DOJ examining bargaining-leverage economic theory in Comcast-Time Warner Cable review

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IN BRIEF

The US Department of Justice is investigating whether an economic theory about bargaining power that has been used to block hospital acquisitions applies to Comcast's proposed buyout of Time Warner Cable, MLex has learned. The deal's critics have said the merger of the two largest US cable providers would result in the combined company having the leverage to restrict television and Internet programming — a contention Comcast disputes.

The US Department of Justice is investigating whether an economic theory about bargaining power that has been used to block hospital acquisitions applies to Comcast's proposed buyout of Time Warner Cable, MLex has learned.

Opponents of the $45.2 billion transaction, such as online video service Netflix and satellite-television provider Dish Network, have been urging the DOJ to consider the combined company's greater bargaining leverage as the basis for blocking the deal in court. These critics have said the merger of the two largest US cable providers would allow the combined company to restrict television and Internet programming.

The bargaining-leverage theory might be deal opponents' best hope of convincing the government that Comcast and Time Warner Cable compete head-to-head, an important step because the DOJ is more likely to sue to stop a deal between direct competitors. Government enforcers have become increasingly comfortable with using the theory to challenge mergers.

Comcast officials have argued in filings with the Federal Communications Commission, which also is reviewing the transaction, that they have no incentive to choke off content its subscribers want. Any enhanced bargaining leverage the company gains, the officials said, would be minimal and could be used to lower programming costs (see here). The officials also said that Comcast and Time Warner Cable don't compete directly.

“Bargaining-power arguments with respect to programmers have no merit,” company spokeswoman Sena Fitzmaurice said in a statement.

The DOJ is still in the middle of its review and hasn’t decided what actions, if any, it will take. A DOJ spokeswoman declined to comment.

The deal’s opponents are basing their argument in part on a paper co-written by Aviv Nevo, who left his post as head of the DOJ’s antitrust economics unit in August to return to Northwestern University.

A chief priority in Nevo’s year-and-a-half term was to get the DOJ to use the theory more in analyzing proposed mergers, he told MLex.

Generally, “you see evidence of larger firms able to extract better terms” after a merger, Nevo said. The bargaining-leverage theory “is a paradigm that will be useful in a lot of different industries.”

Nevo declined to comment on whether his former colleagues were applying the theory to the Comcast-Time Warner Cable deal.

In the view of the merger’s opponents, Comcast and Time Warner Cable are among the biggest players in a national market of content distribution services that includes other cable and Internet service providers and satellite-television companies.

The merger would create a company serving 29 million subscribers that would be a dominant cable and Internet service provider in some of the nation’s largest media markets — New York City, Los Angeles, San Francisco and Philadelphia.

No programmer would be able to attract national advertisers without access to viewers in these cities, allowing Comcast-Time Warner Cable to successfully pressure the programmer to charge a lower rate for the cable company to retransmit their shows, according to opponents.

The power of Comcast-Time Warner Cable is enhanced by the consolidation occurring among other distribution services, such as AT&T’s proposed acquisition of DirecTV, the opponents said.

The merger’s impact is particularly problematic with regard to the Internet because the combined company would control as much as half of the nation's premium broadband service, the opponents said. Netflix has said it fears Comcast-Time Warner Cable would be able to dictate the 'interconnection' fees the online video service would have to pay to gain access to the company's network.

For whatever reason — disputing a retransmission or interconnection fee, cutting off competitors of NBC and Universal programming, which Comcast owns, or disrupting rival services such as Netflix — the combined company could decide what programming people see and what they don't, according to Comcast's opponents.

— Hospital cases —

The governnment has been successful in using bargaining theory to show the anticompetitive impact of hospital mergers. In a paper to be published next year, Nevo and co-authors Gautam Gowrisankaran and Robert Town used hospital and insurance claims data to show prices would rise at Prince William Hospital if it were purchased by the Inova Health System. By itself, Prince William Hospital couldn't negotiate prices with insurers that were as favorable as those it could get being part of the Inova hospital chain, the economists found (see here).

Inova and Prince William abandoned the merger in 2008 after the Federal Trade Commission challenged it in court.

In rejecting ProMedica's purchase of St. Luke's Hospital in the Toledo, Ohio region (see here), the US Court of Appeals for the Sixth Circuit accepted the government's argument about the hospitals' bulked-up bargaining power. A federal judge drew a similar conclusion in ruling against Idaho-based St. Luke Health System's proposed buyout of Saltzer Medical Group (see here).

Nevo and his co-authors said that the "bilateral negotiations" that hospitals and insurers, such as managed care organizations, use to set rates are similar to the talks cable providers and programmers engage in to decide rates for the cable companies should pay to transmit a show.

— Comcast's view —

Comcast has said at best, the merged company might have power to return some balance to negotiations with programmers, which have been able to extract fees from the cable provider that have risen more than 10 percent annually for the past 10 years.

“The transaction would result in Comcast having less than 30 percent of the [pay-TV] marketplace — less than the ceiling the FCC tried to set several times but the DC Circuit twice rejected as much too low,” Fitzmaurice said.

When disputes over programming fees have erupted in public, leading to temporary blackouts of shows, content providers have won, Comcast said, citing battles between CBS and Time Warner Cable, 21st Century Fox and Cablevision, and Disney and Dish Network.

The FCC and DOJ addressed concerns about bargaining leverage during Comcast’s 2011 purchase of NBC Universal by creating an arbitration system for vetting complaints. Comcast has agreed to submit to arbitration regarding any dispute involving Time Warner Cable assets.

Opponents’ portrayals of Comcast-Time Warner Cable behaving as an Internet gatekeeper are untrue, Comcast has said. The combined company would have 36 percent of the Internet broadband market — a share that has been slipping as competitors’ network speeds improve, Comcast said.

Subscribers are attracted to broadband providers that can provide full, not selective, Internet access, the company said.

Comcast has promised to abide by FCC rules to guarantee content providers equal Internet access. The ‘net-neutrality’ rules apply to the last mile of the network between the Internet and the user and not at ‘interconnection’ access points where content providers stream their product into an ISP’s network.

The concern about interconnection rates, which wouldn’t be covered by Comcast’s net-neutrality pledge, is misplaced, Comcast’s Fitzmaurice said.

Competing services are providing alternative ways for Netflix and other content providers to tap into the Comcast’s network, leading to lower interconnection fees, she said. The fight about the fees predates the deal and involves other ISPs such as Verizon, Fitzmaurice said.