

The Consumer Benefits of Telco Entry in Video Markets

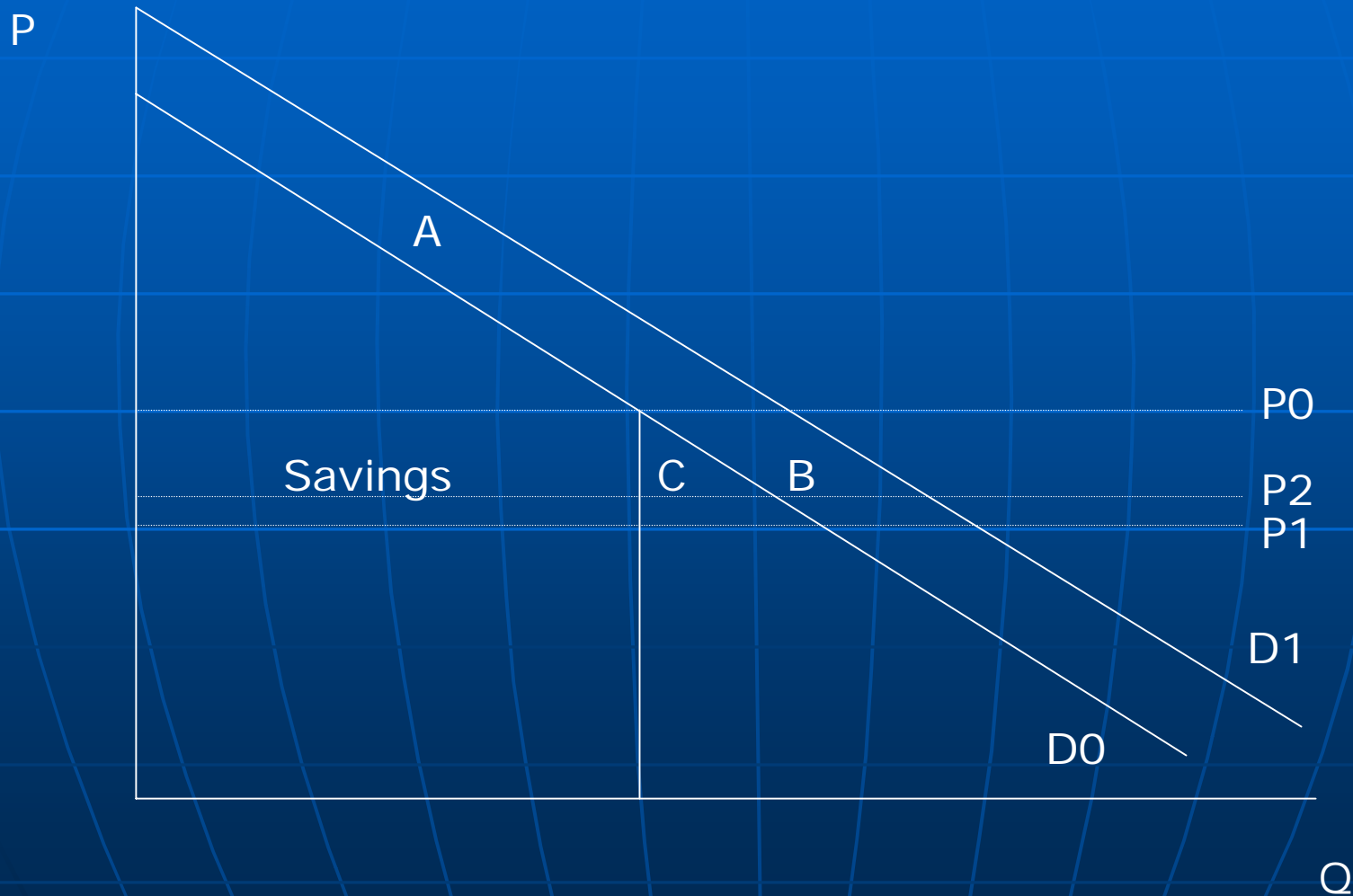
Hal J. Singer, Criterion Economics

Literature

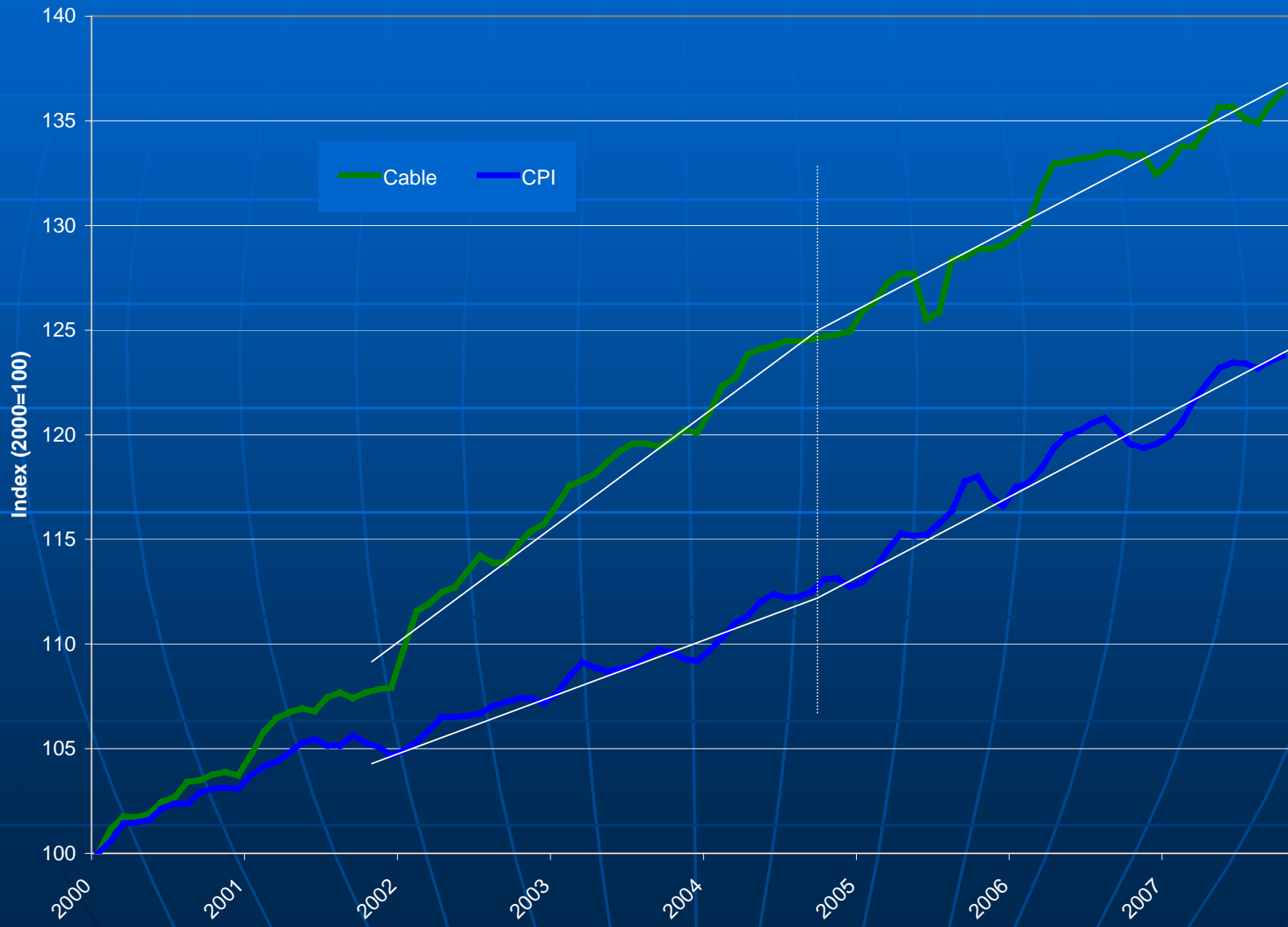
■ Articles

- Crandall, Sidak & Singer, Fed. Comm. L. J. (2007) (estimating annual benefits of \$6 billion)
 - Crandall & Litan, Report (2006) (estimating annual benefits of between \$7.5 and \$14 billion)
 - Hazlett, George Mason Law & Economics Research Paper (2006) (estimating annual benefits of \$9 billion)
 - Brito & Ellig, George Mason Working Paper (2006) (estimating annual benefits of \$8 billion)
 - Ford & Koutsky, Phoenix Center Policy Bulletin (2006) (estimating annual benefits of \$8 billion)
- Estimates are likely conservative because they are based on overbuilder outcomes; telcos are more potent competitors, especially for bundled offerings

Consumer Welfare Increase



Cable Inflation Appears to Be Slowing



Price/Quality Comparison of Double Play (Video/Internet) in Dallas

	AT&T	Time Warner
Price	\$59	\$74.50
Cable Channels	100	85
Internet Speed (down/up)	1.5/1	1.5/.384

Source: *AT&T's launch in bits Cable, broadband deal to come out gradually, may push prices down*, Dallas Morning News, Mar. 6, 2007, at 1D.

