IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,	)	
	)	
Plaintiff,	)	CV No. 17-2511
	)	
	)	Washington, D.C.
vs.	)	April 24, 2018
	)	10:44 a.m.
AT&T, INC., ET AL.,	)	
	)	Day 19
Defendants.	)	
	)	

TRANSCRIPT OF BENCH TRIAL PROCEEDINGS
BEFORE THE HONORABLE RICHARD J. LEON
UNITED STATES SENIOR DISTRICT JUDGE

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P R O C E E D I N G S

DEPUTY CLERK: All rise. The United States District Court for the District of Columbia is now in session, the Honorable Richard J. Leon presiding. God save the United States and this Honorable Court. Please be seated and come to order.

Your Honor, we have Civil Action No. 17-2511, United States of America v. AT&T, Inc., et al.

Counsel for the parties, please approach the lectern and identify yourself for the record.

MR. WELSH: Good morning, Your Honor. Eric Welsh for the United States.

THE COURT: Welcome back.

MR. WELSH: Thank you.

MR. CARSON: Good morning, Your Honor. Dylan Carson for the United States.

THE COURT: Welcome back.

MR. CONRATH: Good morning, Your Honor. Craig Conrath for the United States.

THE COURT: Welcome back.

MR. CONRATH: Thank you.

MR. SCHUETT: Good morning, Your Honor. Ruediger Schuett for the United States.

THE COURT: Welcome back.

MR. KEMPF: Good morning, Your Honor. Don Kempf for the United States.

THE COURT: Welcome back.

MR. PETROCELLI: Good morning, Your Honor. Daniel Petrocelli for defendants.

THE COURT: Welcome back.

MS. ROBSON: Good morning, Your Honor. Katrina Robson for defendants.

THE COURT: Welcome back.

MR. OPPENHEIMER: Good morning, Your Honor. Randy Oppenheimer for the defendants.

THE COURT: Welcome back.

MR. WALTERS: Good morning, Your Honor. Rob Walters here for AT&T and DirecTV.

THE COURT: Welcome back.

MR. BARBUR: Good morning, Your Honor. Peter Barbur for Time Warner.

THE COURT: Welcome back.

MR. ORSINI: Good morning, Your Honor. Kevin Orsini for Time Warner.

THE COURT: Welcome back.

MR. RAIFF: Good morning, Your Honor. Mike Raiff for AT&T and DirecTV.

THE COURT: Welcome back.

All right. Any preliminary matters? Or you're all set?

Call your witness.

MR. WELSH: Thank you, Your Honor.

Your Honor, the United States calls Professor Carl Shapiro as an expert in industrial organization and antitrust economics in its rebuttal case.

THE COURT: Okay.

DEPUTY CLERK: Please raise your right hand.

(Witness is placed under oath.)

DEPUTY CLERK: Please be seated.

THE COURT: You may proceed.

MR. PETROCELLI: Your Honor, may I approach?

THE COURT: Okay.

(Sealed bench conference)

THE COURT:

MR. WELSH:

MR. PETROCELLI:

MR. WELSH:

MR. PETROCELLI:

MR. WELSH:

THE COURT:

MR. WELSH:

(Open court)

THE COURT: Come on back up, Professor.

All right.

MR. WELSH: Try again, Your Honor?

THE COURT: Try again.

CARL SHAPIRO, Ph.D., WITNESS FOR THE GOVERNMENT, HAVING BEEN DULY SWORN, TESTIFIED AS FOLLOWS:

DIRECT EXAMINATION

BY MR. WELSH:

Q Good morning, Professor Shapiro. Welcome back.

A Thank you.

Q Now, Professor, have you been following the testimony in this trial?

A Yes, I have.

Q And, broadly speaking, did the testimony that you reviewed, has that caused you to change any of your opinions that you previously gave the Court?

A Well, I definitely learned things from what I read, but my general opinions have not changed.

Q Okay. So we've got a limited amount of time here this morning. I want to get right to the topic. So the first topic I want to discuss with you is about the bargaining model. Okay?

Professor, did you read testimony from Professor Carlton that you used quite a complicated economic model. Did you hear that comment by Professor Carlton?

A I read that.

Q Professor, what's your response to that comment?

A Well, it reminded me of the famous quote attributed to Albert Einstein, which is, "Everything should be made as simple as possible but no simpler."

I believe that the model I'm using is as simple as possible, while still capturing the fundamental economic forces that are in play here to analyze the likely effects of this merger.

If one were to discard the bargaining model as overly complicated, I think you'd then be in a situation where you would lack any theoretical model, any economic model to evaluate the effects of vertical mergers in a range of industries, including this one, where fees are based on negotiation.

Q Did you also read that Professor Carlton testified that your model was theoretically unsound?

A I noticed that.

Q And what's your response to that comment?

A I think that's clearly false.

The model is a standard "split the difference" bargaining or is a standard model that's in the textbooks;

we teach our students; that's been -- more complicated versions building on that are in the academic literature. So it's without question, in my view, theoretically sound.

I think that what Professor Carlton was saying after that sound bite was that he thought it was improper to apply it here because of the arbitration proposal. That's not about whether the model is theoretically sound. It's a question about how we treat arbitration and remedies. And obviously, we differ on that.

But the model is theoretically sound.

Q And I know you talked about using it in your teaching of students, that sort of thing. Has it also been accepted by the FCC?

A Well, yes. The FCC uses models in their analysis of the NBC, excuse me, the Comcast-NBCU transaction. And, well, the DOJ and the FCC routinely use bargaining models in merger analysis, and sometimes that ends up court as well.

Q Now, you've also read about Professor Katz and his testimony in court, and he's criticized you on a number of issues; is that right?

A He has.

Q Now, has Professor Katz, though, testified that the Nash bargaining models aren't in the mainstream?

A I saw that.

Q Do you agree with his comment there?

A On this point, I am very happy to agree with my Berkeley colleague.

Q All right. Let's change topics now. I want to talk about some of the inputs into the model itself.

There's been lot of testimony since you were last here about this subject.

Did you read some criticism by Professor Carlton that you used a lot of simplifying assumptions and the wrong value for the key variables in your model? Do you recall reading that?

A I do.

Q Now, what's your response to that critique by Professor Carlton?

A Well, I strenuously disagree with his assertion that I used the wrong value for one or more of the key inputs into my model.

I have, I think, a very sound basis for the inputs I used.

And that's really what I'm here today, Your Honor, to talk about, why I -- to defend the inputs I used in my model.

Q And we're going to talk about the inputs in a second, so this will be the subscriber loss rate as one and the margins as another; is that right?

A Yes. Those are the two that got the most attention, I would say, and we'll talk about in a moment.

Q Before we get there, though, do you have any general criticism of the way Professor Carlton went about selecting variables for the modeling that he was doing for his purposes?

A So I think the framing for what you're going to hear today, Your Honor, is that, not surprisingly, Professor Carlton was suggesting lower, lower, lower numbers on all these items than I had. And we're going to talk about that.

But methodologically, I want to flag, before we get into the details, in several of these areas, I provided a range, a low end and a high end. And I tended to testify and emphasize the low end but noted the high end, okay?

And what Professor Carlton has done is taken the low-end numbers and tried to peck away at them, attack them, and we'll talk about that.

But he's pretty much ignored the higher end, or the fact there's this range. And that reflects a certain bias in his approach in favor of his client.

Q Let's move now to talk about specific inputs, and we'll start with the subscriber loss rate.

Did you read that Professor Carlton asserted that your estimate of the effects of the Suddenlink-Viacom blackout, which you talked about before with His Honor, that

that failed to account for significant effect and that the whole industry had started to trend down faster?

Do you recall reading that?

A I do.

Q And I think when Professor Carlton was in here, he proclaimed that that was a "holy mackerel" moment. And he focused, then, the Court on a red line or a magenta line, as he was calling it, from the demonstrative on industry trends.

Do you remember that?

A I do.

Q Now, do you have a response to Professor Carlton's thinking on this point and his criticism of you?

A Yes.

His assertion that there was a change in industry trends that happened to take place at the same time as the Suddenlink-Viacom blackout is false. We can look at the data -- and I have -- and there is no such change in trend.

MR. WELSH: Your Honor, I have a demonstrative which we have used before previously with Professor Shapiro. It's been marked as PXD011-06. It was used the last time Professor Shapiro was here in court.

May I approach?

THE COURT: What's it? 0-what?

MR. WELSH: I'm sorry, it's PXD011-06.

THE COURT: Okay.

MR. WELSH: May I approach the witness, Your Honor?

THE COURT: You may.

MR. WELSH: Your Honor, I provided a copy of PXD011-06 to opposing counsel.

May I proceed?

THE COURT: You may.

MR. WELSH: Okay.

BY MR. WELSH:

Q Professor Shapiro, you have PXD011-06 in front of you. Can you explain to His Honor your thinking about this demonstrative and how this plays into Professor -- your response to Professor Carlton's criticism of you about the industry trends.

