Introduction and overview

Persistent Abusive Monopoly

For policy makers and advocates who believe that competition is the consumer's best friend, the cable industry presents an ugly, anticompetitive picture. In the late 1990s, the assistant attorney general for antitrust called the cable industry "the most persistent monopoly in the American economy."[1] Things have only gotten worse.

Since that statement, AT&T purchased the largest cable owner (TCI) and the fifth-largest cable operator (MediaOne). The pending AT&T/Comcast merger would pull the fourth-largest operator into the dominant firm. It would create the largest cable company in the nation's history, with substantial ownership interest in cable systems that serve one-third of the nation's households and almost half of all cable households.[2] In the same period, the cable industry has also seized a dominant position in high-speed Internet access service, extending its anticompetitive and anti-consumer practices to this critical new market for advanced telecommunications with its broadband cable modem service.[3]

Cable companies use the same technology to provide both video and telecommunications services. The upgrades necessary to provide the current generation of digital video service also make possible the provision of high-speed Internet service. Most costs of the upgrade are common between the two. Cable companies have bundled the two services together. The convergence of video and data in one platform under the control of cable companies poses a critical challenge to the digital economy because the cable industry continues to possess and abuse market power in both the video and advanced telecommunications markets. The available econometric evidence and consumers' real-world experience do not support claims that competition from alternative technologies is sufficient to discipline cable, in either the video-distribution market or the high-speed Internet access market. This book shows that the cable industry is strategically pricing and managing the rollout of the two services to preserve and extend its market power.

As bleak as this picture is, the AT&T/Comcast merger would dramatically increase the potential for abuse in both markets. This merger would raise the level of concentration in the industry to unprecedented levels and reinforce its monopoly power. By creating a dominant firm, the merger would severely diminish the prospects for competition. The resulting huge communications and media company that spans video and high-speed Internet markets would have the incentive and ability to use its market power to undermine competition in both markets.

To appreciate the general problems of market power in digital media and communications networks—as well as the severe threat that the proposed AT&T/Comcast merger poses to consumers, competition, and the public interest—policy makers must take a broad view of the new digital communications network. They not only must analyze traditional measures of market power in the video market (Multi-channel Video Program Distribution or MVPD), but also must understand the unique power that domination of an advanced telecommunications network creates in the high-speed Internet market. Moreover, because the merger involves media and communications industries, policy makers must also recognize that the merger will have a substantial impact not only on commercial activity in the economy but also on civic discourse and the quality of our democracy.

Outline of the Book

Approach

Three steps must be undertaken to evaluate this, or any, merger.

First, an analytic framework must be established. Why do we care about mergers and what standards should be applied? Because media and communications industries span important commercial markets and affect the flow of information and debate in our political process (the marketplace of ideas), it is especially important to have a clear understanding of the goals and effects of mergers in these industries.

Second, because merger review is necessarily predictive, defining the markets and the structural conditions is a critical step for the review. The impact of a merger on competition and consumers, as well as on civic discourse and citizens, depends on the nature of the markets in which the proposed merger would take place.

The third step in the analysis requires a reasonable projection of the impact of the merger on the relevant markets. After demonstrating the presence and abuse of cable market power in both the video and advanced telecommunications services markets, this book identifies ways in which the merger would make matters worse. Confronted with a reasonable projection of harm to competition or the likelihood that a merger would not promote the public interest, policy makers must either block the merger or take remedial steps to correct the problems.

Outline

The book is divided into three parts. Part I deals with the video market and presents a traditional discussion of industrial organization and market structure issues.

Chapter 1 presents a discussion of the underpinnings of public policy concern about market power and mergers in communications and media markets. It identifies the statutory and analytic basis for antitrust concerns about harm to competition. It also discusses the Communications Act concerns about diversity in civic discourse. It explains the measures of market structure and market power used in merger review and in the analysis of industrial organization.

