail. It's difficult to escape the conclusion that this was a politically-driven result, and not one rigorously based on the facts or marketplace reality.

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