A Yes.

So Professor Carlton's attack on my analysis here was based on his assertion that the industry decline in subscribers became more pronounced just about at the same time as this blackout, which was October of 2014.

He said that -- he asked the Court to look at the red line here, which is all MVPDs in the country, measuring their subscribers. And he asserted that the line became steeper after October 2014, reflecting a change in industry trends, a drop-off.

And the line does not become steeper. That is a false statement. And so his attack is invalid.

Q Looking at Professor Carlton's testimony, then, did that make you change your subscriber loss rate for the Suddenlink-Viacom blackout?

A No. My 9.4 percent estimate here stands, because the attack was in error.

Q And I take it, looking at the demonstrative here at that red line, you see no difference in the --

A There is no difference. I looked at that, studied that previously, and the data analysis indicates no change in trend.

Q Now, do you continue to believe, Professor, that your analysis is based on reliable evidence here?

A Absolutely.

Professor Carlton and I agreed that this episode, the long-term blackout of Viacom on Suddenlink, was, I think he would agree, the best single episode of a real-world blackout that we could look to. And my 9.4 percent figure stands unscathed, in my view, because the attack was based on an error.

Q Let's change topics now. Let's talk about a different input, the diversion rates.

Did you read testimony from Professor Carlton that you underestimated the number of MVPD subscribers that would drop their MVPD service entirely in response to a Turner blackout?

A I read that.

Q What's your response to Professor Carlton's criticism there?

A He is -- I believe he's made an error here as well in his criticism.

He is looking in the wrong place, and so he's measuring the wrong thing for the purposes at hand.

Q So what did he look at? And what should he have done? What should he have looked at? Explain that to His Honor.

A So let me -- I have to go back just to make sure what I did and then his attack so we're clear here, Your Honor.

The question that we're asking is, if there's a blackout of Turner on Charter -- that's my ongoing, standing example -- of the people that leave Charter, how many will just give up on pay-TV service? If there are more of those, then fewer of those subscribers will end up at AT&T and the effects I'm calculating will be smaller.

So Professor Carlton claims lot of people would drop their MVPD service altogether.

So to estimate that, I relied on the Altman Vilandrie study, which studied exactly that question, a blackout of Turner on an MVPD, on Charter; how many people would pull the plug? And I used that number.

But Professor Carlton does not use that number. He looks at a different place. He points out that some 20 percent of American households don't have pay-TV service. But that's not the right place to look.

Think about it. We're asking if there's a blackout of Turner on Charter and you're -- suppose you're a Charter subscriber and you're like, hey, I love my Turner content, sports, news. I'm really unhappy here. I'm going to leave Charter. Then you're pretty likely to want to go somewhere else where you can get the Turner content.

And the fact that there are a lot of other households, maybe they're younger, who don't have pay-TV services is kind of beside the point. We're talking about the households who leave Charter because they value the Turner content so highly.

So he's just looking at the wrong number.

I've got a direct estimate of exactly what we want to measure, and he's looking at something else. I think that's a mistake.

Q Did Professor Carlton then use an estimate of diversion that was too high?

A The result of this dispute between the two of us is his measure of this flow out of pulling the plug is two to three times higher than it should be. So -- and, again, because he's measuring -- overestimating the people leaving the pay-TV system, he's underestimating the flows to DirecTV. This was a significant difference. He's got that number two to three times too high, in my view.

Q Let's change topics again. Let's talk about another input, and this is the margins.

Did you read testimony from Professor Carlton that he was doing exactly the same thing as you and using the June 2017 margin data; he was just updating the information?

A I did.

Q Do you agree with Professor Carlton on this point?

A No, I do not. And there are two reasons why I disagree. First, he picked one month from the later year, instead of all three, using all three months. So that's a difference.

The bigger difference is he has brushed aside and not engaged on the larger point that I make about the value of existing subscribers to AT&T being substantially higher than the value of new subscribers, which -- that's a second point.

Q Did he also -- I know you testified earlier this morning about Professor Carlton failing to acknowledge that you're looking at the lowest of the number of ranges. Was he guilty of that here as well?

A Yes, that's true.

Q Now, Professor, do you think it is a valid approach to take the lower bound of a range as both the starting point and the ending point for discussion, as Professor Carlton does?

A No. I think this is -- this is the methodological point I mentioned earlier.

I provide a range, and then he attacks the lower end and pulls it down, okay? And we'll talk about that. I think there's some validity to using the 2017 margin instead of 2016 margins.

But then the range moves, and he's not talking about the range. He's talking just about the low end. And I think that's stilted. I think that's not -- not the way it should be done.

Q Let's talk about the first point that you mentioned. Did you read Professor Carlton's testimony that it wouldn't make any difference significantly to his analysis if you took the average of three months for the lifetime values in 2017, rather than choosing the single lowest month for 2017 as he did?

Did you see his testimony on that?

A I did.

Q Do you agree with his position on that point?

A No, I don't think it's correct.

I think Your Honor's heard a lot about those different -- these data at this point, using the June 2017 figure as he did for the lifetime value.

Instead of taking the average of the three months where we now have data, April -- excuse me, January, April, and June, the average is 28 percent higher than the low month of June, and I consider that significant.

Q And if you were to use the 28 percent higher average for these three months on the 2017 LTVs, these lifetime values, rather than the lowest number that Professor Carlton picked, does it affect the results of your bargaining model in a similar manner?

A Actually, in a more pronounced manner.

When you feed this through the model and account for the elimination of the double marginalization, the net increase in MVPD costs, if you use the average of the three months, is about three times the number that he calculated using the June figure alone.

Q Now, why would you choose -- just explain to His Honor, why would you choose multiple months versus looking at a single month as an economist looking at these issues?

A I think it's simply a matter of reliability.

We know the month-to-month figures move around. Mr. Christopher talked about that. And we can see in the numbers they move around.

So any one number, you know, it could be high; it could be low. It's more reliable to use the average. I think that's pretty intuitive.

The only argument, I think, that's worthy of addressing of using only one month was he did use the last month. He used June. So you could say, well, it's more recent. He did.

But I think that's a very weak argument for a number of reasons.

For one thing, we know from Mr. Christopher's testimony that the number went up after that. And Mr. Christopher, we have from his testimony the July figure, which he said was pretty nearly final, didn't think it would change much at all, was about 10 percent higher than the June figure right there, and we had some figures for subsequent months that weren't quite as -- weren't finalized yet. So there's that fact.

And then there's also just the fact that if we're doing merger analysis and we're talking about evaluating a merger that will have substantial effects for years to come, I think it would be a mistake just to take one month that happens to be the low one and do an analysis based on that alone.

Q Let's talk about a different topic with respect to margins, and this would be the point you raised earlier about the value to AT&T to its existing subscribers, versus the new subscribers.

Now, Professor Carlton criticized your statement that your profit margins were conservative because retaining current subscribers is more valuable to AT&T than gaining new subscribers.

And he went on to say that you provided no quantification of this effect.

Do you recall his testimony on this subject?

A I do.

Q What's your response to Professor Carlton on this point?

A Well, I did provide quantification in my initial report. I pointed this issue out. And the numbers there show that the value of existing subscribers was between 150 and 225 percent as large as new subscribers. So roughly twice as big, let's say, but there's a range.

So I did quantify this, and it's substantial.

MR. PETROCELLI: Your Honor, may I approach?

THE COURT: You may.

(Sealed bench conference)

MR. PETROCELLI:

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MR. PETROCELLI:

THE COURT:

(Open court)

THE COURT: You may proceed.

MR. WELSH: May I approach the witness, Your Honor?

THE COURT: Consistent with our discussion at the bench here.

MR. WELSH: Yes, Your Honor.

BY MR. WELSH:

Q Professor, we were just discussing the quantification question about the existing subscribers versus the new adds. And you testified loosely, I think, that it was about twice as much.

I want to ask you, sir, if you -- you have in front of you your initial report. I think you said that this was in your initial report.

Can you point out to His Honor where this, where you're finding this, where the basis is for your statement.

A Yes, I can.

This is in my initial report on page 144 in the footnote, which is long footnote. It spills over from page 143.

Well, should I read this? I guess I will.

MR. PETROCELLI: No, Your Honor.

THE WITNESS: What do you want me to do?

BY MR. WELSH:

Q Don't read it into the record. But if you could just explain to His Honor, is the basis for what you just testified to, is that in this footnote? And maybe you could just generally explain to His Honor how we get there.

A Okay.

So there's three measures of value that I mentioned in the footnote: the lifetime value, which is the new ads we've been talking about; the active customer value, ACV; and the lost customer value.

The latter two relate more to the value to AT&T of retaining subscribers, and those are the significantly larger numbers that I was referring to in my previous answer.

THE COURT: And those numbers come from the Altman Vilandrie report?

THE WITNESS: No, sir.

These are numbers from AT&T documents. There's two or three AT&T documents cited here where they were concerned about losing subscribers and were trying to figure out how bad that would be for them. And so the value of those subscribers to them, which is exactly the concern -- what I'm trying to measure.

