Comments for the Record

Reply Comments on the Comcast-Time Warner Cable Merger

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Introduction

As noted previously, the Comcast-Time Warner Cable (TWC) deal is clearly in the public interest and should be allowed.[1] Since the initial filing, however, relationships between Comcast and content creators in both TV and broadband have been outlined as areas of concern. Yet, this merger is unlikely to substantially alter those relationships or increase the cable company's power to the detriment of consumers.

Dynamism continues to inject competition in the TV and broadband markets, impelling actors in both spaces to expand service and offerings. Multichannel video programming distributors (MVPDs) like Comcast continue to negotiate with broadcasters and programmers like ESPN to offer diversified content, even though these costs are rising at a precipitous rate. [2] Meanwhile, private investments in cable, VDSL, fiber and wireless technologies have put upward pressure on broadband speeds.[3] In turn, high quality video, which was previously found through cable, telco and satellite companies, can now be sent through wired and wireless broadband connections, further pressing infrastructure providers to upgrade.

Understanding competition in these dynamic markets has assumed its rightful place as a top priority for both antitrust regulators and scholars, and is the central subject of this submission. Thus, it is important in this final round of comments to understand more fully the two most important relationships in this deal: one present with TV content creators and the other with Internet content creators. Ultimately, the merger won't substantially alter the relationship for either of the content providers or erect barriers to entry for the markets.

TV Programming – Upstream Content Programmers and Downstream Content Distributors

The TV business continues to be defined by high quality content. On average, a single Game of Thrones episode will cost $6 million to make, two to three times higher than a typical network or cable show costs.[4] Meanwhile, sports have become big business. ESPN gets nearly $6 billion in fees from cable providers by producing 35,000 hours of television, which amounts to half of all athletic televised events.[5] The results of these changes are hardly surprising. In the last five years, the top three cable operators (Comcast, TWC, and Charter) have seen programming costs per subscriber increase 54 percent.[6]

The high stakes between content owners and distributors has given rise to a unique bargaining arrangement. Content, not infrastructure is ultimately desired by consumers, but the distributors who own the infrastructure have the direct relationship with consumers. Although still rare, programmers can withdraw their content if negotiations breakdown, resulting in losses for MVPDs as consumers find the desired content elsewhere.

Time Warner Cable, for example, saw how bruising a programming dispute can be when they negotiated with CBS this time last year.[7] During the renegotiation, CBS asked for an increase in the fees from Time Warner Cable. When the cable company balked, CBS pulled its content from Time Warner Cable's TV and Internet networks. The result was a record loss of nearly 306,000 subscribers in the preceding quarter, tallying up to nearly 3 percent loss of their entire base.[8] The ISP could have suffered worse losses had it not increased spending on marketing, nor does the subscriber loss take into account the $15 million in credits issued to Showtime subscribers who lost service during the blackout.[9] Consumers ultimately held TWC responsible for the breakdowns in dealings. It further demonstrated that programmers have a powerful bargaining position in these deals and that consumers do readily switch providers. In the future, Comcast will still be constrained in programming negotiations by this dynamic.

Worries about the potential power of TV operators propelled the Federal Communication Commission (FCC) to place a cap limiting MVPDs to a 30 percent market share threshold. Courts struck down the law in 2009, largely because the agency "failed to demonstrate that allowing a cable operator to serve more than 30 percent of all cable subscribers would threaten to reduce either competition or diversity in programming."[10] Even still, after this deal Comcast would sit below this threshold after divestitures.[11] Moreover, they will still be subject to the myriad program carriage rules that were created to deal with programming issues.

At the same time, diversity of programming will continue to be robust. From 2006 to 2014, the total cable channels available to consumers increased from 565 to approximately 900, an increase of about 59 percent.[12] As the FCC noted, expanded basic service has grown nearly 5.9 percent over an 18 year period, with the price per channel declining by 0.3 percent annually. Contrast this to the general inflation rate which grew annually at 2.4 percent over the 18 years.[13] The expansion of service has corresponded to a large drop in the collective power of cable companies, which have stake in just 15 percent of the video content.[14] Even while some condemned Comcast's acquisition of NBC Universal as the end of programming diversity, there was no guarantee of future performance. In a recent stockholder meeting, Comcast's Roberts lamented that the programming unit had yet to create a "breakout" hit, hinting at just how difficult it is to create desired content.[15]

HBO has been one such draw for consumers, which has been a boon for Time Warner. However, consumers have been pressuring the company to do better with their online service, HBO Go. Many have been clamoring for a standalone service to rival Netflix, but the costs are likely to be substantial. The new world we are entering is being driven by content, and all of the players are trying new business models and looking to the Internet as another means to compete.

Broadband – Bargaining Power Between Comcast and Internet Content Providers

On the Internet, the relationship between content providers and the Internet service providers (ISPs) has become a heated policy conversation, as evidenced by the 3.7 million comments filed in the network neutrality proceeding.[16] Even though some have made connections between the ongoing policies concerned with this deal, this merger will not change the barriers to entry for new Internet creators or negatively impact the current relationship between Internet content providers and Comcast. Even after the transaction, the competitive market for content delivery which includes thousands of providers will continue to offer the four basic kinds of service (transit, content delivery networks or CDNs, settlement free peering, and direct connection), affording content creators ample means into the ISP's network, and thus ultimately nullifying Comcast's power over these companies.

Understanding this requires some knowledge of the development of both the Internet and large Internet firms.