Price/Quality Comparison of Triple Play (Video/Internet/Phone) in Fairfax

	Verizon FIOS	Cox Digital Bundle
Price	\$120	\$156
Channels	Digital + Sports & News Tier	Digital + Sports & Info Tier
Maximum Speed (Down/Up)	15/2 Mbps	15/2 Mbps
Telephone	Unlimited	Unlimited

Sources: Cox Bundle Fairfax, available at <http://www.cox.com/fairfax/bundle.asp>;
<https://www22.verizon.com/ForYourHome/NationalBundles/NatBundlesHome.aspx#>

Effect of Wireline Entry in Video Markets (1 of 2)

- FCC (2006): Cable rates **17** percent lower in areas where MSO faced competition from a wireline overbuilder
- GAO (2005): Cable rates **16** percent lower in areas where MSO faced competition from a wireline overbuilder

Effect of Wireline Entry in Video Markets (2 of 2)

- Bank of America survey: in areas where Verizon was rolling out FiOS, MSOs responded with “not actively advertised” price cuts of 28-42% that are offered only in areas where FiOS video service is available
 - Cox 43%
 - Charter 29%
 - BrightHouse 38%

Source: Bank of America Equity Research, Battle for the Bundle: Consumer Wireline Services Pricing, Jan. 23, 2006, at 10 (surveying prices in Herndon, VA, Keller, TX, and Temple Terrace, FL).

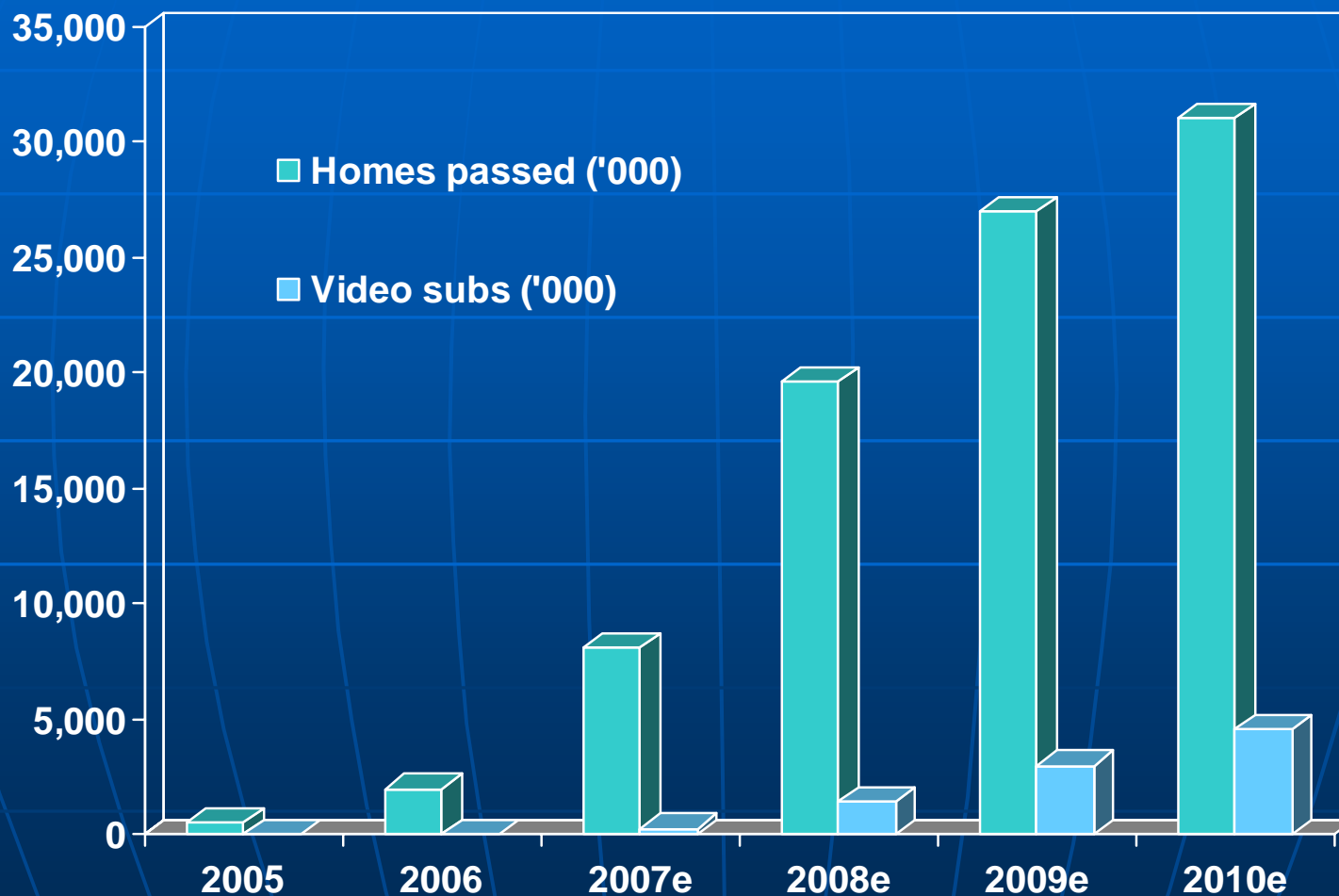
An Alternative Prediction Model

- Structure-Conduct Relationship
- NEIO: $(P-C)/P = HHI/E$ under Cournot
- Need estimate of
 - E (elasticity of demand)
 - Change in HHI from telco entry