THE COURT: Okay.

MR. WELSH: Is that satisfactory, Your Honor?

Thank you.

BY MR. WELSH:

Q You can put that to the side, Professor. Thank you very much.

Now, Professor, can you explain to His Honor why this subject about the existing subscriber values, why this matters to your analysis.

A Well, first, over the longer term, if there's a blackout of Turner on Charter -- I'll stick with that -- an important benefit to AT&T-DirecTV is that they will retain subscribers; they'll have reduced churn.

And if that value is high, then all the effects I'm talking about, bargaining model, are higher. And so this higher number we're now talking about is what gives me a higher end of my range.

And I had done an analysis with the lower numbers for the gross adds. Those are lower because we have to take out all the costs of getting the subscribers, the subscriber acquisition costs.

So the higher numbers mean there's more value to AT&T of that blackout on Charter, and it gives them more leverage in the bargaining. And it's a significant factor.

So that's the answer.

Q Okay. Thank you.

One last topic on margins.

Professor, did you read Professor Carlton's testimony that there was nothing in the underlying documents that he reviewed to support the idea that customers gained by DirecTV because of a Turner blackout would be especially valuable?

Do you recall that testimony?

A I do.

Q Sir, do you have a response to that?

A I do.

I think there is some very pertinent evidence in the record that I did mention. There was a temporary blackout of Fox, under the Fox programming on Dish. And, as a result of that, AT&T gained some subscribers. And they observe that these subscribers were especially valuable, the super-low risk.

And as -- the way I think about it at least was, these are subscribers who generally don't move around, but they left because of the backout. So they're kind of sticky.

So if they unstick from Dish and they move over to DirecTV, they're going to probably stick around for a while. And so they're valuable.

And this is directly relevant evidence, in terms of the type of subscribers that DirecTV would pick up if there were a blackout of Turner content on any other MVPD. So I think we do have evidence on that, and I cited it.

Q And how does that affect your analysis?

A Again, the higher the value of these subscribers are to AT&T, the more bargaining leverage they get, and they -- larger the effects that I'm measuring, that I'm quantifying, and the greater consumer harm in the end.

Q Now, Professor Carlton also criticized you by presenting a chart to His Honor when he was here that had lot of red numbers on it.

Do you remember that chart?

A I do.

Q And what was your response -- what's your response to what Professor Carlton did there?

A I think it's easy to produce a chart with a lot of red numbers. I can produce a chart with a lot of black numbers.

And the reason they're getting the red numbers is because there's a credit that I've acknowledged for the efficiencies, elimination of double marginalization. So if you peck away sufficiently at the harms, you'll end up with these red numbers. So that's what's going on.

But in the end, it's not how many numbers you can produce or what colors they are. It's, what are the reliable numbers? What are the best estimates?

And I am -- that's why I'm here today, to tell Your Honor, well, I think my inputs are well supported. And so the red numbers come from making changes that I don't think are justified based on the underlying evidence.

Q Let's change topics now. Let's talk about the estimates of consumer harm here.

Now, Professor Carlton testified about how you calculated the amount of increased MVPD costs that would be passed through to consumers. Do you remember his testimony

on that subject generally?
A I do.
Q And Professor Carlton called the model that you used as being a basic model, I think, was his words.
Do you recall that?
A I do.
Q What's your response to Professor Carlton's statement about this point?
A Well, just to be clear, Your Honor, now we're talking about -- this is not the bargaining model. This is the model of how the MVPDs compete and set their prices, which we're using to see about how cost changes are passed through to consumer prices.
And so I think he and I are agreeing that the model I used is kind of a basic off-the-shelf model of competition, price competition.
So we agree on that.
Q Now, he also suggested that the model can sometimes have, I think he called it, peculiar implications.
Do you remember his testimony there?
A I do.
Q Do your findings -- Professor, do your findings regarding consumer harm here depend upon peculiar implications of the model you applied to MVPDs?
A Not in my view.

Part of what Professor Carlton was referring to there, I believe, were the pass-through rates, how much of the costs of MVPDs, cost change due to the Turner content, how much of those costs will get passed through and show up in the form of higher prices paid my consumers for their pay-TV service.

So the pass-through rates are very important. And I believe he -- one of the things he's referring to was the fact that in this modeling exercise, the harm to consumers, millions of dollars per year, was greater than the net increase in MVPD costs.

And you -- Your Honor, actually noticed this as well at the end of my testimony. And so I don't -- I wouldn't call that peculiar, but I think it does warrant some explanation.

Q Okay.

A And he did seem to be mentioning that point as well.

Q Now, after reading Professor Carlton's testimony, do you believe that the pass-through rates that you derived using your standard merger simulation model are reliable?

A I do.

This is a feature of the standard model in this setting.

And here's what is going on, Your Honor.

The AT&T -- let's say DirecTV is experiencing lower costs. That's the efficiency I've accredited it. And they passed those lower costs on to some degree in the form of lower prices for their customers. That's part of what I'm expecting, predicting, actually.

But all their competitors are experiencing higher costs for the Turner content.

So this is an asymmetric situation. One firm, DirecTV, has lower costs. Everybody else has higher costs.

So AT&T, there's kind of two things that are warring in terms of what happens. They're tempted to lower their price because their costs went down, but they're also tempted to raise their price because all their competitors did. All the competitors are raising the price.

When you work that through, the model shows that AT&T only lowers their price 22 percent as much as their costs went down. So a lowish pass-through rate for them.

While as everybody else, since all of them are experiencing these cost increases for Turner, their pass-through rate as a group is 62 percent.

So the pass-through rate for AT&T is 20s. The pass-through rate for the others as a group is 60s. Both of those, on its face, would seem reasonable. I mean, they're between 0 and 100 percent, so there's a partial pass-through of costs.

And when you then put that in -- when you do the arithmetic with that, you end up with the result that was more surprising, which is the overall consumer harm is greater than the net MVPD costs.

So that's what's going on. It's different pass-through rates for AT&T versus their rivals and then added up.

Q So I understand that. Why are the pass-through rates then different for AT&T versus the other MVPDs? Can you explain that?

A So because from AT&T's point of view they -- I'll say DirecTV. They, like I said, they wanted -- they have an incentive to lower their price because their costs went down. And they do lower their price some.

But since all of their competitors, in any given region, are experiencing a price increase, that pulls up their -- that's the countervailing incentive.

And while as the other competitors, they're going to be raising their prices more, because it's only the one competitor at DirecTV to them who has the lower price.

So it's not symmetric, like I said, and that's what gives us this result.

The surprising bottom line, if you will, it does follow from arithmetic once you use the 22 percent and the 62 percent pass-through rates.

Q Thank you.
Now, is there an alternative here, Professor, to using a merger simulation model to assess the downstream consumer price effects?
A Yes. The alternative is simply to take the net MVPD cost changes -- that was the $235 million a year at the low end that I mentioned -- and just use that and use that and apply a pass-through rate to that number. I suggested 75 percent to 100 percent.
It would gave somewhat lower numbers than I'm giving for consumer harm, but you could get there without using this downstream model of competition at all, okay?
The point of the model downstream is to have what I think of as a more accurate or better way of calculating this pass-through. But if you don't use it, you can get somewhat lower numbers.
Q Let's change subjects. I want to talk to you about efficiencies.
I have one question for you on efficiencies.
Professor, how does the distinction between fixed and variable costs help guide the merger analysis?
A Well, so I better define the terms first.
So variable costs are costs that the company incurs that vary with, depending on how much out output it produces. It's often used if you think of a manufacturing

setting. If you're making automobiles, you make more cars, you're going to need more labor; you're going to need more raw materials. Those are variable costs.

But headquarters costs are not going to vary if you make more cars this month or this quarter. So those would be fixed. Okay?

So those are the two categories.

And it's basic microeconomics. I guess that when a firm's variable costs go down, they will tend to lower their price. We've been talking about that actually.

But if the fixed costs go down, it doesn't have the same effect, okay? And that's just -- that's the way the economics work. I can explain more if you want.

And so for that reason, in merger analysis, if we're looking at how efficiencies affect prices, we focus very much on variable costs.

And if we think a merger might cause prices to go up and we're asking if there's some offsetting efficiency, we would look to the variable cost efficiencies because those are the ones with that would put the downward pressure on price but not the fixed costs.

Q Let's move to the final topic here. I want to talk about prior vertical mergers.

Professor Carlton testified that the evidence that he's seen from prior vertical deals is the best evidence to assess your claim that prices will go up after the merger.

Do you recall his testimony on that subject?

A I do.

Q Now, first off, Professor, can you explain to His Honor how you think about evidence from prior transactions when you're looking at merger analysis? Can you explain that?

A Yes, I would like to.

So, first, Your Honor, I would want to make very clear, I agree with Professor Carlton, that looking at prior transactions is a good thing to do for trying to evaluate a transaction in front of us that hasn't happened yet. So that's agreement.

