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# Widgets All the Way Down

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# Widgets All the Way Down

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The Comcast/Time Warner Cable deal is a useful jumping off point for consideration of a less common theory of potential anticompetitive harm. While most transactions are challenged because they are alleged to have unilateral or coordinated effects, whether this cable deal is challenged may turn on vertical issues.

I can't claim to be an expert on the markets for the sale and distribution of entertainment content, so I don't want to discuss the cable deal in too much specific detail. I just don't have the facts. But DOJ will make itself expert in these markets, if it has not already, and the DOJ staff has already given us some insight into what they think in the materials filed with the consent agreement that imposed conditions on the Comcast/NBC Universal joint venture. But first, let's talk a bit about vertical issues in general.

Most of the time, when we're talking about ways that a merger can lead to reduced competition, we're talking about horizontal issues. Gaining too large of a market share may give the merged firm the power to increase prices, or may lead to the upward pricing pressure that is the namesake of my blog.[2] Those are unilateral effects. As the name implies, they create market power for the individual merged firm.

In other cases, the reduction in the number of competitors that a merger entails will make it easier for the remaining competitors to coordinate (tacitly or otherwise) their competitive conduct. For example if a merger reduces the number of competitors from four to three and removes the one competitor that had historically been particularly aggressive on price, perhaps the transaction will make it easier for the remaining players to play nice. This type of scenario has been creatively named "coordinated effects."

As you can see, both unilateral and coordinated effects are horizontal concerns—they relate to competition across the same level of the chain of distribution. There's a whole set of guidelines from the FTC and DOJ that set out how they analyze these issues and nearly every merger challenge hinges on a horizontal theory.

But there can also be vertical concerns—concerns that the transaction will reduce competition across two or more levels of distribution. The basic idea underlying vertical concerns is foreclosure—that something about how the transaction will rearrange the market structure will allow the merged entity to stifle competition by foreclosing competitors' access to the market. For example, if a deal combines a vertically integrated manufacturer/distributor with

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[2] http://upwardpricingpressure.com/blog/.

a large rival at the distribution level, perhaps the combined firm would have the ability and incentive to remove access to its powerful distribution network to a competing manufacturer.

I often think of vertical concerns as a bit secondary. For there to be much concern about vertical issues, the merged firm likely also has to have horizontal market power on at least one level. So if the deal at all enhances that existing market power, that's the more straight-forward case to make. For example, our hypothetical vertically integrated manufacturer/distributor likely would need to have market power at the distribution level before there is too much concern. So maybe a way to sum up the most typical vertical concern is to think about an entity with market power on one level of distribution becoming vertically integrated via acquisition.

And that's where a case like the cable deal comes in.

Rather than delve into the specifics of that combination, let's do a stylized thought experiment first. Let's imagine a world before the internet (or even mail order) and convenient delivery service. Let's imagine in this world that there are two, large, dominant retailers that sell widgets, one on either side of the Mississippi. Let's imagine further that, in its infinite wisdom, Congress has enacted a statute that prevents retailers from operating locations on both sides of the river. So what we have is Retailer A, monopolizing the retail sale of widgets on the eastern part of the country and Retailer B, monopolizing on the western part.

Now let's say I'm a manufacturer of retro spinning neon widgets located in Minneapolis. Despite my location straddling the great river, I've never had a relationship with Retailer B. But that's okay, I sell all my production through Retailer A in the east, who has enough demand to take all of my capacity, so I'm golden. Retailer B, meanwhile, gets his widgets from my myriad competitors located throughout the country.

Now let's say that the two retailers have gotten smart lawyers involved who figure out that co-ownership by a single holding company does not violate the Congressional ban on retailers on both sides of the river, so the two companies agree to combine under common ownership, with Retailer B's management running the show. They announce the combination in perfect confidence that the antitrust agencies can't bother them, because not only do they not currently compete, there's a federal statute that prevents them from doing so even if they remain separate. No problem, right?

Well, not so fast. The new combined entity, in our hypothetical world, is the only outlet to the market for widget manufacturers. What's to stop them from cutting me off? And if they cut me (and others situated like me) off, will there be adequate competition in widget manufacturing going forward?

Sadly, even those facts may not be enough to ground a strong vertical case. After all, I, as a poor lowly widget maker, was always at the mercy of one or the other retail monopolist. But what if last year, before the current deal, Retailer B had made the decision to vertically integrate upstream and acquire its own widget maker? Well, now we have a vertically integrated firm with an incentive to use its market power at the retail level to advantage its widget manufacturing business. That could be something. It could be that the deal has the effect of raising my costs (or any other widget maker's costs) if I would have to also enter at the retail level to continue to compete, thus raising barriers to entry in the widget industry.

And, finally, what about the cable industry? Does it resemble my hypothetical widget industry? Well, Comcast and Time Warner have certainly made no secret that they do not currently compete with each other in cable distribution, because there are no zip codes in which both offer service. As I understand it, that's often the result of local ordinances that prevent such direct competition, making each a local monopolist (setting aside, for the moment, competition from other forms of distribution). And one of them recently vertically integrated via the Comcast/NBC Universal JV.

After reviewing that transaction, DOJ alleged that the joint venture would substantially lessen competition in the market for "the timely distribution of professional, full-length video programming to residential customers." Or, in other words, distributing shows and movies to home viewers. One way to distribute video content is through cable television distribution, but a growing alternative way is to stream it directly to viewers over the internet. Much of the streamed internet content is also carried into our homes by the cable companies, who are major providers of broadband. In its Competitive Impact Statement, DOJ said there was "an inherent conflict…between Comcast's provision of broadband services to its customers… and its desire to sell them [cable] services."

That conflict is explicitly about vertical concerns, i.e. the threat that online, streamed content poses to traditional cable distribution and the incentive that the newly vertically integrated Comcast would have to use its portfolio of content to stifle online competitors.

Does the new transaction heighten those concerns? And, if so, are those concerns so great as to justify blocking the current proposed transaction? Or is the existing remedy, which imposes restrictions on the JV's licensing practices, adequate?

Vertical cases are rare, and tend to be about the initial vertical integration (i.e., Retailer B buying the widget manufacturer) not about potential vertical effects from a subsequent horizontal merger. Nonetheless, Comcast further expanding its distribution footprint could create concerns about its vertical integration that weren't there when it was smaller.