THE FREE STATE FOUNDATION

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Perspectives from FSF Scholars
June 2, 2014
Vol. 9, No. 20

The Comcast/Time Warner Cable Deal: Keep the Focus on the Consumer Welfare Benefits

by

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Introduction and Summary

The May 18 announcement of AT&T's proposed deal to acquire DirecTV is the latest episode in a series of transactions that evidences the fast-changing dynamics of the video and advanced telecommunications landscape. Just three months ago, Comcast announced its proposed merger with Time Warner Cable. And a deal to include Charter Communications in a sale and swap of assets in conjunction with the Comcast/TWC transaction also appears in the works. Meanwhile, news reports continue to speculate about a possible merger of Sprint and T-Mobile.

In free markets, mergers and acquisitions are a critical component of the entrepreneurial, competitive process. And where conditions are right, mergers can significantly benefit consumers. As then-U.S. Department of Justice's Antitrust Division Chief Christine Varney explained in 2009, "the vast majority of mergers are either procompetitive and enhance consumer welfare or are competitively benign."

On its face, Comcast/TWC poses a number of likely consumer welfare-enhancing benefits. If approved, the merger has the potential to:

- Accelerate transition from analog to digital for cable video transmission to more broadband Internet consumers;
- Enable faster deployment of DOCSIS 3.1 to more retail video subscription consumers;
- Improve the competitiveness of the market for broadband services to business enterprise customers, including nationwide and inter-regional business customers; and
- Increase efficiency as well as expand the supply and geographic scope for wireless backhaul infrastructure services needed to transmit wireless data.

The purpose of this paper is not to endorse or oppose the Comcast/TWC transaction. Rather, its purpose is to set out basic principles and an analytical framework by which the FCC should analyze Comcast/TWC as well as other proposed mergers.

Aside from the straightforward matter of ensuring compliance with FCC licensing provisions and existing rules, the FCC's primary consideration in reviewing mergers should be consideration of the overall potential benefits to consumer welfare. Principled economic analysis should be employed in determining whether Comcast/TWC would either potentially benefit consumers or likely result in consumer harm.

It is possible that an economic examination of the proposed merger could uncover potential anticompetitive conduct concerns. But unmistakable evidence will be needed to demonstrate that to be the case.

Importantly, Comcast/TWC is not a "horizontal" integration. The two providers do not compete head-to-head for broadband Internet or multichannel video (“MVPD”) subscribers. Should the deal be approved, no consumers of those services would lose a choice among providers. Moreover, although "vertical" integration effects often enhance consumer welfare, here even vertical aspects of the merger are minimal. Time Warner Cable lacks majority ownership of any nationwide cable video programming network or nationwide TV broadcasting network. Comcast's 2012 sale of 17 video networks means that post-merger with Time Warner Cable, Comcast will have fewer affiliated programming networks than it did upon the FCC's approval of its merger with NBC-U in 2011.

Pursuing a merger review policy based on principled economic analysis has further implications. It means the FCC must:

- Disregard pleas for it to reject Comcast/TWC out of hand, based on appeals to emotional incredulity or "big is bad" sloganeering;

- Stand firm against calls that, under the guise of protecting consumers, the agency impose conditions in order to protect market rivals from the competitive process;
- Reject dragging out its review process and thereby making itself even more susceptible to political pressures having little or nothing to with the potential consumer welfare benefits of the proposed transaction; and
- Avoid the imposition of any conditions on the merger unrelated to demonstrable concerns over market power and anticompetitive conduct.

Whatever the FCC ultimately decides regarding Comcast/TWC, the proposed merger deserves a swift process for review that is informed by rigorous economic analysis. The FCC should not depart from its precedents recognizing the potential competition-enhancing effects of non-horizontal mergers. Rather, it should stay focused on the potential consumer welfare-enhancing benefits that Comcast/TWC would bring.

The Proposed Comcast/TWC Merger at a Glance

Under the proposed Comcast/TWC merger, Comcast would acquire all of Time Warner Cable's outstanding shares for just over $45 billion. That is, Comcast will obtain all of Time Warner Cable's services for cable video, retail broadband Internet, business enterprise broadband, and wireless backhaul. To Comcast's approximately 30 million subscribers to MVPD or broadband Internet services, it will add 8 million of Time Warner Cable's 11 million. Comcast already has proposed to divest more than 3 million subscribers in a deal with Charter that, if approved, would bring the combined Comcast-TWC's nation-wide share of residential subscribers below 30%.

The Dynamic Marketplace Context of Comcast/TWC

The critical backdrop to Comcast/TWC is the dynamic video and advanced telecommunications marketplace. Simply put, the early 1990s bottleneck assumptions regarding cable services have long since passed into oblivion.