But I want to flag for you and emphasize three cautions in doing that that apply in general. I'm not even talking about this case yet. I'm just talking general.

First, are the prior transactions, are they very similar to the current one? If they're not very similar, they're not going to be as informative, in terms of either the transactions themselves or the market conditions when they took place. So how close is the analogy, the analog? I think it's common sense.

The second point is, how good is our data to evaluate the prior transactions?

The fact is that economists in my field, we love the idea of looking at merger retrospectives, is the term we use, because what happened, that's -- that's the evidence. And there's a lot of literature on that.

But very often, we just have trouble telling what happened. You know, we have a hospital merger, and the prices went up. But is that because of the merger, or is it because of something else that went on? Overall market conditions? Other costs went up as a result?

Or maybe we don't have very good data on what happened because it's confidential prices. So you just want to ask, how good is our data?

A lot of the time we can't tell what the effect of a merger is because we don't have good enough data. And when we can, we're happy. That's good.

But just be careful. How good is the data? That's my second point.

And the third is if there's an antitrust remedy, then it's not going to give to clean test of a merger, at least unless the merger currently under study is also remediated in a comparable way.

Q So we have the general observations there. Let's talk about, more specifically, as to Professor Carlton's criticisms of, as it might apply here.

Professor Carlton criticized your modeling by saying that there's nothing like 20 percent price increases for Turner content based on the industry data that he's looked at.

Do you remember his criticism on that?

A I do.

Q Can you -- what's your response?

A So we have the first point about, are these other transactions analogous? But then we have a -- the main point I want to emphasize here is the problems with the data.

So a lot of Professor Carlton's analysis uses this SNL Kagan data. And it's pretty poor for these purposes.

And there are two fundamental problems with the data. One is that SNL Kagan is relying on public sources. They don't have the particular contracts and the rates the way we have them from discovery.

And so -- and they report a rate charged for a network or a group of content to all of the distributors on average, okay?

So when we're looking at mergers, I mean, such as this one, I'm predicting -- and vertical integration, some rates will go up; some rates will go down. They're just looking at an average. So it's much harder to detect the effects because they just have an average.

And that includes what is the price within the vertically integrated company for content, which is not a real market price.

So that's just a fundamental problem with those data, because they're relying on public sources and doing an average. So there's kind of a schmearing going on that makes it harder to find stuff we're looking for. It's like you have the binoculars, but they're out of focus.

The other thing is the presence of long-term contracts, is we know there are these multi-year contracts between programmers and distributors. So when we have a transaction in the industry, a vertical merger or disintegration, the effects of that will only be felt over time.

And SNL Kagan doesn't have the data on the length of these different contracts because that tends to be confidential. So there's a schmearing over time, as well as across average in the industry.

So that's a lot of -- that's serious limitations on these data. It's not Professor Carlton's fault. That's just the data.

And so we're trying to take the binoculars, look closely at what happened, and they're either really poor binoculars or they're out of focus. So we don't see what we're looking for. It's just not a very strong test. So you just -- just be careful about that.

Q So let's put the SNL Kagan data to the side.

Professor Carlton also testified about using DirecTV data to claim that there's just no evidence that vertical integration has a significant effect on raising prices.

Do you remember his testimony on that?

A Yes. This is DirecTV data you're asking about.

Q Yes.

A Okay. I'm with you.

Q Okay. What's your response to this point?

A Well, this is better data, okay, because now we're talking about DirecTV's own data.

But the problem here is that we know that in evaluating the Comcast-NBCU merger and from the DirecTV data is that for five years, the first five years after the merger, they were paying rates under a long-term agreement that had been negotiated before that merger.

So then we have a renegotiation in 2016. And we can talk about that, and he has a chart about that. But you just need to understand that's one event, one renegotiation. And so we can look at what happened, but you have to be careful not over-interpreting the one -- what that one data point is, effectively.

MR. WELSH: Your Honor, I have a demonstrative that Professor Carlton used, which was DXD0113.

May I approach?

THE COURT: You may.

MR. WELSH: May I approach the witness, Your Honor?

THE COURT: You may.

MR. WELSH: Your Honor, I've handed a copy of DXD0113 to opposing counsel.

May I proceed?

THE COURT: You may.

BY MR. WELSH:

Q Professor Shapiro, you have DXD0113 in front of you. This is the demonstrative that Professor Carlton used in court. Can you explain to His Honor what you draw from this in terms of your response to Professor Carlton?

A Yes, certainly.

So the blue line, the blue kink line is the NBCU rates that he's indexed; and he's comparing that to the black line, which is the other networks.

So through 2016, whatever the blue line tracks, that based on the contract from before the merger. So that doesn't tell us anything about the effects of the merger.

After that, we can learn something. And we see there's a significant increase in rates right away under that contract, and then there's some further escalation in the contract.

I just don't think we can get much from this in terms of effects of the merger.

We do see a significant increase right away in the first year, very substantial, actually.

And we also -- just let's remember, this also was done in the shadow of the FCC order that applied to Comcast and NBCU.

Q Thank you.

Now, Professor Carlton testified that the very fact that you're seeing vertical disintegration in this industry is antithetical to the government's position.

Do you remember his testimony there?

A I noticed that.

Q What's your response to that comment by Professor Carlton?

A I disagree. I think it's an error.

So here's why. If we look at the Time Warner disintegration with Time Warner Cable, which I believe is what he's referring to, that in no way disproves or rejects the theory I'm putting forward, Your Honor.

Mr. Bewkes was asked why they spun off Time Warner Cable. And he gave an answer that made lot of sense to me. He said it was primarily for financial purposes.

There were different sets of investors who were interested in the cable company, which had a more steady stream of earnings than those interested in the other part, the Time Warner, what's now Time Warner.

And so there were some financial gains. I think he said you could issue debt more easily against the cable side. This is more reliable. Perfectly sensible to me.

And there was also the possibility that Time Warner Cable might want to merge with another cable company later for scale, which did happen.

So those are perfectly good reasons. And those -- so Professor Carlton seems to have brushed those aside or, I don't know, he did not account for those reasons.

And once you do, there's no inconsistency, in my view, between Time Warner choosing to do that ten years ago and the bargaining approach and effect of vertical integration that I'm describing here. I think they're perfectly consistent.

Q So, Professor, let's go ahead and wrap up here.

Despite the criticisms that Professor Carlton has made, do you continue to stand behind your opinions and your belief and your models and the reliability of your inputs?

A Yes. I came to court today -- and thank you, Your Honor, for letting me come again, appearing here -- to explain why I think a number of these attacks are either in error or there's methodological problems.

And so I stand by my opinions, the ranges I've offered, and I hope I've explained why.

MR. WELSH: Thank you, Your Honor.

I pass the witness.

THE COURT: All right.

I'll see counsel. You can step down.

(Sealed bench conference)

THE COURT:

MR. PETROCELLI:

THE COURT:

MR. PETROCELLI:

THE WITNESS:

MR. WELSH:

MR. PETROCELLI:

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MR. WELSH:

MR. PETROCELLI:

THE COURT:

(Open court)

THE COURT: Professor, we're going to take the morning recess. You are a witness under oath in the case. You know the rules. Refrain from discussing your testimony so far or what it might be when you return with anyone. Stay independent of all others, okay?

THE WITNESS: Yes, sir.

THE COURT: See you back in 15 minutes.

THE WITNESS: Okay.

THE COURT: All right. We'll stand in recess.

DEPUTY CLERK: All rise.

This Honorable Court will now take a brief recess.

(Recess from 11:44 a.m. to 12:00 a.m.)

DEPUTY CLERK: The United States District Court for the District of Columbia is again in session, the Honorable Richard J. Leon presiding. God save the United

States and this Honorable Court. Please be seated and come to order.

MR. PETROCELLI: May I proceed, Your Honor?

THE COURT: When you're ready.

CROSS-EXAMINATION

BY MR. PETROCELLI:

Q Good morning, Professor. We meet again.

A Hello.

Q You closed your direct examination by saying you stand by all your opinions.

Do you remember that?

A Yes.

Q And one of the opinions you stand by is your use of a profit margin based on the second quarter of 2016, almost two years ago, correct?

A I stand by those calculations; but I also said it would be reasonable to use the 2017 margins if one did it in the context of the rest of my analysis.

Q Now, let's talk about your failure to use any margins more current than the second quarter of 2016.

Now, first of all, the number you came up with for LTV, for the long-term value, or lifetime value, was 1324, 1,324, is that right, for your second quarter of 2016, right?

A I did not come up with that number. That was the number from AT&T's documents.

Q That's the number you used in your calculations, right?

A That is correct.

Q And we went through this, so I'm not going to go through it again in detail. But you knew, as of February 14, when Mr. Christopher testified, that the number for June of 2017 had dropped from your number of 1324 or AT&T's number of 1324 down to $821.

That was in the very deposition of Mr. Christopher that you cited in your report but apparently never read.

Do you remember all that from your trial testimony?

A I do remember talking about that with you. I do. Yes, sir.

