Before the
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, DC 20554

In the Matter of	)	
	)	
Applications of AT&T Inc. and	)	MB Docket No. 14-90
DirecTV for Consent to	)	
Assign or Transfer Control of	)	
Licenses and Authorizations	)	

REPLY TO OPPOSITION
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SUMMARY

AT&T's proposed acquisition of DirecTV, which has occurred in response to Comcast's merger with Time Warner Cable, is a troubling development in an already concentrated industry. If both mergers are approved, two companies will control half of the multichannel video programming distribution ("MVPD") market and half of the wired high-speed broadband Internet service provider ("ISP") market. Such an outcome would significantly concentrate control of our nation's communications platforms, undermining competition, content diversity and consumer choice. On its own, the AT&T and DirecTV (together, "Applicants") transaction is likely to harm upstream content providers in MVPD and online video markets and to reduce competition, leading to higher prices for consumers.

The merger reduces direct competition for MVPD service in 129 designated market areas ("DMAs") and further consolidates the national market for distribution of video programming. This outcome will increase Applicants' bargaining power over broadcast and cable networks. AT&T intends to take advantage of DirecTV's buyer power as an MVPD to reduce its content costs by 20%. Applicants provide no evidence to suggest that these programming fees overvalue the content provided by networks, but with increased control of the market nationally and locally, Applicants will have sufficient leverage to force programmers to agree to their contract demands. Local broadcast stations in U-verse video markets will be particularly harmed by the reduction in distributors. The merger will also likely harm smaller MVPDs as programmers may attempt to raise their rates to recoup losses from Applicants. While Applicants have projected significant cost-savings for themselves, the most likely outcome for consumers will be higher prices resulting from reduced competition.

The merger also poses a threat to the burgeoning online video market by significantly increasing AT&T's incentives to engage in anticompetitive behavior and by establishing DirecTV's ability to harm unaffiliated online video distributors ("OVDs"). AT&T's acquisition of 20 million MVPD customers and desire to offer more profitable bundled products gives the company strong incentive to limit the attractiveness of OVDs, which could become substitutes for an MVPD service. Combined, Applicants can use increased scale as an MVPD and AT&T's control of Internet distribution to institute practices that harm OVDs, including restrictive distribution agreements that limit the ability of programmers to release content online, anticompetitive interconnection agreements, data caps and bundles.

Applicants claim that AT&T's incremental expansion of fiber broadband to 2 million customer locations and wireless local loop broadband to 13 million homes are transaction-specific benefits, but ongoing network investment and competitive incentives indicate that such investment is likely to occur absent the transaction. AT&T claims that acquisition of DirecTV's video service is necessary to transform company incentives to invest in broadband, but its $14 billion investment in wired and wireless network expansion and upgrades, carried out with no significant expansion of its video business, belies this assertion. AT&T's intention to retire its copper plant requires that the company develop offerings to replace its legacy networks. Further, the growth prospects and profitability of broadband service provide strong incentives for AT&T to continue investing in its broadband networks regardless of whether it is permitted to acquire a satellite MVPD with no broadband facilities.

Should the Federal Communications Commission ("FCC" or "Commission") choose to approve the transaction it must require strong, enforceable conditions that mitigate the likely harms. To limit the harm to consumers who will lose a competitive choice for MVPD service, the Commission should require that Applicants maintain DirectTV's standalone video service at nationwide prices for a period of ten years. To protect programmers who will face an MVPD with increased bargaining leverage, the FCC should require binding arbitration should television networks and Applicants fail to reach or renew carriage agreements. To protect the OVD market, which has enhanced video competition, the Commission should require that Applicants offer affordable standalone broadband service, be prohibited from implementing data caps, engage in fair interconnection practices and allow competitive ISPs non-discriminatory access to broadband facilities. In addition, Applicants should be required to abide by the 2010 Open Internet Rules, superseded only by stronger rules issued by the Commission.

Applicants have not demonstrated that this transaction serves the public interest. Rather, the merger is likely to produce significant harms, and the benefits offered are not transaction-specific and do not outweigh the prospective harms. It is in the public interest for the Commission to deny this transaction.