According to data collected in the FCC's *Fifteenth Video Competition Report*, by the end of 2013, cable providers only held 52% of MVPD subscribers. Telephone entrants and two nationwide direct broadcast satellite (DBS) MVPDs claimed about 8.4% and 33.6% of MVPD subscribers, respectively. At the end of 2011, 98.6% of subscribers or 130.7 million households had access to at least three MVPDs. And 35.3% or 46.8 million households had access to at least four MVPDs.

Meanwhile, innovative new platforms for consumer access to video services have emerged, including online video distributors (OVDs). The video marketplace now offers consumers a wide range of devices to access video content, such as IP-connected MVPD provided set-top boxes, multi-room DVR and home networking solutions, tablet devices, gaming consoles, Internet-connected smart phones and table computers, and home monitoring systems that act as extensions of cable MVPD networks.

Importantly, Comcast/TWC should be viewed in the context of the broader transformation taking place in the video and advanced telecommunications landscape. Cable companies once viewed as monopolies today face a variety of competitive challenges in seeking and retaining consumer loyalties.

Potential Consumer Welfare Benefits of Comcast/TWC

Consider a bit more closely the potential consumer welfare benefits to result from Comcast/TWC. First, the merger would likely accelerate the transition from analog to digital for cable video transmission. Comcast's MVPD footprint is already transitioned to all-digital. However, only 17% of Time Warner Cable's MVPD footprint is transitioned. Apparently, Time Warner Cable's plans call for just 75% of its footprint to be converted to all-digital by the end of 2016. The merger would make available all-digital cable video services to more consumers more quickly.

Comcast's plans to upgrade its broadband Internet infrastructure by deploying DOCSIS 3.1 would also encompass Time Warner Cable's footprint. Thus, the proposed merger will potentially enable faster deployment of DOCSIS 3.1 than Time Warner Cable would have enabled had it remained separate.

Further, Comcast/TWC would likely enhance the competitiveness of the market for broadband services to business enterprises. Geographic boundaries of both Comcast and Time Warner Cable inhibit their ability to offer attractive, uniform services across large regions or to nationwide businesses. For businesses operating super-regionally or nationwide, this requires them to undertake the time and expense of negotiating for broadband services with multiple providers. Or else it requires competing providers to undertake the time and expense of working out arrangements in order to serve business customers. Aside from the financial costs, those kinds of arrangements can pose technological difficulties due to the interfacing of different types of network infrastructure and software.

Comcast and Time Warner Cable have a combined market share for small- and medium-sized business enterprise services of only 10-15%. And the combined market share of the two companies in serving nationwide business enterprises of 500 or more employees is even smaller. Post-merger, the combined entity can hardly be said to possess market power to impose substantial, above-market price increases. But Comcast/TWC's improved competitive position regarding business enterprise services would put pressure on other competitors to enhance their own respective services and to keep their prices lower.

Additionally, the Comcast/TWC merger would potentially improve market competitiveness for wireless backhaul services. As the FCC described it in its *Sixteenth Wireless Competition Report* (2013), "[b]ackhaul facilities link a mobile wireless service provider's cell sites to the mobile switching centers that provide connections to the mobile wireless service provider's core network, the public switched telephone network, or the Internet, carrying wireless voice and data traffic for routing and onward transmission." As the *Sixteenth Report* further explained, "[m]obile backhaul needs will keep increasing as wireless carriers continue to deploy LTE technology in their networks."

Efficiency gains from expanded geographic scale and uniformity of operations would likely be achieved in providing wireless backhaul services, should the merger take place. Combined, Comcast and Time Warner Cable would be better positioned to provide more geographically extensive services. And if combined, the new entity would be better able to invest more financial resources into fiber-optic backhaul infrastructure. By accelerating growth in the supply of that critical input and further increasing technological efficiencies, the proposed merger could ultimately help reduce costs of wireless data transmission to the benefit of wireless consumers.

According to the companies, Time Warner Cable now offers wireless backhaul services to approximately 14,000 cell sites. Comcast serves approximately 8,500 sites. To put those numbers in perspective, by year's end 2012, more than 300,000 cell sites existed throughout the United States. And both providers possessed just under 3% of the wireless backhaul market share in 2013. From a nationwide market standpoint, this makes it extremely unlikely that the proposed merger would create a market power scenario that poses risks of consumer harm.

Consumer Harm Rendered Less Likely by Deal's Dynamics

On the face of things, Comcast/TWC appears to pose little risk of consumer harm. It remains a possibility that a searching economic analysis of the proposed merger could uncover potential anticompetitive conduct concerns. But given the nature of the combination, market power concerns stemming from Comcast/TWC appear minimal.

Critically, Comcast/TWC is not what economists typically regard as a "horizontal" integration. In such cases, the combination of two competitors results in the elimination of one choice for products or services in the market. Horizontal mergers pose market power and anticompetitive conduct concerns where the market in question is already concentrated or offers consumers limited choices.