Q And then you also remember that when you issued your rebuttal report, there was additional backup data that was provided for the $821 LTV, together with some prior months, January 2017 and April 2017.

Do you recall that?

A That that was provided in the backup materials to Professor Carlton's rebuttal report.

Q On February 26th, right?

A Give or take. Okay.

Q Well, that was the day.

A Okay.
Q So we don't have to give or take. We actually can be certain.
A Very good.
Q Okay. As of February 26th, 2018, you had data for not only June 2017 for the 812 LTV, but you also had data for January and April. Right?
A That is correct.
Q Now, when you gave your deposition on March 8, you did not update your second-quarter 2016 profit margin to reflect this new data, correct?
A That is correct.
Q And when you testified at trial a couple of weeks ago now I guess, you didn't update your calculations to reflect that more recent profit margin data, correct?
A I think I presented the original calculations, but I discussed this newer data that had come later.
Q Now, so you didn't update it, right? I just want to be clear.
MR. WELSH: Your Honor, may we approach?
THE COURT: Okay.
(Sealed bench conference)
THE COURT:
MR. WELSH:

MR. PETROCELLI:

THE COURT:

MR. PETROCELLI:

(Open court)

THE COURT: You may proceed.

BY MR. PETROCELLI:

Q So going back to my question, Professor, I'm just establishing, which I think is clear already from the record, that you did not update the 1324 number by using the January, April, and June 2017 numbers, correct?

A When I testified previously, that is correct.

Q Now, you could have done that, but you chose not to do that, right?

A I don't know what's allowed -- it's very unclear to me in this case what I'm allowed to do and not since every time I try to add two numbers together, apparently I'm not allowed to present it to the Court.

Q Well, you didn't seek to file a supplemental report. Your lawyers didn't ask to follow file a supplemental report before you testified the first time, simply seeking to insert the new profit margin figures from 2017, in lieu of the old profit margin figures.

That never happened, right?

A I believe what happened was --

Q Can you answer that question?

A -- that the DOJ sought additional discovery.

I'm not going to use those numbers until I understand better where they're coming from. So I just --

Q So the answer to my question is --

A Let me finish my answer.

Why there are --

Q The answer to my question is that you didn't do it?

THE COURT: Whoa, whoa, whoa. One at a time, please.

Let him finish his answer; then you ask him --

THE WITNESS: There are three months. They're not even consecutive months. Okay? This data was provided very late. I didn't have it before.

It is -- it is not my practice, sir, to take such data without checking it out and use it.

My practice would be to look into it more and figure out how reliable it is.

Q And you had every opportunity to do so; but, instead, you stuck to your guns to use a high number that you knew was not reflective of today's profit margin, correct?

A I already explained what I did.

Q Is that correct? You're sticking to your number because it's higher and it produces a higher price increase. That's the reason you're sticking to it?

A No. That's completely false.

The reason I'm sticking to it at that time was because I did not know enough about the new numbers.

Look, this whole problem is created because, as far as I can see, because AT&T, for months, did not provide the data that I would normally expect to get.

Fine. That's where we are.

Q You had --

A Then when I'm given more data later and now we've had the trial, I understand that more; that's why I said this time around, I could see using the 2017 data. I did not have confidence to do that before.

Q Well, let's use the 2017 data.

You said it produces a number three times higher than Professor Carlton's number.

Do you recall that?

A For the net increase in annual MVPD cost.

Q And so -- and you know that the number that Professor Carlton used was the most current final number that AT&T has, which was for June 2017, correct?

A I understand his number is based on June 2017, that single month.

Q And you know that's the most current finalized number that the company has, right?

A I agree with that, but I've certainly explained why I think it's a mistake to use that number, but I do know that's what he did.

Q But even if you averaged January, April, and June of 2017, I think you indicated you would come up with a number higher than Professor Carlton's but still significantly lower than yours, right?

A That is true.

That is true. And that would now be the anchor of the very low end of my ranges for this Court.

Q So that number -- the prior number that Professor Carlton utilized, the, I guess the net number was approximately 30 million. So when you said it was three times higher, that would put the number at 90 million, right?

A It's 98 million.

Q 98 million. Okay. That would be the net harm to consumers on a, what, annual basis?

A Yes, that's the -- no, it's not consumers, sir.

That's the net increase in MVPD costs on an annual basis.

Again, that's a very low end. And in my supplemental report, I showed much higher numbers. But that would be the new low end, except in the 2017 figures.

Q So 98 million would be the new low end, in lieu of your prior 235 million, correct?

A That is correct.

Q And now, if you run $235 million through the merger simulation model, I think you came out with a 27-cent per-subscriber/per-month overall price increase, taking into account the DirecTV elimination of double marginalization, and consequent, lower prices, right?

A I have $269-million-a-year figure in my head. But we could translate it, and we have done that, into per subscribe/per month.

Q About 27 cents was the number you had in your first report, right?

A Okay.

Q Okay.

A I want to check, but I'll accept your representation.

Q Okay.

But if you used the new low number of 98, you're down to about 13 cents rather than 27 cents, correct?

A Again, that sounds roughly right. Again, I just feel it's important for the record to be clear, that is absolutely the new low end. And you are doing the same thing Professor Carlton does, which is forget about the fact that there's a range and that's the low end. But you're allowed to do that.

Q And you recommended the low range in your opinion. You gave a range. You had a departure rate, for example, of 9 percent. You had a departure rate of 14 percent. And you chose 9 percent as the departure rate. That was the low end, as you said in your report, correct?

A Apparently, I'm suffering the consequences of being conservative.

Q Well, you had good reason to pick the low end. You were trying to be conservative, in your opinion, correct? That's what you just said.

You didn't do it out of the goodness of your heart?

A That is true.

Q Okay.

A So the way I think about these things is that I have a range. And since the low end of the range led to significant consumer harm, that is what I reported, while noting there was a higher end. That is what I did. And that is my normal practice, and I will stick with it.

Q I want to talk about the margins over the last couple of years from the time that you used your 2016 figure to calculate harm in your model.

You are aware of Mr. Christopher's trial testimony, I believe after you testified, that margins are going down, right?

A Yes, I am.

Q And you are aware, sir, of the testimony of pretty much every other competitor witness in this case who has testified that their video margins are going down, right?

A Yes.

And let's make sure we're precise about that, the video margins, because the multiproduct margins are going up.

Q Well, we can address that, too, although you didn't talk about it on your direct exam.

A Fair enough.

Q Mr. Holanda, for example, of RCN testified that his video product margins have decreased by half over the past number of years.

You recall that testimony?

A I did not read his testimony, actually.

Q And Mr. Schlichting said that his profit margins are declining. I know you read his testimony.

A You are correct.

Q And Mr. Hinson of Cox said his margins are going down.

Do you recall that?

A I think it is not disputed that the video margins are going down.

Q And so same would be true, then, of Mr. Montemagno of Charter and Mr. Sejen of Cable ONE?

A I don't specifically recall their testimony; but as I said, I don't think this is a point in dispute.

Q So now, when you testified on direct -- and it seemed to me that what you were trying to do is justify this old, obsolete, inflated 1324 profit margin -- you said, "The larger point now," and then you started talking about this theory that we should be looking at customers who DirecTV is retaining because, in your example, Charter, for example, doesn't have Turner.

Do you recall that?

A I do.

Q And you called it the larger point.

Do you remember saying that?

A Okay. Yes.

Q Now -- and just so we can all understand what this larger point is, what you're talking about is that in the event of a blackout or potential blackout that these negotiators are hypothesizing as the alternative to the deal that you're model assumes they're going to make, DirecTV is realizing that it has some customers who might otherwise leave to go to Charter or elsewhere, but won't go because Charter doesn't have Turner; so, therefore, they're retained.

That's the general idea, right?

A Correct.

Q And you're saying that those customers, existing customers, are higher-value customers because they have been at DirecTV; the subscriber acquisition costs have been baked off by now, and they're worth more. That's the idea of trying to put a higher margin on these existing DirecTV customers, right?

A   That's the idea. It's not -- it's what AT&T does. It's clearly correct. That's the idea.

Q   Now, to be clear, this larger point now on the last day of trial that you've argued to the Judge, was buried in footnote 414 of 300 pages of expert reports, including some ten appendices. And this was an appendix No. 9; is that right?

A   I don't know which number appendix.

Q   Well, you know, sir --

A   We can look -- I letter them, so I don't know the numbers.

Q   You know --

A   I can look. If it matters, I can look it up.

Q   Why don't you look. Why don't you look.

You know that footnote 414, I think out of a total of 417 footnotes. It barely made the cut. In the next-to-last appendix, no less.

This much larger point that all of a sudden has become the cornerstone of your margin opinion.

Am I correct? Is it at 414?

A   Yes, that's the right number.

Q   Is it appendix 9?

A   Appendix I, so we could count up. But let's say it's 9.

Q Okay.

A But, look, you've got some nice flare here. It's at the very end of a long report on a footnote. You got me on that one.