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I. INTRODUCTION

Writers Guild of America, West, Inc. ("WGAW") offers this Reply in response to the Opposition[1] of AT&T and DirecTV (together, "Applicants") to our Petition to Deny[2] ("Petition") their application to transfer licenses and authorizations.[3]

Our Petition detailed numerous harms that would result from the merger of DirecTV, the second largest multichannel video programming distributor ("MVPD"), with AT&T, the fifth largest MVPD and second largest Internet service provider ("ISP") and wireless carrier. We highlighted the uncontested fact that the proposed merger would eliminate direct competition between Applicants in 129 designated market areas ("DMAs"). WGAW argued that the loss of local competition, together with national consolidation giving Applicants control over 26 million MVPD subscribers, would enhance AT&T's leverage over programmers. AT&T has stated that an explicit goal of the merger is to cut programming costs. If approved, Applicants' combined size will give them the requisite power to reduce payments below competitive levels and negotiate content rights that may limit the development of the online video market, for example, by requiring exclusivity for online distribution or by refusing to carry networks that make content available online. For consumers, the merger will result in fewer MVPD choices and higher prices from reduced competition. Such outcomes are contrary to the public interest.

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[1] *Joint Opposition of AT&T Inc. and DirecTV to Petitions to Deny and Condition and Reply to Comments*, MB Docket No. 14-90, October 16, 2014. *(Opposition).*
[2] *Petition to Deny of the Writers Guild of America, West, Inc*., MB Docket No. 14-90, September 16, 2014. *(WGAW Petition).*
[3] *In the Matter of Applications of AT&T Inc. and DirecTV to Transfer Control of FCC Licenses and Other Authorizations*, MB Docket No. 14-90, June 11, 2014. *(Application).*

In response, Applicants attempt to assert that they are not competitors, claiming that DirecTV's primary business is video distribution and AT&T's primary business is broadband service. Applicants further attempt to minimize the loss in competition by framing this transaction as a combination of complementary services. Applicants claim that the merger is necessary for their ability to compete with providers of bundled video and Internet service. Unfortunately, the subscriber data of the two companies suggest otherwise. DirecTV is the second largest MVPD in the United States, despite lacking broadband facilities, and 49% of AT&T U-verse customers subscribe to standalone broadband.

WGAW also highlighted how this merger would increase the incentive and ability of Applicants to limit the development of a competitive online video market. With the addition of 20 million MVPD customers, AT&T's incentive to protect its MVPD business from subscriber losses will be greatly increased. The merger also gives DirecTV an ability not currently possessed to harm unaffiliated online video distributors ("OVDs") through AT&T's control of wired and mobile broadband connections. In response, Applicants have claimed that the merger does not increase AT&T's *ability* to harm OVDs and that a vibrant OVD market is a complement to AT&T's broadband business. However, AT&T's interconnection dispute with Netflix demonstrates its willingness to use control of distribution to harm unaffiliated OVDs, providing significant evidence to the contrary.

Our Petition also raised serious questions regarding transaction benefits claimed by Applicants. Despite projecting significant cost-savings for themselves, Applicants only offer consumers hypothetical cost-savings. We noted that AT&T had announced significant broadband investment prior to the merger, challenging the assertion that the incremental investment Applicants now offer would be unlikely to occur absent the transaction. In response, Applicants continue to maintain that acquisition of DirecTV's video business is necessary for the minimal broadband expansion AT&T now commits to, even though broadband is far more profitable and offers more growth potential than the mature MVPD market.

Our Petition made clear that Applicants had not met the Commission's public interest standard for merger approval. Applicants bear the burden of demonstrating, through a preponderance of evidence, that benefits are specific to this merger, verifiable and unlikely to occur outside the transaction and that such benefits outweigh potential merger harms.[4] In this reply, we further outline how this merger will harm upstream programmers in MVPD and OVD markets while producing few benefits for consumers. In consideration of these concerns, the WGAW continues to respectfully request that the Commission deny the merger. However, should the Commission approve this transaction, we outline conditions the Commission should require in order to mitigate the harms of this merger.

II. HORIZONTAL CONCENTRATION IN LOCAL AND NATIONAL VIDEO MARKETS WILL HARM PROGRAMMERS AND CONSUMERS

AT&T and DirecTV are MVPDs that directly compete for subscribers in 129 DMAs. Applicants also compete in the national market for distribution of video programming. The decrease in the number of buyers of video programming will unduly increase the bargaining power of distributors over both national cable networks and local broadcast stations. Applicants anticipate that this power will allow them to cut programming costs and demand more expansive

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[4] *In the Matter of Applications of Comcast Corporation, General Electric Company and NBC Universal, Inc. For Consent to Assign Licenses and Transfer Control of Licenses*, Memorandum Opinion and Order, MB Docket No. 10-56, January 20, 2011, ¶¶ 226, 251. (*Comcast-NBCU Order*).

distribution rights.[5] Local broadcasters in DMAs where Applicants compete directly will be particularly harmed by the loss of competition. Smaller MVPDs may also be harmed as programmers seek to raise rates to compensate for lost revenue from Applicants in what economists call a "waterbed effect." It is questionable that consumers will see lower prices as a result of this transaction because a merger of companies offering substitute products is likely to result in upward pricing pressure and AT&T officials have refused to commit to any cost-savings for customers. As such, the merger is likely to harm participants in upstream content markets and cost-savings are likely only to benefit Applicants.