But cable providers typically serve distinct geographic territories. Head-to-head competition between cable providers scarcely exists. Rather, cable providers face competition in the MVPD retail market from two nationwide DBS providers as well as traditional telecom providers that have recently entered local MVPD markets with IP-enabled video services.

Comcast and Time Warner Cable do *not* compete against each other in any local MVPD market. The two cable providers serve separate geographic territories. A merger of the two would not reduce the number of MVPD choices for any consumer.

Agency precedents recognize that horizontal integration-related consumer harm is typically absent in cable provider mergers. As the FCC explained in its *Adelphia Order* (2006), "[s]ince there are almost no MVPD markets in which seller concentration will increase immediately as a result of the proposed transactions, traditional antitrust analysis of the effects of an immediate increase in seller market power does not apply." It continued: "An important prerequisite for HHI analysis, as described in the *Horizontal Merger Guidelines*, is that the sellers compete for customers' business in the same product and geographic market."

Given the non-overlap between areas served by cable companies, it should come as little surprise that neither Cablevision's 2010 acquisition of Bresnan nor Charter Communications' subsequent acquisition of Bresnan in 2013 elicited any public comments to the FCC in opposition. Both transactions were approved by routine orders of the FCC's Media Bureau.

There are "vertical" integration aspects of Comcast/TWC that must be considered. By virtue of Comcast's ownership of NBC-U, a merger would mean the integration of NBC-U's video programming content with Time Warner Cable's cable video services. But Time Warner Cable's ownership of cable video networks is limited. It is not a majority owner of any national cable video network; it only has non-controlling interests in iN Demand and MLB Network. And Time Warner Cable does not have ownership interests in any national broadcast TV networks. It bears noting, that Comcast sold 17 A&E video networks in 2012. Combined, Comcast and Time Warner Cable would own less cable video programming than Comcast did upon the completion of its merger with NBC-U.

More importantly, agency precedents recognize that vertical integration, by itself, is a good thing. As the *Adelphia Order* explained:

> [A]ntitrust law and economic analysis have viewed vertical transactions more favorably than horizontal transactions in part because vertical transactions, standing alone, do not directly reduce the number of competitors in either the upstream or downstream markets. In addition, vertical transactions may generate significant efficiencies.

Process Implications of a Consumer Welfare-Based Review

A more definitive determination of whether Comcast/TWC would potentially harm consumer welfare in any particular video market will depend on a thorough, fact-specific examination. But basic economic principles regarding consumer welfare should guide the FCC's decision.

That means the FCC should disregard calls for it to reject Comcast/TWC out of hand or to impose conditions on it out of concern for the well-being of other marketplace competitors. Consumer welfare should not be mistaken for competitor welfare. Protecting competitors from competition freezes in the status quo and inhibits the marketplace process in which mergers are themselves an important entrepreneurial pursuit that can accelerate innovation and improve efficiencies. Pursuing protectionist policies risks long-term harm to consumers.

Similarly, the FCC must not let its review of Comcast/TWC be influenced by public pressures resting on little more than "big is bad" sentiments or slogans. It bears repeating that consumer welfare-enhancing effects can result from mergers characterized by efficiencies through economies of scale and scope. And it bears further repeating that Comcast/TWC is not a horizontal merger. No retail subscriber for MVPD or broadband Internet services will lose a choice if the proposed deal is approved.

Nor should the FCC abuse its merger approval authority by dragging out its review process. That only increases opportunity costs for merging parties left waiting in the lurch. It also increases opportunity for marketplace rivals or interest groups to mount undue political pressure on the agency in order to shape the outcome of its review.

For the FCC to take economic analysis seriously means it must avoid the imposition of any conditions on the merger unrelated to demonstrable concerns over market power and anticompetitive conduct.

Perhaps one of the most conspicuous examples of abuse on this score was the FCC's condition imposing net neutrality restrictions as conditions for approval of the Comcast/NBC-U. The *Comcast/NBC-U Order* (2011) provided that those restrictions would remain in place on Comcast even if courts of law ever determined that such rules were otherwise unlawful. (Keep in mind that the FCC made no findings of market power or likely anticompetitive conduct when it previously imposed its net neutrality regulations.) Sure enough, the FCC's net neutrality regulations were struck down in *Verizon v. FCC* (2014). Despite that ruling, the otherwise unlawful regulations remain in force as merger conditions on Comcast. That misuse of its merger approval authority is one bad precedent that the FCC should not replicate.

Conclusion

Comcast/TWC is indicative of the fast-changing dynamic market for video and advanced telecommunications services. A preliminary look indicates that Comcast/TWC poses a number of likely consumer welfare-enhancing benefits. And the proposed merger appears to pose little risk of consumer harm. However, a close, economically-based analysis is called for. Such an analysis should inform the FCC as to whether Comcast/TWC would likely enhance consumer welfare or whether it could potentially harm it. In all events, the FCC's review of Comcast/TWC should remain focused on the potential consumer welfare-enhancing benefits that the merger would bring.

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