At its commercial genesis in 1995, Internet traffic was broadly distributed across countless players. But maturation in the market, driven by demand for video content, largely reconfigured traffic distributions beginning in the late 2000s. Global traffic increased more than fivefold in the past 5 years, and is expected to grow at 21 percent per year from 2013 to 2018.[17] In 2009, half of all Internet traffic originated in less than

150 large content and content distribution companies. In just five years that number was cut down to just 30 companies.[18] Netflix alone contributes at least 34 percent of peak Internet traffic in the United States, even though this number could be as high as 45 percent.[19] These new traffic patterns have come in tandem with significant changes in the agreements between content creators and those that deliver the content. These interconnection deals, as they are known, have proliferated in complexity and helped to spur investment at the critical junctures of the Internet. Because market players have come to the table to negotiate without government interference or heavy handed regulatory burdens, widespread congestion has been avoided.

Interconnection deals have adapted as companies have sent over more traffic, leading to a typical progression, which most large Internet companies have followed. First, a company usually leases data services from other providers through an arrangement called transit. Even from the beginning, an Internet-based company pays for transportation of their content through various deals, which is a continual cost of running a content business. Yet, this is a very low cost, even for the largest of content providers like Netflix.[20] Due to abundant competition and thousands of competitors, prices in this market have declined by 99.94 percent on a price per Mbps basis from 1998 to today.[21] More importantly, Comcast, like the other ISPs, have thousands of deals in place with these transit providers.[22] As consumer demand advances for a site, a firm will typically move to more advanced distribution platforms called a content delivery network (CDN), which places copies of the content near consumers in computer servers.[23] Again, there are countless providers of CDN service, which content companies can access.[24] The 40 major settlement-free peering partners like AT&T, Cogent, and Verizon all offer content delivery, affording yet another option for content creators.[25] Thus, there is ample choice and competition at every level of service for content companies to gain entry into Comcast’s network, which will not change with the merger.

The interconnection deal between Comcast and Netflix over its massive data demands are often cited as evidence of market power for the ISP, but a comprehensive view of available data suggest otherwise. As one would expect, Netflix has been looking for a variety of methods to lower its interconnection costs because of its size. As industry watchers have noted, the video company likely got a better deal by directly connecting with Comcast.[26] Most also believe the deal is on the same terms as those that Comcast has with other partners that directly connect.[27] Even on the face of it, the contours of the deal do not suggest bargaining power on the side of Comcast.

Research from David Clark, a leading engineer of the Internet and scientist at the MIT Information Policy Project, found that during the bargaining between Netflix and Comcast there were no widespread congestion problems.[28] As is typical of well managed networks, congestion would pop up during periods of high demand only to be ameliorated hours later through normal business negotiations.[29] The implication is that occasional congestion involving large Internet content providers is not a sign of power on the part of an ISP, but is rather a typical operation indicating the growing pains of a company with massive content demands searching for the lowest costs.

Clark also found that “congestion does not always arise over time, but can come and go essentially overnight as a result of network reconfiguration and decisions by content providers as to how to route content.”[30] Netflix is akin to CBS in its bargaining position. Because Netflix has highly sought after content, nearly 30 percent of peak traffic is dedicated to its delivery, and as Clark notes, it has discretion in determining the route of traffic in a network.[31] Combined, the content provider has substantial bargaining power in negotiations that limits Comcast’s bargaining position.

Indeed, free bargaining between content and conduit peers has been a hallmark of the Internet’s development, contributing mightily to its rapid growth. Investment reached those connections that consumers chose making widespread congestion nearly nonexistent.[32] The usage patterns of the United States and Europe help to explain it more fully. U.S. households receive nearly double the broadband investment dollars as those in Europe, but they also consume nearly double the amount of data.[33] The reason is Netflix and other video streaming services, since Americans spend a significantly higher amount of time streaming video over the net.[34] As traffic volumes grow from video demand, companies like Netflix will see their bargaining power continue to increase. Competition, which is sure to continue, will thus keep a Comcast merger in check.

Comcast has a further incentive to keep the pipe flowing for not just Netflix, but also for Hulu, YouTube and increasingly a service called Twitch. Amazon just bought the site, which streams video games for viewers for just shy of $1 billion.[35] The site sits just ahead of Hulu but a couple of percentage points behind Apple as the top streamer on the net.[36] Though it has hardly been mentioned in comments, its meteoric rise reinforces just how easy entry is in the content market. In total, the multiplicity of arrangements and competition for entry points into the Comcast's network severely hampers their power over both large and small content providers.

From the outside, interconnection seems messy, but it continues to benefit all the parties involved because of free contracting. Transaction economists who study these relationships tend to be sanguine about the recent deals.[37] There is no reason to believe that problems exist in this space, as former FCC Commissioner Julius Genachowski suggested when he declined to include it for the broader network neutrality proceeding. Yet, if there is to be any action taken on this topic, it should be done via the normal FCC procedures and not via merger conditions. As countless economists and analysts have expressed over the years, there are vast challenges in regulating these complex settlements mechanisms, of which the Commission should be well aware.

Conclusion

The dynamic competitive elements in both the video programming and Internet content spaces won't change with a merged Comcast, as the transaction will likely not increase bargaining power in either of these two markets. Nor will the new company be able to erect barriers to entry for either market. Given these likelihoods, robust competition in these two markets is likely to continue, further supporting our previous comments.

[1] Douglas Holtz-Eakin & Will Rinehart, *Comments to FCC on the Comcast-Time Warner Cable Merger*, http://americanactionforum.org/comments-for-the-record/comments-to-fcc-on-the-comcast-time-warner-cable-merger.