A. The Merger will Reduce Competition in Relevant Local and National Video Markets

The merger of AT&T and DirecTV will reduce competition in national and local video markets. The merger will reduce choice in the local retail market for MVPD service. The majority of Americans—roughly 90% of television households—rely on MVPDs to view local, regional and national television networks.[6] Since cable MVPDs generally do not overlap in local service and telephone company MVPDs are geographically limited, consumers typically choose from one or two locally available wireline MVPDs and the two national direct broadcast satellite ("DBS" or "satellite") providers. As the FCC has noted in prior mergers, "the relevant geographic market for MVPD services is local because consumers make decisions based on the MVPD choices available to them at their residences and are unlikely to change residences to

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[5] *In the Matter of Applications of AT&T Inc. and DirecTV to Transfer Control of FCC Licenses and Other Authorizations*, MB Docket No. 14-90, June 11, 2014, Declaration of John T. Stankey, Group President and Chief Strategy Officer, AT&T Inc., ¶¶ 6, 23. *(Stankey Declaration).*

[6] Federal Communications Commission, *In the Matter of the Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* MB Docket 12-203, Table 17 (2013).

avoid a small but significant increase in the price of MVPD service."[7] For the 27 million locations that are currently offered U-verse video service, this merger would reduce competitive offerings for MVPD service.

The merger will also increase concentration in the national market for distribution of cable networks. These networks negotiate distribution by MVPDs across the country to reach viewers for nationally licensed programming and usually depend on advertising revenue based on national distribution to fund programming. As the Commission stated in the *Adelphia-Time Warner Cable Order*, "We have found it reasonable to approximate the relevant geographic market for video programming by looking to the area in which the program owner is licensing the programming. For national cable programming networks, the relevant geographic market therefore is at least national in scope."[8] Applicants' proposed merger would reduce the number of buyers for such networks, thereby increasing their leverage over programmers.

Local broadcast television stations, in DMAs currently served by DirecTV and AT&T, will also be harmed by the merger as they seek to negotiate carriage with a much larger MVPD in a more concentrated local market. The Commission recognized the local nature of this market in the sale of Hughes-DirecTV to News Corporation: "…in the case of broadcast television programming, it is reasonable to use DMAs to define the relevant geographic market for each individual broadcast station. Contracts between broadcast stations and the providers of programming, as well as FCC regulations and broadcasting technology, limit the extent to which

[7] *In the Matter of Applications for Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation to Time Warner Cable Inc.,* Memorandum Opinion and Order, MB Docket No. 05-192, July 21, 2006, ¶ 64.
[8] *Ibid*., ¶ 68.

broadcast station signals can be distributed outside of the assigned market area."[9] In those markets where U-verse television service is offered, the proposed transaction will reduce the number of buyers of local broadcast programming.

B. The Merger will Significantly Enhance Applicants' Leverage over Programmers

By increasing market share locally and nationally, Applicants will increase their power as buyers of video programming. Applicants claim that programmers hold the power in the video distribution industry, citing rising retransmission and affiliate fees, as well as increasing prices for sports programming.[10] However, as we noted in our Petition, basic cable networks have invested heavily in original programming and the growth in content spending has outpaced growth in affiliate fees.[11] Programming fees also account for a host of additional rights including on-demand, online and out-of-home availability of programmers' content, which adds significant value to an MVPD service. Applicants offer no evidence to suggest that programming fees overvalue content, but simply intend to use their increased market share and the elimination of a direct competitor in U-verse video markets to cut AT&T's costs below competitively negotiated rates. Video programmers already face a consolidated distribution market in the U.S. The four largest MVPDs controlled 71% of all multichannel subscribers as of the third quarter of 2014.[12]

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[9] *In the Matter of General Motors Corporation and Hughes Electronics Corporation, Transferors, and The News Corporation Limited, Transferees, For Authority to Transfer Control*, Memorandum Opinion and Order, MB Docket No. 03-124, January 14, 2004, ¶ 65.
[10] *Opposition*, p. 50.
[11] *WGAW Petition*, p. 11.
[12] Leichtman Research Group and Company Quarterly Financial Reports. Leichtman estimates 95.3 million MVPD customers. Comcast reported 22.3 million customers, DirecTV reported 20.2 million, Dish reported 14 million and TWC reported 10.8 million customers in the third quarter of 2014.

