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The FCC Risks Over-Conditioning the Comcast-NBCU Merger

By

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Tick-tock goes the Federal Communication Commission's merger clock counting the days the agency has spent reviewing the proposed Comcast-NBC Universal merger. The FCC says it tries to act on merger applications within 180 days. The clock is now at "Day 215" – more than a month of working days past its self-professed goal.

The good news: The FCC is likely to vote soon to approve the merger. The bad news: There may be so many conditions attached to the approval that the new entity could be constrained from realizing the economic efficiencies envisioned when the merger was conceived.

The combination is primarily a "vertical" rather than a "horizontal" merger. Rather than offering services and products that compete directly ("horizontally") in the marketplace, Comcast and NBCU offer complementary ("vertical") services. Comcast mostly is a broadband services provider and cable television distributor, a transmission conduit for others' content, while NBCU largely is a content provider, with its ownership of broadcast and cable television networks and a movie studio.

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The risks of collusion and market concentration are considered much greater with horizontal combinations. In contrast, a vertical integration of complementary services is generally viewed favorably because it is intended – if all works out as the parties envision, which is not always the case – to lead to increased operating efficiencies through reduced transaction costs. The cost savings inure to the benefit of consumers, providing capital for investing in innovative services and facilities.

This is not to say that mergers like the Comcast-NBCU combination shouldn't be scrutinized by the government to ensure the merged entity will not be in a position to exercise undue market power to the detriment of marketplace competition and consumer welfare. But with the FCC reviewing the merger under the Communications Act's indeterminate "public interest" standard, the agency ought to exercise a large measure of self-restraint.

The agency's five commissioners should be wary of the difficulty of predicting the course of the technologically dynamic and competitive communications and media markets – especially so given the agency's spotty predictive record.

In this instance, the FCC has spent a considerable amount of time worrying about whether the combined entity would have the ability to impede development of the emerging online video marketplace. The suggestion is that the new entity, perhaps concerned about consumers "cutting the cord" – that is, giving up their cable TV subscriptions in favor of satisfying their video appetites online – will withhold programming from Internet video sites. So the FCC is considering conditioning its merger approval on a requirement that Comcast and NBCU share their programming assets with web video sites on "fair" and "nondiscriminatory" terms.

As a matter of sound competition analysis, the FCC's concern is problematical. The commission has acknowledged that the video distribution marketplace in which Comcast competes is competitive, with two satellite television operators, telephone companies, and now wireless providers. In a January 2009 report, the agency declared, "[t]he marketplace for the delivery of video programming services is served by a number of operators using a wide range of distribution technologies." And it added, "[t]he amount of web-based video provided over the Internet continues to increase significantly each year."

The FCC's handling of the ill-fated AOL-Time Warner merger should be a cautionary tale. Egged on by so-called "consumer" groups, the FCC spent almost a year considering the merger in January 2001. In April 2000, in language nearly identical to that which the same groups now use to oppose the Comcast-NBCU merger, they proclaimed: "The merger would allow two enormous firms to dominate the market for broadband and narrowband Internet services, cable television, and other entertainment services, which could leave consumers with higher prices, fewer choices, and the stifling of free expression on the Internet."

Despite the fact that the merged AOL-Time Warner struggled in the marketplace almost immediately; that AOL was spun off from Time Warner in 2009 and now is battling just to stay afloat; and that Time Warner Cable, the broadband services provider, was then spun off from Time Warner, the content owner; the consumer groups continue reflexively to oppose almost all mergers involving communications and media firms.

The consumer groups aren't going to change. But as the marketplace becomes ever more competitive, we should expect more from the FCC, especially in light of its own misplaced conjecture about the impact of the AOL-Time Warner merger. A key issue slowing down approval of that merger was the agency's concern that AOL's supposed dominance in the text-based instant messaging (IM) market would afford the merged entity an anti-competitive advantage in what the FCC called the emerging advanced Instant Messaging based high speed services market. To allay its concern that Microsoft and Yahoo, not exactly start-ups, might not be able to compete against AOL-Time Warner, the FCC conditioned its approval on AOL-Time Warner's agreement to make its advanced IM service interoperable with unaffiliated IM services.

Today there is no distinguishable advanced IM market, and if there were, AOL wouldn't dominate it. Indeed, the FCC eliminated the interoperability condition in 2003 in light of AOL's rapidly declining market share.

FCC Commissioner (and later Chairman) Michael Powell dissented from imposition of the IM condition in words that are particularly apt as the present commissioners consider imposing onerous conditions on the Comcast-NBCU merger. Focusing on the difficulties of predicting the development of emerging markets, such as the newly-conceived advanced IM market, Powell warned that "the key is not to let our imaginations run away with us, given the absence of strong evidentiary moorings." And he decried the agency's history of adopting conditions "divorced from the perceived harms" outside of the commissioners' "core responsibilities and competencies."

The FCC commissioners would do well to have in mind the agency's mishandling of the AOL-Time Warner merger, especially Michael Powell's admonitions. There are obvious parallels between the agency's concern then with what it saw as AOL-Time Warner's potential dominance of the emerging advanced IM market and its concern now about Comcast-NBCU's potential anti-competitive actions in the nascent online video market. In practical effect, there is not that much difference between the AOL-Time Warner interoperability condition and the mandatory program sharing condition apparently now being considered. Both conditions, by mandating sharing of proprietary firm resources, under terms to be determined by the FCC based on vague notions of fairness, have the effect discouraging new investment and innovation.

With the FCC approaching decision day, the commissioners should be acutely aware of the limits of their ability to predict future marketplace developments. Absent findings that the merged entity will possess monopolistic market power, which is not the case with Comcast-NBCU, the regulators should be skeptical concerning their ability to fashion merger conditions that will benefit consumers more than the marketplace operating free of regulatory constraints.

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