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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA *Plaintiff*, v. AT&T INC., DIRECTV GROUP HOLDINGS, LLC, and TIME WARNER INC., *Defendants*.	Case. No. 1:17-cv-02511 (RJL)

SUPPLEMENTAL EXPERT REPORT OF CARL SHAPIRO

21 April 2018

1. Using the 2017 Average LTV Figures

Professor Carlton used AT&T's reported LTV for June 2017 to calculate estimated harm using my bargaining model. [Tr. 2448] The June LTV was provided to Prof. Carlton by AT&T in February 2018 and produced in the backup of his rebuttal expert report of February 26, 2018 along with LTVs for January and April of 2017 (these were subsequently corrected by Prof. Carlton for errors).[1] Prof. Carlton testified that using an average of the January, April and June 2017 LTVs provided to him by AT&T "wouldn't make any difference, significantly, to what I've testified to." [Tr. 2585]

Relying upon the June 2017 LTV figure, with a 9% subscriber loss rate, Prof. Carlton calculates the net annual increase in MVPD costs at $30 million using my bargaining model. In contrast, using the average LTV from January, April, and June 2017, the net annual increase in MVPD costs is significantly higher, at $98 million.[2]

Using the June 2017 LTV figure, with a 14% subscriber loss rate, the net annual increase in MVPD costs using my bargaining model is $241 million. In contrast, using the average LTV figure from January, April, and June 2017, the net increase in MVPD costs is $348 million.

2. Retaining AT&T Subscribers vs. Gaining New AT&T Subscribers

At trial, defense counsel represented to Prof. Carlton that I testified that my "margin estimates were conservative, because … the loss of Turner to DirecTV's rivals might help DirecTV keep high-margin customers." [Tr. 2508] Prof. Carlton responded that he had "seen no quantification of this effect" from me, and had "not seen it in any of the underlying documents [he] reviewed." [Tr. 2509]

In footnote 414 of my February 2, 2018 report, I explain that "retaining current subscribers … is likely more valuable to MVPDs than gaining new subscribers, and the evidence shows that AT&T factors this into its decision making." I cited documentary evidence of how AT&T calculates Lost Customer Value (LCV) and Average Customer Value (ACV) and considers LCV in computing the value of subscribers lost during blackouts. The LCV and ACV estimates generate margins that tend to be significantly higher than the margins generated by LTV estimates that I used. This is because they are not based on newly added subscribers and, therefore, do not need to take into account subscriber acquisition costs (SAC). Over time, a large portion of the benefit to AT&T in the event of a blackout of Turner Content on a rival MVPD would be likely due to reduced churn at AT&T, reflecting subscribers who would have gone to that rival if not for the blackout and are instead retained by AT&T. For those subscribers, AT&T would incur retention costs that tend to be lower than the SAC incurred on new subscribers.

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[1] Letter to Eric D. Welsh from M. Randall Oppenheimer, Mar. 26, 2018.

[2] By "net annual MVPD cost increase" I mean the cost increases to MVPDs for Turner Content net of the lower costs faced by AT&T due to the elimination of double marginalization. See backup materials for more detail.

To quantify the potential size of this effect, I compute an estimate of the value of retained subscribers by adding LTV and SAC for gross adds to DTV.[3] I do this for (a) Q2 2016, (b) an average of January, April and June 2017, and (c) June 2017 alone. This leads to significantly higher estimates of subscriber value. I use margins implied by these higher values as inputs in my bargaining model to calculate the range of likely net MVPD cost increases due to the merger. Figure 1 below presents this range of net cost increases.

Figure 1. Subscriber Values and Range of Net Increases in MVPD costs, 2016 market configuration

Time period	Subscriber Value		Net Annual Increase in MVPD costs, $ millions (9% subscriber loss rate)		Net Annual Increase in MVPD costs, $ millions (14% subscriber loss rate)	
	Gross adds	Existing subscribers	Gross adds	Existing subscribers	Gross adds	Existing subscribers
Q2 2016	[redacted]					
Jan, Apr, and Jun 2017						
Jun 2017						

3. Crediting Variable Versus Fixed Costs as Merger Efficiencies [Tr. 3569]

To benefit consumers, synergies from a merger must be of the type and magnitude that will offset the merger's anti-competitive effects. As explained in my rebuttal report, "[i]n most circumstances, efficiencies that lower variable costs, i.e., those affecting costs that vary with the firm's output, put downward pressure on prices. In contrast, efficiencies that lower fixed costs typically do not put downward pressure on prices."[4]

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[3] This assumes that monthly gross margins on existing subscribers are the same as those earned on newly gained subscribers. However, AT&T's ACV estimates suggest that AT&T earns much higher gross margins on existing subscribers than on those newly added.

[4] Expert Rebuttal Report of Professor Carl Shapiro, Feb. 26, 2018, at page 50.