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Comcast/Time Warner Cable: Potential Competitive Harms Significant Despite Lack of Geographic Overlap; Public Outcry May Motivate Robust Review

Conclusion

Comcast, the nation's largest cable operator, yesterday announced an agreement to acquire 100% of the equity of number two Time Warner Cable (TWC) in a deal valued at about $45.2 billion. Following the merger announcement, antitrust and industry experts appear too optimistic that a lack of horizontal overlap creates a low level of antitrust risk at the antitrust agencies. Further, observers may not appreciate that the profoundly negative and immediate public reaction to the proposed deal could exert political pressure on the government agencies, particularly the FCC, which is required to conduct a broader review on the merger's effect on the "public interest." For our previous report on cable consolidation, please click here.

Key Points

Potential harm. The companies thus far have been successful in laying out their arguments for why the deal would be "pro-competitive" and "pro-consumer," but reports have been light on the potential antitrust harms that the regulatory authorities are likely to examine. Such potential harms include:

- Comcast's enhanced ability and incentive to discriminate in its distribution of rival content;
- Comcast's enhanced ability and incentive as sole wired broadband provider to a significant portion of U.S. businesses and consumers to hinder competition from rival On-Line Video Distributors (OVDs), Voice-Over-Internet Protocol (VOIP) providers and other Internet applications providers;
- Comcast's enhanced ability and incentive to withhold from its multichannel video programming distributor (MVPD) competitors reasonable access to its content;
- Consolidation of Comcast's control over regional sports programming, which threatens the ability of satellite providers, the Telcos, and new fiber entrants to compete with Comcast.

Political environment and framework for regulatory review. Stakeholders should also note that a high level of public outcry against the merger may lead to more aggressive enforcement by the reviewing agencies—the FCC and presumably the DOJ Antitrust Division (although the FTC has some experience with cable mergers, we expect antitrust review of this transaction to be carried out at the DOJ, in light of their previous review of the Comcast/NBCUniversal merger). Notably, the FCC standard of review is broader than that of the antitrust agencies, allowing it to take a wider range of public interest concerns into account.

Pro-merger arguments; conference call takeaways. In yesterday morning's conference call announcing the deal to reporters, executives of both firms touted the deal's benefits and downplayed its risks, claiming that the deal would yield a less than 30% post-merger market share in video distribution (after divestiture of up to 3 million TWC subscribers). In addition, the parties argued that the deal would not lessen competition, as the parties' service areas do not overlap, and as a result, the parties "do not compete in a single zip code in America." Furthermore, conditions of the Comcast-NBCUniversal merger, including program carriage and content availability obligations and stand-alone and "net neutrality" rules for broadband, effective until 2018, will immediately apply to all TWC subscribers acquired.

In-Depth Examination of Potential Harms

In a previous report assessing different TWC merger scenarios, we identified the potential competitive harms of a Comcast/TWC merger, which we revisit in the first section, below. The sections that follow discuss the parties' arguments in favor of the merger, the public outcry against the deal, and the FCC and antitrust agencies' different standards for merger clearance.

Potential competitive harms. The increased scale and scope of a combined Comcast/TWC would exacerbate all of the potential competitive harms identified in the FCC's 2011 Order conditionally approving the Comcast-NBCUniversal deal. The competitive threats include both vertical and horizontal elements.

Program carriage. The FCC found that the combined Comcast/NBCU would have the ability and incentive to discriminate in its distribution of rival content, so it imposed a "non-discrimination" condition that requires Comcast "not to discriminate in video programming distribution on the basis of affiliation or non-affiliation of vendors in the selection of, or terms or conditions for, carriage, including in decisions regarding tiering and channel placement." As background, tiering is the placement of programs into a separately-priced bundle of programming that may be purchased in addition to a basic cable package.

The greatly expanded footprint of a combined Comcast/TWC suggests the continuing need for these program carriage conditions. A refusal to carry programming to 22 million subscribers constitutes one threat level while a refusal to carry programming to 30 million subscribers constitutes another. Objectors are likely to point to the dismal failure of content providers to obtain any meaningful relief under the FCC's program carriage regime as proof that such conditions are too ineffectual to ameliorate the competitive harm.

Bloomberg has been battling under the Comcast/NBCU Order for two years to be placed in the same channel neighborhood as Comcast's other business news offerings, but the company has so far successfully resisted doing so, despite the non-discrimination condition and the FCC's requirement that if Comcast places news and/or business news channels in a neighborhood, then "Comcast must carry all independent news and business news channels in that neighborhood."