Chapter 2 analyzes the structure of the video market. It demonstrates that cable companies possess and have abused market power in multi-channel video program distribution. It demonstrates that cable industry claims about competition at the point of sale presented to the Federal Communications Commission are a mixture of blatant misrepresentation of the empirical evidence and simplistic analysis that is incorrect and misleading. After demonstrating the lack of competition with elasticities of demand and substitution and with patterns of market expansion, the book draws on the results of an extensive survey of cable and satellite customer attitudes to provide a realistic map of the multi-channel video product space. The chapter concludes by demonstrating that the cable industry is highly concentrated at the local and regional levels and moderately concentrated at the national level. It documents the industry's market power and the inevitable result of the exercise of market power unfettered by competition or regulation – a clear pattern of pricing abuse and denial of access in the industry.

Chapter 3 examines discrimination and other anticompetitive practices of cable operators in video-programming markets. As buyers of programming who are frequently integrated into program production, cable operators have a long history of discriminating against new programming that threatens to compete with their marquee offerings. Because they have the dominant means of distributing video programming, cable operators have withheld their programming from competing distributors (or sought to prevent programs from being made available to competing distributors). The chapter shows that such anticompetitive practices combine with the economics of program production to create a moderately concentrated video programming market in which a small number of programmers dominate—all of whom have guaranteed access to distribution mechanisms, either through ownership or carriage rights.

Part II deals with the more unique aspects of the proposed AT&T/Comcast merger and presents the less traditional discussion of communications platforms. Chapter 4 presents a description of communications platforms and the unique concerns about market power in communications platforms. It describes the uniquely dynamic information environment created by open communications platforms and the end-to-end principles of the Internet. It rejects claims that the public interest is served by allowing the exercise of market power in these industries.

Chapter 5 describes in detail the specific sources of leverage in cable's closed communications platform and the strategies for exercising market power when firms dominate closed platforms.

Chapter 6 discusses cable modem service in the high-speed Internet market. It shows that advanced telecommunications markets are dominated by a very small number of facility owners who have the incentive to foreclose and discriminate against independent content providers. It demonstrates that cable companies possess and have abused market power over this product. It then examines the cable industry's strategic pricing and withholding of high-speed Internet access service—strategies that parallel the anticompetitive behaviors in the video product space.

Part III deals with the impact of the proposed AT&T/Comcast merger in the market structures identified. Chapter 7 shows that the merger would make matters much worse in both the video and high-speed Internet markets. It shows that the merger violates the guidelines of both the Department of Justice and the FCC in terms of allowable increases in concentration. Consequently, it will harm competition and will not promote the public interest. It discusses how the merger would undermine competition in the high-speed Internet market and increase the likelihood that a closed communications platform would dominate the next generation of the Internet, to the detriment of consumers and the economy.

Although the book recommends that the merger be rejected, Chapter 8 also presents a series of remedial measures that could be used to blunt the negative impact of the merger. Both federal and local policies to prevent anticompetitive effects and provide consumer protection are identified.

The Public Understands the Danger of Mergers in the Mass Media and Communications Industries