Q Well, I didn't get you; you got you.

A Well, I would not draw the same implications that you seem --

Q You put it in there.

A -- to be about where it happens to be situated, sir.

THE COURT: All right. Look, let's move on to the next thing.

BY MR. PETROCELLI:

Q Now, you have -- I think as you said there in that footnote, you have actually no way of quantifying the number of people at DirecTV who might be ready to leave but for the fact suddenly that some other MVPD might not have Turner, right?

A No, that's not correct.

Q Okay. But you have not quantified the number of such people, right?

A No. I have. That's part of the subscriber loss rate.

Q Well, but the subscriber loss rate are people that are leaving -- were leaving the affected MVPD, plus the reduced number of gross adds, right?

A No, you don't have that right, sir.

Q Well, subscriber loss rate are people who would leave Charter, right, and disperse to different places. That's part one of the loss rate, correct?

A That's part of it.

Q But the overwhelming part of it, I think you said, the most important part of subscriber loss were the reduction in gross adds to Charter because it doesn't have Turner, right?

A Oh, yes, to Charter, that's good, yes.

Q That's what I said before, to Charter.

A It was a little confusing to me. Maybe I -- I'm with you.

Q Okay. But you haven't calculated the number of unhappy DirecTV subs who are about to leave DirecTV but decide to stay because Charter doesn't have Turner?

A No. I have calculated that.

Q Well, what's the number of such people?

A Well, this would be the -- this would be the -- it's about 10 percent after countermeasures, I'd have to check.

Q Are you talking about the outside good there when you say "10 percent"?

A No, sir. No, we're not talking about that.
Q So where did you get the 10 percent?
A So if you go back to the Altman Vilandrie document, they have calculations for what will happen to Charter's existing customers and how many they'll lose and then what'll happen to their ability to get gross adds.
So when you use -- that's the number that corresponds to the reduced churn at DirecTV.
Q You mean the prospective customers?
A That's right. The prospective customers at Charter, because that would be the Charter gross adds that you're talking about.
And if they can't, if they lose a certain share of their gross adds a certain number of those would have come from DirecTV. So that's the number we're now talking about, which is the reduced churn at DirecTV. So I have calculated that.
Q But it's not 10 percent because 10 percent is the total of lost prospective customers. They're not all coming from DirecTV?
A No. That's fair.
But that's -- what we're doing is we take that lost gross adds at Charter since they don't have Turner, and then we apply the diversion rate to them. And that is how I calculate the number you were asking about, which is the

reduced churn at AT&T. And those are the retained subscribers that have this higher value.

Q Now, on that 10 percent, by the way, from the Altman Vilandrie, do you know how they got to 10 percent?

A Well, I have to go back and look at their document. I have not -- I have not looked at that for a couple of weeks.

Q Well, are you aware, can you tell the Court, then, what part of their methodology did they use to derive this 10 percent figure that you use in your analysis as representing the reduced gross adds?

A Let's have a look at the document, and I think I can answer that.

Q The answer is you don't know without looking at the document, correct?

A That is true.

Q And do you know whether it was part of a survey question?

A Again, I don't have these things memorized. I'd want to look at the document that I relied on.

Q And do you believe that they asked, in their survey -- I'm talking about Altman Vilandrie now, and I'm talking about the derivation of this 10 percent figure that reflects prospective customers. We're on the same page, right?

A I understand you.

Q Okay. Is it your belief that in order to come up with that number, they actually surveyed people about whether or not they would decline to join Charter if Charter did not have Turner? Is that your belief?

A Again, I was not testifying about that here earlier. I don't have that memorized. I would just need to look at the document. I don't have any particular belief except that I need to look at the document.

Q So what if I told you, sir, that in the Altman Vilandrie -- and to be clear, you have previously testified that you're not familiar with the Altman Vilandrie work product, other than you read the report, correct?

A And then subsequently reading Mr. Bewley's testimony about it.

Q But you didn't talk to anybody at Altman Vilandrie, correct?

A As we -- that's correct, as we discussed previously.

Q And you didn't talk to anybody at Charter about the project?

A No, not -- I did not talk to them directly.

Q And you didn't even get all the documents from DOJ. We went over that last time, including the original, final report, right?

A I don't have anything more to add from last time. I used the report that I've cited in my report.

Q They didn't even give you the cover emails that indicated that they had previously sent a final slide presentation on April 21. You got the one on April 27, correct?

MR. WELSH: Objection, Your Honor.

THE COURT: You can approach.

(Sealed bench conference)

MR. WELSH:

MR. PETROCELLI:

THE COURT:

MR. PETROCELLI:

THE COURT:

MR. PETROCELLI:

THE COURT:

MR. PETROCELLI:

(Open court)

THE COURT: You may proceed.

BY MR. PETROCELLI:

Q So we can establish that all you did was read the report, right?

A I relied on the report. I didn't dig behind it.

Q And you don't really know how Altman Vilandrie derived their 10 percent customer number that you heavily rely on?

A I don't know sitting here. I'd have to check the report.

Q Now, you also recall -- when you testified last time about this, you indicated, Professor, that you had not been aware that they had originally came out with a hybrid subscriber loss rate of 5 percent, because you hadn't been shown that document, right? The first one you saw was the one that had 9 percent.

Do you recall that?

A That was from my deposition testimony.

Q Yeah.

And that's when you learned for the first time, when you were confronted with this at your deposition, right?

A That's correct.

Q Now -- but when we were together last time, you, I think I was asking you the questions. I think you said to me that it would not have mattered very much, even had you seen the 5 percent figure, because the key number was the 10 percent figure for the prospective customers, and you testified that number was not changed, right?

A Yes. That that number is more important in the end for calculating the long-term subscriber loss rate; that's correct.

Q But you don't know how they derived that 10 percent, right?

A Again, without going back and looking at the study, I can't give you details on that right now.

Q And you said that number had not been changed, like the 5 percent had been changed, right?

A I don't know whether it was changed or not. I was just indicating that one is in the end, more important.

Q Well, wait a second, sir. You testified -- let me get it for you. Okay?

A Well, maybe I can help -- oh, go ahead.

Q Page 2387 of your trial testimony on April 11.

"And the other thing, though, is that, as I mentioned, the more important figure in my analysis is -- is the -- is actually what they have as 10 percent, which is the gross -- the new customer rate, because that's what matters in the long term. And that has much more impact on the long-term subscriber loss rate that I calculate. And that was not changed here. What was changed was the short-term rate, the departure rate."

Do you recall giving that testimony under oath?

A Okay. That sounds right.

Q Now, in fact, you were mistaken in giving this testimony, because the 10 percent was also changed from a prior number, correct?

A I don't know about that or whether that may have been a different change than I was referring to. These are just details I certainly cannot tell you sitting here.

Q Well, let me show you what I had previously shown you, which is the relevant page of the document. I'll give you Plaintiff's Exhibit 79 and Defendants' Exhibit 684, is it?

What I'm going to do, instead, is I'm just going to give you the ones that have just the relevant pages to avoid, so I'm going to hand --

MR. PETROCELLI: Your Honor, may I approach?

THE COURT: You may.

BY MR. PETROCELLI:

Q So here's Plaintiff's Exhibit 79.

And then I'm going to hand you a demonstrative, Defendants' 10, which is taken from defendants', I believe it's 684.

MR. WELSH: May I have a copy?

And, Your Honor, I would object. The witness should have the full document.

THE COURT: Well, let's see if he needs the full document. If he does, we can get it for him.

BY MR. PETROCELLI:

Q If you need the full documents, I'd be happy to give them to you. But as I did last time, the numbers you're talking about are only on these pages.

So take a look, first, at the one that you saw and you base all your work on, which was Plaintiff's 79. And you'll see there, under the hybrid method, you'll see actual 9 percent for existing customers, correct?

A I see that.

Q And then you go to prospects.

And you'll see the 10 percent number that you said was very important, right?

A Yes, that's correct.

Q And -- but you notice how on the 9 percent above it, it says "Actuals."

Do you see that?

A I see that.

Q But look under the 10 percent, it says "Implied."

Do you see that?

A I do.

Q And we've just established, you don't have any idea how they implied this 10 percent?

A Well, if you want to talk about that, I should see the whole document, which I have mentioned on several answers previously.

Q Now, take a look at Exhibit 10, the demonstrative 10, which is the original slide deck presentation.

And you indicated when you were here in court last time that you now see that it shows 5 percent for actuals in the hybrid category, right?

A I see that.

Q And that's the number that you said, when combined with the 10 percent, which you said was not changed, would yield only a modest reduction of your subscriber loss rate from 9 to 8.5 percent, correct?

A That is correct.

Q But if you look directly to the right of the box containing the 5 percent, you see under "Prospects," a number, 6 percent, not 10 percent, correct?

A I see that.

Q So you were wrong when you testified under oath in your trial examination a couple of weeks ago when you said the 10 was not changed. The 10 was changed from 6, correct?