In *Tennis Channel v. Comcast*, the DC Circuit reversed an FCC order requiring Comcast to carry Tennis Channel on the same tier where Comcast carries its own Golf Channel and NBC Sports. The court did not find Comcast's decision to place Tennis Channel on a more expensive (and much less widely viewed) digital tier to be "discriminatory." One member of the court accepted Comcast's refusal to carry Tennis Channel on a lower tier as the legitimate rejection of a business proposal it saw as being of no benefit to Comcast.

The result is particularly puzzling in light of the Commission's identification of Comcast/NBCU's ability and incentive to refuse carriage for anticompetitive reasons as a specific competitive harm intended to be cured by program carriage conditions. Objectors are likely to point to this result to demonstrate that such rules and conditions cannot be relied upon to curb the anticompetitive exercise of market power, which would weigh against approval of even a highly conditioned Comcast/TWC transaction.

Broadband, on-line video content, and rival applications providers. The Commission also found in the Comcast/NBCU Order that Comcast would have the incentive and ability to hinder competition from rival On-Line Video Distributors (OVDs), including MVPDs and non-MVPDs (i.e., OVDs that do not control the signal path to the subscriber but must rely on the subscriber's broadband connection, which have not yet been granted MVPD status by the FCC). In the time since then the "net neutrality" and "open Internet" debate has crystallized the concern over the ability of broadband providers to tilt the competitive playing field to favor affiliated applications or impede rivals. Although the threat of this incentive is most clearly felt by on-line video distributors which compete with Comcast's core video programming delivery business, as the company expands into other Internet powered applications the threat to independent providers will widen.

In the Comcast/NBCUniversal deal the Commission noted the availability of strategies such as, 1.) Restricting access to affiliated on-line content, 2.) Blocking or degrading or otherwise violating open Internet principles with respect to delivering unaffiliated on-line content to Comcast broadband subscribers, and 3.) Using Comcast set-top boxes to hinder the delivery of unaffiliated on-line video. Accordingly, the FCC required Comcast to provide affiliated programming to OVDs on terms that are economically comparable to non-vertically integrated "peer" content providers. Comcast's peer content providers for sports and news are the networks and for other programming are the major studios. Acquisition of additional TWC content would appear to strengthen the need for these program access remedies.

Rival MVPD access to Comcast-TWC content. Comcast's ability and incentive to withhold from its MVPD rivals reasonable access to the merged entity's content was also identified by the Commission as a competitive threat posed by the NBCU transaction. This threat is intensified by the addition of TWC's additional subscriber base and service areas. The FCC recognized in the NBCU Order that Comcast-NBCU "will take into account the possibility that any harm from failure or delay in reaching agreement" with rival MVPDs to carry its content "would be offset to some extent by a benefit to Comcast, as reaching a higher price would raise the costs of Comcast's rivals." As in that transaction, a TWC acquisition is likely to further "improve Comcast's bargaining position, leading to an increase in programming costs for its video distribution rivals."

Deal consolidates regional sports networks. The addition of TWC's RSNs would hand Comcast additional, high-value sports content (*i.e.*, additional "marquee" content) with which to engage in strategic exclusionary conduct directed at rival MVPDs, while the significant expansion of its service area will ensnare additional cable and telecommunications rivals in the threat zone. Comcast currently operates RSNs in San Francisco, CA, Oakland/Sacramento, CA, Chicago, IL, Houston, TX, Washington, D.C., Portland, OR, Boston, MA, Philadelphia, PA, Atlanta, GA, and New York, NY.

The transaction increases Comcast's roster of affiliated RSNs from 18 to 28, representing significant consolidation in the control of sport programming that the FCC and the antitrust agencies are likely to scrutinize closely. Particularly for New York and other metropolitan areas where Comcast's clustering will increase, control of regional sports networks could emerge as a significant competitive sticking point, because of the leverage control that such programming affords the clustered cable operator vis-à-vis competing satellite providers, Telcos, and other new entrants.

Negative Public Response Could Affect Broader FCC Public Interest Review. In the wake of the merger announcement, many people took to social media to lament what they see as the likely effects of the merger. Customers predicted the merger would increase already too-high prices, decrease already poor customer service, and slow down already lagging internet speeds. Comcast customers warned TWC customers that they now would be subject to data caps. TWC customers told Comcast customers to prepare for slow Netflix streaming.

The intense dissatisfaction that consumers collectively have for TWC and Comcast is at a level ordinarily reserved for monopolies, which in many markets the companies indeed are. While a multitude of market participants likely will oppose the deal, what sets this deal apart is the unusually high public opposition. The court of public opinion hence will be on the regulators' side and may embolden them to fully utilize the range of tools at their disposal. On the other hand, if the reviewing agencies clear the deal, they can expect to face consumers' ire.