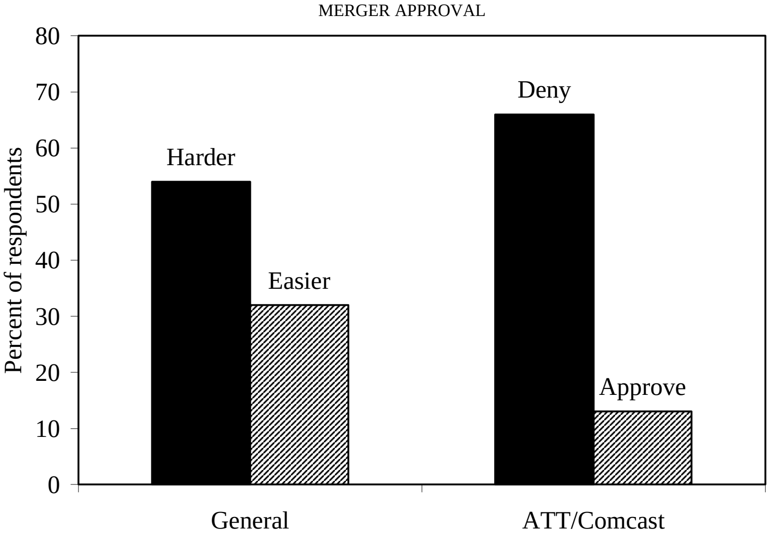
The economic and regulatory concepts used throughout this study are grounded in theory and empirical research and framed in the complex terms of economic analysis. The conclusion is clear: Increasingly concentrated media and communications markets serve the public poorly. Before we launch into that technical analysis, it is important to stress that the public has borne the brunt of past abuses of market power and will be the victims of the increased market power resulting from the pending AT&T/Comcast merger. The public feels these effects through rising prices, restricted choices, and poor service. Public opinion toward mergers is shaped by the real-world experience of consumers and reflects the generally negative effects of past mergers on the public.

In response to survey questions, the public expresses strong concerns about increasing size and concentration in the media and communications industries. With respect to the AT&T/Comcast merger, two-thirds of respondents to one recent survey said that the AT&T/Comcast merger should be denied (see **Figure 1**).[4] With communications industry mergers, the most frequent problem volunteered by respondents was the resulting lack of choice and competition (34%). The second most frequent problem was higher prices (24%). The sheer size of the companies was a distant third (9%).

The public has had this dim view of communications industry mergers for some time. In late 1995, just before the passage of the Telecommunications Act, respondents to an opinion poll who did not have a specific merger in mind felt that public policy should make it harder, not easier, for cable mergers to take place (54% to 32%) (see Figure 1)[5] Half of all respondents felt that such mergers would lead to higher prices compared to only one-eighth who felt that prices would go down (see **Figure 2**). By more than a 2-to-1 margin, respondents believed that quality would become worse, not better (36% versus 14%) (see Figure 2). They also believed that cross-ownership of media would decrease the diversity of news coverage and editorial viewpoints.

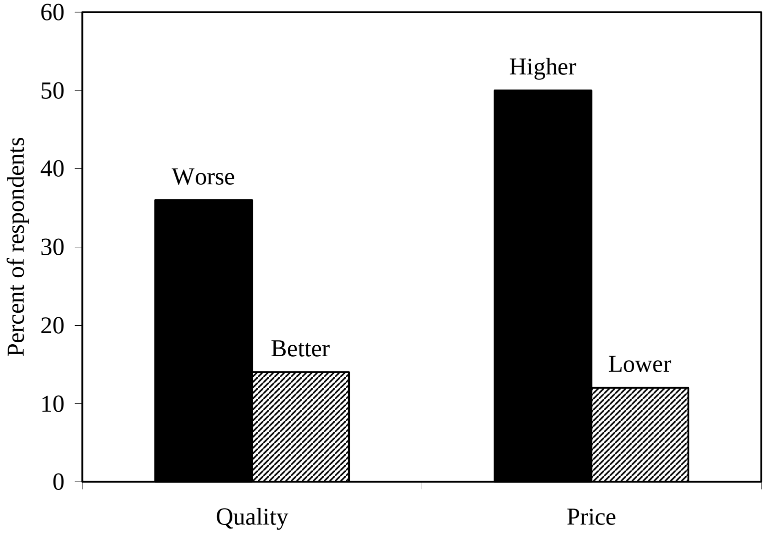
This book shows that the public's opposition to these mergers is well-justified, not only by their everyday experience, but also by the overwhelming weight of the technical economic evidence.

FIGURE 1 The public opposes mergers in the media and communications industries



Source: Consumer Federation of America and Center for Media Education, 1995; Lauer Research Inc, 2002.

FIGURE 2 Impact of mergers on quality and price



Source: Consumer Federation of America and Center for Media Education, 1995.