A Well, to look at this document, that seems to be the case. So it appears that I was not aware of that change, so I made a mistake on that. It seems to be correct.

Q And you've been working on this for, what, 16 months now --

A Yes.

Q -- with a team of people?

A Yes, I have.

Q Including a whole bunch of people at DOJ, including economists?
A Yes.
Q And so your testimony about 8.5 percent, if you use these lower numbers, is wrong.
If you use 5 percent and 6 percent, you don't get 8.5 percent, do you?
A I don't know exactly what you get, but this is a good example of how I've been -- I'm using the low numbers, and then you're coming after me.
Why don't be look at the 16 percent figures that aren't changed that are for the pure simulation base and the pure STB, just like the 14 percent numbers weren't changed before. I could have taken an average, and I didn't do that.
Q That was your choice, and you made the choice to rely on these numbers. And you can go back and question yourself, but I'm questioning you about the very opinions that you rendered.
A But that that's --
Q So bear with me now.
On the 5 percent and the 6 percent, if you use those numbers instead of 5 and 10, do you know what that does to your departure rate?
A Well, I think it's going to end up in that range

of 5 or 6 percent.

Q Exactly.

A Okay. That's exactly my point, that if I mention the higher numbers -- I explain in my reports that I was using the lower numbers because -- I explained why, and that's conservative.

And it says you're doing exactly the same thing again, which is totally invalid as far as I'm concerned, which is you're taking the low end of a range. And you've got a good point here in terms of how it was changed --

THE COURT: Sir, you're not here to editorialize. Your counsel will ask you questions if you need to explain something more fully. Listen to the questions and answer them.

THE WITNESS: I apologize.

THE COURT: That's all right.

THE WITNESS: I get -- I have my views. I apologize.

THE COURT: You're entitled to your views.

Okay. Next question.

BY MR. PETROCELLI:

Q And you know that if you use the 5 and the 6 percent, rather than the 9 and the 10 percent or the 5 and the 10 percent, it's going to yield a departure rate between 5 and 6 percent. And as you previously testified, that's going to wipe out entirely any price increase, correct?

A If you just make that change alone, I think we figured that largely eliminates the net MVPD cost increase.

Q Now, let me go to another topic, then, since I think we're -- I think I'm done with Altman Vilandrie, okay?

Let me go to -- I think we covered margins. I think I'm going to go to -- briefly on outside good. You also relied on Altman Vilandrie for outside good, right?

A That is correct.

Q And they came up with a 16.8 percent number, which you converted to 10 percent after taking into account, I think, market shares, right?

A Yes, that's right. At least to a 10 percent -- that's correct.

Q Now, do you realize that they derive their 16.8 percent number that you relied on by coming up with a figure and then reducing it by 40 percent?

A I am aware of that.

Q Were you aware of that when you relied on it? Or are you just recently aware of it, by reading Professor Rossi's trial testimony?

A I can't remember exactly.

Q But you did read Professor Rossi's trial testimony, where he indicated that Altman Vilandrie inexplicably reduced their outside good figure, their cord-cutting figure by 40 percent?

A I'm aware of his testimony.

Q And you don't have an explanation from the Altman Vilandrie work product as to why they did that?

A My understanding is Mr. Bewley explained he did that based on evidence that reflected market conditions in Altman Vilandrie, as part of their analysis.

Q But all you know is what Bewley said, right?

A Well, he's the one who led the study, I think, so that is what I know.

Q So moving past that, let's go to Suddenlink, okay?

Now, on Suddenlink, your number through your work was a 9.4 percent subscriber loss rate, right?

A Long-term subscriber loss rate, yes.

Q Right.

And I took you through this the last time, and so I don't want to repeat it. But you do know that if you stack yours up against Professor Carlton's and everybody else's, yours is the outlier. You're aware of that, right?

A Well, I don't think other people are measuring the same thing, so I don't think that's quite accurate.

MR. PETROCELLI: Can I -- may I approach, Your Honor?

THE COURT: You may.

BY MR. PETROCELLI:

Q This is marked as Defendants' Demonstrative 124. This is --

MR. WELSH: Your Honor --

(Sealed bench conference)

MR. WELSH:

THE COURT:

MR. PETROCELLI:

THE COURT:

MR. PETROCELLI:

THE COURT:

MR. PETROCELLI:

THE COURT:

MR. PETROCELLI:

THE COURT:

MR. PETROCELLI:

(Open court)

MR. PETROCELLI: I'm not going to the show you the demonstrative.

THE WITNESS: I'll forget that I saw it.

BY MR. PETROCELLI:

Q But you are aware that under everybody else's reported subscriber loss rate -- I know that you disagree with them, including Professor Carlton's -- they all would lead to an overall price decrease, correct?

A It's not a matter of whether I agree or disagree with what they've measured. Almost all of these are measured in very short-term loss rate. It's not the right thing to look at, and Professor Carlton and I agree about that.

Q Well, I'm not going to take issue with that now because I already did. And I already crossed you on that, including testimony of people who were talking about the event long after the fact and the impact that it had. So I will move on to a different Suddenlink topic, which is your chart.

Could we take a look at the chart that counsel showed you. You have his Suddenlink chart?

A I have it.

Q Can I see it.

A This one here, you mean, right?

Q Yeah, that one right there.

THE WITNESS: Do you have that, Your Honor?

THE COURT: 011-06?

THE WITNESS: (Nodding head.)

THE COURT: Okay.

MR. PETROCELLI: Let me make sure it's the same one.

May I approach?

THE COURT: You may.

MR. PETROCELLI: Yep, that's it.

THE COURT: Okay.

BY MR. PETROCELLI:

Q Now, you know that Professor Carlton says that you did not -- in doing your Suddenlink work, you did not control for industry trends. You know that's his position, right?

A I do.

Q And that he has run regressions, in which he contends that -- around the time of the Viacom-Suddenlink blackout, the industry changed and it declined at an accelerated pace, correct?

A That appears to be his belief.

Q And you have a contrary belief, right?

A He's incorrect.

Q Okay. Well, take a look at your chart for a minute, please.

Now, the way you constructed this is you started essentially at ground zero, around the time of the event. And then you kind of worked backwards 21 months to see what the actual industry data reflected, right, using your red line for now?

A Okay.

Yes, that's correct.

Q Okay. So if you go back, you start at zero in the middle of your chart, around September 2014. Do you see that? Or right around the time of the blackout, right?

And if you go back to the first month, January 2013, that you have plotted, that's 21 months, correct?

A Okay.

Q Yes.

And the red line starts at about 1 percent above zero there, correct. It's halfway in between 0 and 2.

Do you see that?

A I see that.

Q And now, it's dropping down to zero at about the time of the blackout in on or about September of 2014, right?

A Yes.

Q Now, if we go 21 months forward, past that event, that would take us to about June 2016.

Do you see that?

A Yes.

Q If you just draw an imaginary line there --
A Okay.
Q -- instead of going out to November of 2016, you'll see that the red line is now at 2 percent, right, below zero.
So it's dropped faster after the event than before the event, correct?
A Taken on those average periods that you've picked, that is correct.
Q But if we go past June, it's even dropping more, correct?
A Well, it's continuing to go down.
Q Yes.
A I mean, that's what these trends are.
Q Okay.
So then it is true, then, that there was an increase in the decline post blackout for the industry as a whole, correct?
A Well, for the periods you have picked, that's correct. We did the statistical analysis, and there was no statistically significant difference in the trends.
Q Well, I didn't pick this. This is your chart.
A No. You just picked a particular time period, sir.
Q Well, I started at the beginning of your chart,

January 2013.

A That's correct.

Q And I went all the way -- and we can even go -- I was just trying to be fair by measuring 21 months versus 21 months.

A I see, yeah.

Q If we want to go out to November and add some more months, it continued to decline even faster, right?

A I can't eyeball that. I've looked at the data and done the econometrics on that.

Q Now, when you looked at the data, you had data, sir, through December of 2016, right?

A It looks to me like it's -- I see November here. I don't know the exact extent of our data. Yeah.

Q Well, you -- we have from your work papers -- we have from your work papers a page from your computer file that shows that you had data for all these distributors going all the way through December 2016, yet your chart cuts it off at November 2016.

Does that ring a bell?

A No.

Q Did you prepare this chart, or did your team do this?

A Well, the team actually did the graphing of the chart, yeah.

Q Well, did anybody make aware to you when they were preparing this chart to present in court that if you did one more month, there would have been a precipitous drop in the -- in your red line here in the industry subscriber counts?

A I would have to ask my team about that additional data point, if whether it was reliable. I don't know sitting here.

Q Well, what if I told you that there were over 1 million subs that were lost in that month bigger than any of the prior months in your data set going all the way back to January 2003. Would you accept that?

A Well, I would -- we can look at the data. I don't know. I don't have that in my head.

MR. PETROCELLI: Let's mark as the next exhibit for identification Defendants' what?

This is a -- I'm marking this, Your Honor, as exhibit, defense exhibit -- this is not a demonstrative. This is actually from his file, so give me the next exhibit in order.