Predicted Price Effect

- Hazlett (2006)
- Inputs
 - $E = -1.5$
 - Telco market share = 20% (based on RCN penetration rate)
- Predicted decrease in price: 14%

AT&T's Projected Video Subscribers/Homes Passed



Source: Buckingham Research, Oct. 4, 2007

25 Markets Entered by AT&T as of October 2007

- 6/2006 – San Antonio
- 11/2006 – Houston
- 12/2006 – Muncie, Indianapolis, Anderson, Stamford, New Haven, Hartford, Bloomington, San Jose, San Francisco
- 2/2007 – Racine, Milwaukee
- 3/2007 – Dallas-Ft. Worth, Kansas City
- 5/2007 – Detroit, Ann Arbor, Ventura County, Riverside County, Los Angeles County
- 6/2007 - Cleveland, Akron, San Diego
- 8/2007 - Sacramento, Oklahoma City

Competitive Responses (1 of 4)

- Santa Rosa, California
- Comcast
- "Comcast is likely rushing to deliver the new features [video-on-demand, more channels] in Santa Rosa because rival AT&T has started offering its own digital TV service in select neighborhoods."

Source: Comcast Raising Prices Again, Except In Most Of Santa Rosa: Average Cable Bill To Jump Almost 5%; Santa Rosa Rates Unchanged As System Gets Upgraded, The Press Democrat, Oct. 17, 2007, at A1.

Competitive Responses (2 of 4)

- Houston
- Comcast
- “Partly as a response to these two IPTV deployments, Comcast will offer more linear and high-definition channels, video-on-demand titles and digital phone features to its 700,000 basic customers in and around Houston before the end of June.”

Source: Comcast Promises To Fight For Every Customer As It Faces DBS And IPTV Competition In Houston, CableWorld, Apr. 16, 2007.

Competitive Responses (3 of 4)

- San Antonio
- Time Warner Cable
- Time Warner Cable Product Director said that he was launching new products, including a triple-play service, as a direct response to AT&T entering the market in San Antonio.

Source: Meet the System San Antonio: Time Warner Cable Fights AT&T in its Hometown, CableFax's Cable World, Aug. 13, 2007.

Competitive Responses (4 of 4)

- San Diego
- Cox
- "Regional manager of Cox San Diego says the Tech Solutions program, Pivot and the expansion of video-on-demand, high-definition and local programming are ... key weapons to be used against Cox's competitors, a field that's grown recently: AT&T premiered U-verse in portions of the city earlier this year."

Requirements Associated with Cable Franchise

- pay a gross earnings tax
- designate channels for public use
- construction of Public-Education-Government (PEG) studios all over the state
- protect information on customers' viewing habits
- build out systems to every household in the service area (“universal service”)

Connecticut Saga

- 12/01/06: AT&T began offering U-Verse in parts of nine towns
- 6/07/07: Department of Public Utility Control (DPUC) rules that AT&T's U-Verse is not a cable service
- 7/19/07 : Trade group of cable companies filed a federal lawsuit and a state appeal
- 7/29/07: Federal judge rules U-Verse is a cable offering

Connecticut Saga (continued)

- 9/4/07: Governor signs bill into law that allows new entrants to apply for a franchise and offer services within 30 days
- 10/1/07: AT&T files an application under the new law
- 10/2/07: AT&T's motion for reconsideration is denied
- 10/15/07: DPUC orders AT&T to stop signing up new video customers and installing new facilities until it has obtained a legacy cable franchise
- 11/1/07: Superior Court Judge overturned DPUC's ruling

Connecticut Saga (continued)

- “[The DPUC's decision is] a **huge total victory** for Connecticut consumers. This decision embodies completely the position that I have advocated—that this service is cable and must be regulated as cable to protect against AT&T cherry picking the wealthiest and most accessible consumers.”
 - AG Richard Blumenthal (10/15/07)

A Change of Heart

- “Continued legal combat ill serves the common objective of providing consumers with lower prices and better service. Any perceived tilt in the video playing field should be addressed by legislators in the 2008 session.”
 - AG Richard Blumenthal (11/1/07)

Policy Implications

- Key policy question: Should video entrant be saddled with universal service requirement for the sake of regulatory symmetry?
 - No: Incumbent MSO subsidized universal service requirement with monopoly profits
 - Even if incumbent MSO terminated service in certain areas, every home is passed by DBS

Policy Implications (continued)

- Pareto efficiency: an outcome is more efficient if at least one person is made better off and nobody is made worse off
- Requirement that all Connecticut consumers benefit *before* any individual resident benefits is the Anti-Pareto rule