If the Commission approves both the instant transaction and the Comcast-Time Warner Cable ("Comcast-TWC") merger, two companies will control more than 50% of the MVPD market.

Large MVPDs, like DirecTV and Comcast, already have the necessary market power to extract lower programming rates compared to smaller MVPDs because they represent a sizeable share of the national video distribution market. Applicants and their economist admit that larger MVPDs pay less, indicating AT&T will reduce programming costs by 20% as U-verse carriage agreements are superseded by DirecTV's programming rates.[13] Large national MVPDs have buyer power because most broadcast and cable networks program content for a national audience. These programmers also rely on advertising revenue, which makes scale critical to their financial survival. According to one advertising executive, marketers don't usually buy from networks that reach less than 25 million homes and, for many, that number is 50 million.[14] As such, television networks must negotiate for carriage with large MVPDs to achieve sufficient scale. This gives larger MVPDs negotiating leverage over the programmers that seek carriage over their facilities. This merger would give Applicants more subscribers—26 million or about a quarter of the market—than *any existing* MVPD. Depending on the outcome of the Comcast-TWC proceeding, AT&T will either become the largest or the second largest MVPD. Applicants' increased scale will allow them to threaten permanent or temporary foreclosure to 25% of the market in order to force programmers to agree to their contract demands.

[13] *In the Matter of Applications of AT&T Inc. and DirecTV to Transfer Control of FCC Licenses and Other Authorizations*, MB Docket No. 14-90, June 11, 2014, Exhibit A, Declaration of Rick L. Moore, Senior Vice President of Corporate Development, AT&T Inc., p. 8; and *Opposition*, p. 16.

[14] Jeanine Poggi, "What 'A La Carte' TV Would Mean For Advertisers," *Ad Age*, September 25, 2013, http://adage.com/article/media/a-la-carte-tv-advertisers/244292/.

This merger concentrates the national video market and eliminates competition in local markets, enhancing Applicants' negotiating leverage over television programmers. Because AT&T and DirecTV overlap in service, they compete for many of the same MVPD customers. This consolidation would reduce the alternate paths to consumers in affected markets and eliminate the ability of programmers to realize any benefits of playing Applicants against each other in carriage negotiations. Post-transaction, Applicants' bargaining leverage over programmers will increase because the combined company will face less competition. As Free Press notes, "The outcome [of this transaction] would be what antitrust authorities describe as a 'highly concentrated' pay-TV market in 64 separate DMAs, where nearly all of AT&T's video subscribers reside."[15] This result, Public Knowledge and the Institute for Local Self Reliance explain, "…violates antitrust law. Under the Clayton Act, transactions that substantially lessen competition, or tend to create a monopoly in any line of commerce, are illegal."[16]

1. Applicants' Enhanced Buyer Power will have a Disproportionately Negative Impact on Local Broadcast Markets

Since broadcast stations serve a more limited geographic market than national cable networks, the merger of AT&T and DirecTV will create even greater disadvantages for local broadcasters in U-verse video markets. MVPDs already have significant negotiating power over broadcasters because of the limited number of distributors in any given market and the cable MVPD strategy of clustering their systems so that a single wired MVPD will cover most, if not

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[15] *Petition to Deny of Free Press,* MB Docket No. 14-90, September 16, 2014, p. 9.
[16] *Petition to Deny of Public Knowledge and Institute for Local Self-Reliance,* MB Docket No. 14-90, September 16, 2014, p. 3.

all, of a given broadcast station's footprint. The National Association of Broadcasters points out, "Local markets are frequently dominated by a single MVPD—who can make or break a broadcasters' access to MVPD subscribers in that market."[17]

Applicants' desire to cut programming costs will be acutely felt by local broadcast stations in U-verse video markets where this merger will further concentrate distribution among a few large MVPDs. In recent years, retransmission fees have become an important source of revenue for local broadcasters. SNL Kagan estimates that broadcasters will collect $4.9 billion in retransmission revenue in 2014.[18] Current retransmission rules allow local stations to negotiate fees that appropriately value the content they provide to MVPDs. Broadcast networks remain the most watched programming services. In an average week, the top four broadcast networks all reach more than two-thirds of television households.[19] The broadcast networks also offer sports programming and award shows that attract the largest live audiences in each year. In the 2012-2013 television season, broadcast accounted for 96 of the top 100 programs among adult viewers aged 25-54.[20] Simply put, the broadcast networks are responsible for a great deal of the must-have programming—both first run and syndication—that make an MVPD service attractive.