In addition to the ordinary citizen, consumer groups and groups against media consolidation instantly mobilized against the deal. Free Press, for instance, immediately issued a statement calling the merger "a disaster" for consumers, and also sent a petition to the FCC and DOJ. Public Knowledge released a comprehensive statement opposing the deal and explaining that Comcast "is already the nation's largest ISP, the nation's largest video provider, and one of the nation's largest home phone providers. It also controls a movie studio, broadcast network, and many popular cable channels." Moreover, Public Knowledge cautioned that "it is simply dangerous for a large proportion of our nation's critical communications infrastructure to be in the hands of just one provider."

Several other media outlets have expressed a level of opposition to the merger not frequently seen. Michael Hiltzik of the LA Times wrote: "Let's get to the bottom line. There's no way this combination can conceivably be in the public interest." The New Yorker even published a spoof letter from Comcast and TWC to customers with a Q&A section: "Q: How will the merger affect the price of my cable service? A: There is no clear answer to that. But we will be introducing financing options, roughly similar to those that enabled you to attend college." The rarely seen public outcry at this deal may indeed inspire the DOJ or FTC to look beyond mere calculations of market share increases to truly drill down on competitive effects. Additionally, rampant opposition may also pressure FCC to scrutinize the merger more closely.

FCC standard of review is broader than the antitrust agencies' standards. The antitrust review will focus on whether the deal violates Section 7 of the Clayton Act, which prohibits mergers the effect of which "may be substantially to lessen competition, or tend to create a monopoly."

By contrast, the FCC, will review the transaction pursuant to Sections 214 and 310(d) of the Communications Act of 1934, in order to ensure that "public interest, convenience, and necessity will be served thereby." The Commission's competitive analysis is broader than the antitrust agencies', and it may consider "whether a transaction will enhance, rather than merely preserve, existing competition," in addition to "tak[ing] a more extensive view of potential and future competition and its impact on the relevant market."

As the FCC explained in clearing the 2006 Adelphia/Time Warner/Comcast deal: "The Commission's competitive analysis, which forms an important part of its public interest evaluation, is informed by traditional antitrust principles, but is not limited to them. In the communications industry, competition is shaped not only by antitrust law, but also by the regulatory policies that govern the interactions of industry players. In addition to considering whether a transaction will reduce existing competition, therefore, the Commission also must focus on…the transaction's effect on future competition."

Further, as the FCC's 2006 Adelphia/Time Warner/Comcast memorandum opinion and order explained: "unlike the role of antitrust enforcement agencies, the Commission's public interest authority enables it to rely upon its extensive regulatory and enforcement experience to impose and enforce conditions to ensure that a transaction will yield overall public interest benefits." Accordingly, the FCC can factor the wide range of public concerns about the deal into its analysis more readily than can the antitrust agencies.

Summary of Pro-Deal Arguments

Parties express confidence in regulatory approval. Despite these potential harms, the parties expressed high confidence that regulators would clear the deal after a review process expected to last nine to 12 months. The parties emphasize that the deal combines non-overlapping video distribution operations covering fewer than 30% of video subscribers (after subscriber divestitures). No break-up fees have been negotiated, so each party bears its own risk of a regulatory failure.

Despite high resulting concentration in fixed broadband access, the parties claim the deal increases broadband competition. In the market for broadband access the picture is different from the video distribution market. While video services have lost subscribers in recent years, broadband access has become increasingly important. In difficult-to-follow logic, Comcast claims that combining the companies will increase broadband competition by increasing the scale of the company, promoting additional broadband infrastructure investments, and further leveraging its broadband into Wi-Fi. But, the debate over the FCC's Open Internet rules makes close scrutiny of the broadband piece of the transaction likely.

Costs synergies. The parties expect to achieve $1.5 billion in cost synergies over the next three years by eliminating duplicative expenses related to programming operations. Existing TWC content agreements are to be folded into Comcast existing content agreements.

Comcast-NBCUniversal conditions to apply. Completion of the transaction would include TWC subscribers under the conditions imposed by the FCC and the court on Comcast in connection with its acquisition of NBCUniversal. Thus, until 2018, the merged entity will be required, for example, to abide by net neutrality rules and offer reasonably priced stand-alone broadband. The parties are likely to point to these conditions as prophylactic measures sufficient to ameliorate any competitive concerns in this merger.

National "smart pipe" network creates new television advertising models. The combined company is likely to exert pressure on the current television advertising model by offering advertising through its "smart pipe" that exceeds the current capabilities of broadcasters and satellite MVPDs to target specific audiences and localities.