MS. ROBSON: I have 943.

MR. PETROCELLI: 943.

May I approach, Your Honor?

THE COURT: You may.

BY MR. PETROCELLI:

Q So I've placed front of you 9 -- what has been identified as Exhibit 943, which I will represent to you is a printout from one of the computer files that accompanied your expert reports that you provided to us. And you'll see that it goes through December 2016, correct?

A I see that.

Q And you'll see that there's quite a big jump -- quite a big decline, I should say, from November to December that's not reflected on your chart, correct?

A I believe that's correct.

MR. PETROCELLI: Okay. Your Honor, I'd like to move this into evidence. It's directly from his work papers.

MR. WELSH: Objection. I'd like to be heard.

THE COURT: You may be heard.

(Sealed bench conference)

MR. WELSH:

MR. PETROCELLI:

THE COURT:

MR. WELSH:

MR. PETROCELLI:

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MR. WELSH:

MR. PETROCELLI:

THE COURT:

(Open court)

THE COURT: You may proceed according to our discussion at the bench.

BY MR. PETROCELLI:

Q Professor, so you see that these numbers started January 2013, and they track the months in your -- number of the months in your chart, right?

A I do.

Q Okay. And I represented to you that this came from the computer file, one of them that you submitted with your expert reports.

Do you have any reason to doubt that?

A No.

Q And do you have any reason to doubt these numbers?

A No.

MR. PETROCELLI: So I would ask that it be admitted into evidence.

THE COURT: Well, let me just ask you this, Professor. Where did you get these numbers from, if you can recall?

THE WITNESS: These numbers are from the distributors themselves. They're measuring their subscribers counts. And then we added them all up to get the total.

THE COURT: Okay.

MR. PETROCELLI: So I'd move it into evidence, Your Honor.

THE COURT: All right. It will be admitted.

MR. PETROCELLI: Okay. Thank you.

Does this need to be confidential?

THE COURT: It's DX943, right?

MR. PETROCELLI: Yes, 943.

MR. WELSH: Yes, apparently so.

MR. PETROCELLI: Okay.

(Defendants' Exhibit DX943 received into evidence under seal.)

BY MR. PETROCELLI:

Q Now, can you go back to --

MR. PETROCELLI: Actually, I'll move forward, Your Honor --

THE COURT: All right.

MR. PETROCELLI: -- now that I have that in evidence.

BY MR. PETROCELLI:

Q Let me talk a little bit about the so-called natural experiments of Dr. Carlton that you comment on, the prior transactions, okay?

Now, without going back over my examination the last time on this, just to kind of set the stage, you had made a determination that it would not be fruitful, I think was the word you used, to do the kind of analysis into these three transactions or so that Dr. Carlton did, right?

A Above and beyond what I'd already seen, including from AT&T's own economists.

Q But you -- would you agree with the following sentence with regard to the utility and usefulness of precedent transactions?

"Ideally, the reliability of different methods of evaluating proposed mergers should be gauged by an intelligent combination of theoretical analysis and empirical evaluation. The most direct way to do the latter is to compare the observed changes from completed mergers against premerger predictions."

Would you agree with that statement?

A Not fully.

Q You are aware that is your own statement, right?

A I didn't recognize it.

Q Well, you wrote an article with -- is it Professor Farrell?

A Yes, Joe Farrell, Joseph Farrell.

Q Joe Farrell and yourself in 2010?

A Okay.

Q And that appears at page 34, footnote 68, and you wouldn't dispute that, would you?

A Again, I generally agree with it. I was processing -- there's a lot there. It might be a little bit demanding in terms of what one could do, but I agree with the general thrust.

Q And do you agree with this statement: "In light of the significant vertical acquisitions that have occurred in this industry, we believe that Professor Rogerson would need to provide considerably more empirical evidence before the Commission should place any significant weight on his bargaining theory."

Do you recall that?

A That one I do recall, yes.

Q And that's an opinion that you gave in support of the News Corp. acquisition of DirecTV -- yeah, DirecTV back in 2003, correct?

A It was a partial acquisition, but that's correct, yes.

Q Right.

Okay. Now, regarding the chart that you showed, you were shown on -- let's see if I can find my copy. You were shown by Mr. Welsh, I think you were shown one of Professor --

MR. PETROCELLI: May I approach?

BY MR. PETROCELLI:

Q You were shown Defense Exhibit 113.

I also would like you to take look at Professor Carlton's Defense Demonstrative Exhibit 112.

Now, on -- you talked about 113 and indicated that the --

MR. WELSH: Can I have a copy?

BY MR. PETROCELLI:

Q That the Comcast-DirecTV [sic] deal was done in or about 2016, and then the prices started to go up there, kind of catching up to the DirecTV line with the other programmers, right?

A In 113?

Q In 113, yes.

A Yes.

Q Okay. And you know that when a contract is up for renewal and re-negotiate, there's a re-set of prices, prices you would expect to go up when a new contract is negotiated between a distributor and a programmer, given the general increase in programming costs, right?

A Yes.

Q Now, take a look at Defense Demonstrative 112. You recognize this from Professor Carlton's testimony, right?

A Yes.

Q And this is based on Kagan data for all distributors and all networks, right?

A Well, these control networks, yes.

Q Yes.

And you see -- and this is based on Kagan data, right?

A That's correct.

Q And you see here that the NBC line is consistently under the industry line, right?

A I see that.

Q And in terms of the use of Kagan data, you are aware that many of the people in the industry who negotiate these deals use Kagan data, right?

A Yes. I think it's commonly used.

Q And even the FCC used in one of the orders that you cited last time you were here when they did the retrospective on the Fox transaction. That was based on Kagan data in the FCC order that you relied on, right?

A I believe that's correct.

Q Okay. Actually, with that, I think I only have a final question or two, and that's on the -- on your bargaining model in general.

Do you agree with the following statement?

"According to Professor Rogerson's version of the bargaining theory and vertical coordination, every, even partial, vertical ownership acquisition would lead to a significant danger of programming price increases by changing the threat point for the vertically integrated programmer. This -- his bargaining theory proves too much."

Do you recall making those statements in your expert submission in that case?

A Yes, I do. And the main reason is because Professor Rogerson did not give any credit to the elimination of double marginalization. So he was just looking at one side of the balancing.

Q Do you also recall making the following statement:

Professor Rogerson does not address the real-world complexity of the bargaining environment?

A Yes. He didn't do any of the analysis that I've done here.

Q And do you recall making this final statement.

"This per se approach is also suggested by the fact that he does not provide any evidence that integrated cable programmers actually have previously acted in accordance with his concerns."

Do you recall making that statement?

A That's correct. Since he did not do empirical analysis to support his bargaining model and did not have prior historical evidence, my view was that his analysis was incomplete.

Q And here, you are very familiar with the trial testimony of the witnesses who have actually worked in vertically integrated companies, who have also testified that they have never acted or even thought about the issues you have presented in your bargaining model, correct?

A Well, I understand that the parties of this transaction say that, but it's also quite clear that the distributors who stand to be disadvantaged by this transaction if it goes forward do, indeed, indicate concerns that are consistent with the bargaining model.

Q And you're also familiar with the testimony of

Greg Rigdon and Matt Bond of Comcast-NBCU that they never thought of that these things that you're positing. You recall that testimony?

A I do.

MR. PETROCELLI: Nothing further, Your Honor.

THE COURT: Let me see counsel.

(Sealed bench conference)

THE COURT:

MR. WELSH:

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MR. PETROCELLI:

MR. WELSH:

THE COURT:

MR. PETROCELLI:

THE COURT:

(Open court)

THE COURT: All right. We're done for today, Professor. You may or may not be coming back on Thursday. You're going to be talking to your counsel only about logistics, nothing else.

I'm not releasing you as a witness in the case. You are not released. So if they need to ask you more questions, which is their decision, not yours, you need to be here on Thursday.

And if you're not here, then they take the consequences of you not being here and they forgo asking you any other questions.

The only thing you can discuss with them, since you're not being released, is logistics issues: your schedule, getting back here, and all that.

On Thursday, we'd be reconvening at 2:30 in the afternoon. So you talk to them about whatever arrangements you need to make in order to meet that schedule. They understand the consequences of your not being able to be here, and we'll leave it at that.

Thursday, we will discuss further closing arguments, what day, what time, how much time each side has, and how much of the government's can be used for rebuttal purposes.

So we'll stand in recess until Thursday at 2:30.

MR. PETROCELLI: Okay.

MR. WELSH: Okay.

DEPUTY CLERK: All rise.

This Honorable Court now stands in recess until the return of court.

(Proceedings concluded at 1:06 p.m.)

C E R T I F I C A T E

I, William P. Zaremba, RMR, CRR, certify that the foregoing is a correct transcript from the record of proceedings in the above-titled matter.

Date: April 24, 2018________ /S/__William P. Zaremba______

William P. Zaremba, RMR, CRR