Increasingly, retransmission fees are about more than providing the linear channel feed to MVPDs. These negotiations now encompass additional rights such as video on-demand

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[17] *Comments of the National Association of Broadcasters*, MB Docket No. 14-90, September 16, 2014, p. 5.
[18] Cecilia Kang, "CBS, Dish reach deal on retransmission fees," *The Washington Post*, December 6, 2014, http://www.washingtonpost.com/news/business/wp/2014/12/06/cbs-dish-reach-deal-on-retransmission-fees/.
[19] TVB, "Television Basics," Updated June 2012, http://www.tvb.org/media/file/TV_Basics.pdf, p. 7.
[20] TVB, "The 2012/2013 Television Season: The More Things Change…," http://www.tvb.org/research/2053636/2012-13_Season_Recap.

("VOD") on set-top boxes and online through "TV Everywhere" initiatives, as well as the right to make the linear network feed available to Internet-connected devices in and out of the home. These rights provide tremendous value to MVPDs seeking to remain attractive to consumers who now have online video alternatives and who spend increasing amounts of time streaming video from mobile devices.

But MVPDs have made clear their opposition to retransmission fees. In proceedings before the FCC and as part of legislation such as the reauthorization of the Satellite Television Extension and Localism Act, MVPDs have attempted to weaken retransmission rules to enhance their leverage over local broadcasters. Testifying before the House Committee on Energy and Commerce in June 2013, Michael Palkovic, Executive Vice President of Services & Operations for DirecTV, said "broadcast television has gotten far too expensive."[21] In comments for the Commission's 16th Video Competition Proceeding, AT&T claimed that broadcasters and programmers can demand "excessive retransmission consent fees…"[22] With this merger, Applicants will gain the power necessary, through increased control of distribution in many local markets, to cut fees paid to broadcasters. Broadcasters will lose revenue despite offering the most watched content at lower rates than many cable network affiliate fees. And while households can access local stations using a digital antenna, broadcast stations must go through MVPDs to reach the 90% of television households that use an MVPD service.

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[21] *The Satellite Television Law: Repeal, Reauthorize, or Revise?: Hearing Before the H.R. Comm. On Energy and Commerce, Subcomm. on Communications and Technology*, 113th Cong. 1 (2013) (written testimony of Michael W. Palkovic, Executive Vice President, Services & Operations for DirecTV).

[22] *Comments of AT&T Inc., In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 14-16, March 21, 2014, p. 1.

C. The Merger will Harm Smaller MVPDs Through the "Waterbed Effect"

This proposed transaction will further harm competition by increasing the chasm between what the largest MVPDs pay for programming compared to smaller competitors. Applicants' enhanced buyer power will allow them to drive prices below market rates, leading programmers to try to recoup that loss from smaller distributors. Economists have named this phenomenon the "waterbed effect." As the American Cable Association writes, "Operators of small cable systems explain that in their experience when larger MVPDs demand lower programming prices, they are saddled with the differential increase in their programming rates. Accordingly small cable operators believe that after the merger, when programmers do not receive what they expect from AT&T-DirecTV, they will make it up by charging higher prices to those smaller providers who lack the bargaining leverage to resist."[23]

The lack of competition in the MVPD market, exacerbated by the merger proceedings currently before the Commission, makes it more likely that the waterbed effect will harm consumer welfare. As economists Roman Inderst and Tommaso Valletti explain, "Such consumer detriment from the waterbed effect is more likely if the adversely affected firms are already sufficiently squeezed, due to relatively higher wholesale prices and, consequently, lower market shares."[24] As noted earlier, the four largest firms in the MVPD market control more than two thirds of the market and smaller firms are left with minor market shares. If the Commission approves both the instant transaction and the Comcast-TWC merger, the two largest firms will control half of the MVPD market and Applicants will be almost twice the size of DISH, the next

[23] *Comments of the American Cable Association*, MB Docket No. 14-90, September 16, 2014, p. 19.
[24] Roman Inderst and Tommaso Valletti, "Buyer Power and the 'Waterbed Effect," The Journal of Industrial Economics, March 2011, p. 2.

largest MVPD. Programmers squeezed by Applicants will likely try to compensate for the reduction in programming fees by raising rates for smaller MVPDs, which in turn may pass these costs onto subscribers.

