

Ex Parte Comments on Experimental Economics Study Examining Horizontal Concentration in the Cable Industry

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MM Docket Nos. 92-264, 94-150, 92-51, 87-154  
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1. These ex parte comments are in response to the Media Bureau's Public Notice seeking Comment on Experimental Economics Study Examining Horizontal Concentration in the Cable Industry. They also follow an informative discussion that I had with Dr. Mark Bykowsky of the FCC's Office of Plans and Policy on July 2, 2002.
2. I am an Assistant Professor in the Business Law Department at the University of Miami School of Business Administration. My current research focuses on the intersection of regulation and competition, with a focus on telecommunications.
3. I am working on a paper discussing federal regulation and the state of competition in the market for cable video programming and high-speed data access. The underlying premise of my argument is that choice in video programming and rapid deployment of advanced services such as broadband is critical to the United States from an economic and social perspective, and that regulatory bodies must play a central role in facilitating this choice and deployment.
4. My central thesis is that to achieve this infrastructure, we must move away from regulatory definitions based on historical distinctions toward a regulatory framework based on economics, with the goals of maximizing both efficiency and equity.
5. My research to date indicates that based on a variety of measures, including the Herfindahl-Hirschmann index (HHI), concentration in the cable industry has been rising steadily. In parallel, prices increases have outpaced inflation, as market participants have increased economic rents (for example, as measured by Tobin's q ratio). On the other hand, as competition increases, prices tend to fall and consumers benefit. The bottom line is that increasing levels of industry concentration may be a boon to the cable industry, but may in fact have detrimental effects on society and consumer welfare.
6. As a consequence, I am very interested in the experimental economics study and believe it is an important step in understanding cable markets from an economic perspective. Several of the study's findings seem consistent with my research, in particular:
  - i) higher levels of horizontal concentration lead to reductions in economic efficiency (when the number of programming networks exceeds the cable operator's channel capacity)
  - ii) there is a decrease in direct broadcast satellite (DBS) operator's bargaining power when two cable operators serve 44% and 33% of the market, than when the largest cable operator serves 27%

- iii) large cable operators have greater bargaining power than small operators, given their ability to include “Most Favored Nation” (MFN) provisions (ensuring they will not pay higher affiliate fees than smaller buyers), and even their ability to negotiate lower affiliate fees
7. I would strongly encourage that the study’s methodology be used to simulate a real market – for instance, as specific geographical area. To do this, the study would need to be extended along at least two dimensions:
    - i) The maximum market share of the largest cable operator in the study’s hypothetical market is 51%. In actual markets, concentration may actually be higher, with a single wireline cable company occupying closer to 80% share and competing against 1-2 direct broadcast satellite (DBS) companies. For example, the study reports that a cable operator with 27% market share is as powerful as one with 51% share, which nicely tees up the question of what the power would be if the share were substantially greater than 51%?
    - ii) Cable operators’ affiliations with programming networks may in fact affect the competitive decisions cable operators make. Currently, this is not built into the study.
  8. As a first step, it would be useful to for the experimental economics model to try to simulate the historical development of an existing cable market and, data permitting, compare this to what actually happened. This could serve as a “pilot” case and to “calibrate” the model. A subsequent step would then be to test forward-looking “what if” scenarios with the model in order to inform regulatory policy.
  9. If the model shows that increasing levels of concentration lower overall economic efficiency, then it would also be supported by my research findings. Importantly, a case could then be made for regulation of the space to limit concentration and the analysis can move from a descriptive to a normative phase.
  10. For instance, the framework that I propose involves identifying the scarce resource (or “bottleneck” input), determining whether a market participant is exerting monopoly power over the input to the detriment of competition or public policy, then regulating and pricing this resource based on empirical economic models.
  11. Analyzing issues with this approach may put existing public policy debates in a slightly different light. For example, the debate around cable providers offering “open access” to internet service providers (ISPs) may be recast as a discussion around how to allocate scarce bandwidth between and among video programming and advanced services. For example, typically only 6MHz of a 750MHz cable system is allocated to broadband, creating some of the limitations that have impeded high-speed access deployment.
  12. As discussed with Dr. Bykowsky, I will send him a draft copy of my paper over the next few weeks. Additionally, I am happy to provide further information and help contribute to this public policy debate of great national importance.

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