D. The Merger is Unlikely to Result in Cost-savings for Consumers

Despite the cost-savings Applicants will realize as a result of paying less for programming, there is no reason to believe that these savings will benefit consumers. In fact, after many years of MVPD consolidation, the only result for consumers has been higher prices and the worst customer service record of any industry. According to the FCC's Report on Cable Industry Prices,

> The average monthly price of expanded basic service (the combined price of basic service and the most subscribed cable programming service tier excluding taxes, fees and equipment charges) for all communities surveyed increased by 5.1 percent over the 12 months ending January 1, 2013, to $64.41, compared to an annual increase of 1.6 percent in the Consumer Price Index (CPI). The price of expanded basic service has increased at a compound average annual growth rate of 6.1 percent during the period 1995-2013. The CPI increased at a compound average annual growth rate of 2.4 percent over the same period.[25]

Even Applicants' management acknowledges that there is little or no chance of consumer savings when it refuses to commit to any specific, enforceable reductions in prices. AT&T CEO Randall Stephenson, when asked in a Senate hearing whether he would commit to passing costs savings from the merger to consumers dollar for dollar, responded, "No sir, I can't… I don't think

[25] Federal Communications Commission, *Report on Cable Industry Prices*, MB Docket No. 92-266, p. 3 (2014).

we want to intimate that."[26] Similarly, DirecTV CEO Mike White said, "It's pretty hard to commit to lower prices on pure-play TV because of the price of content."[27]

A recent Time magazine article highlighted the likely outcome for consumers if this transaction is approved, "They [telecom mergers] rarely benefit customers—in fact, reduced competition in telecom has historically meant higher fees."[28] Media analysts seem to agree. Colin Dixon, chief analyst at nScreenmedia notes, "The bigger you are the more likely you are to have greater influence over the content providers…However, that won't trickle down to the cable subscriber."[29] It is unrealistic to believe that any merger cost-savings will benefit the public when MVPDs face little competition at the local level and this transaction will further reduce competition. Instead, such savings will accrue to the new company as a private, not public, benefit.

III. THE MERGER ENHANCES INCENTIVE AND ABILITY TO HARM UNAFFILIATED OVDS

In our Petition, WGAW noted that the combination of Applicants' MVPD subscribers with AT&T's broadband assets would enhance the merged entity's incentive and ability to harm upstream content markets. We discussed how Applicants could use practices such as bundling,

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[26] Brian Fung, "AT&T: Buying DirecTV would cut our costs — but probably not yours," *The Washington Post*, June 24, 2014, http://www.washingtonpost.com/blogs/the-switch/wp /2014/06/24/att-buying-directv-would-cut-our-costs-but-probably-not-yours/.
[27] Marina Lopes and Alina Selyukh, "AT&T tells lawmakers DirecTV deal won't guarantee lower prices," *Reuters*, June 24, 2014, http://www.reuters.com/article/2014/06/24/us-at-t-directv-congress-idUSKBN0EZ1X220140624.
[28] Kevin Kelleher, "AT&T's $50 Billion DirecTV Buy Is Risky, But Probably Not Great For You," *Time*, May 19, 2014, http://time.com/104428/att-directv-merger/.
[29] Peter Suciu, "AT&T-DirecTV merger: Heavy regulatory scrutiny ahead," *Fortune*, May 21, 2014, http://fortune.com/2014/05/21/att-directv-merger-heavy-regulatory-scrutiny-ahead/.

data caps and interconnection fees to harm unaffiliated OVDs. We also highlighted AT&T's anticompetitive behavior in the wireless market as evidence of how the company can use its control of distribution to harm competition in upstream markets. Applicants have responded that because the merger involves few programming assets and DirecTV owns no broadband assets, the transaction does not affect AT&T's *ability* to harm online content markets.[30] AT&T also claims that it has no incentive to undermine unaffiliated OVDs because online video provides "an opportunity to enhance the value of its broadband offering—and thus drive greater adoption of broadband bundles."[31] Neither response is persuasive. In this section we offer additional detail on how the merger increases both the incentive and ability to harm OVDs and outline practices Applicants could engage in to harm competition in the online video market.

A. The Merger Enhances AT&T's Incentive to Harm OVDs and Establishes DirecTV's Ability to Harm OVDs

While the merger does not increase AT&T's share of broadband distribution, it substantially increases its MVPD business. If approved, AT&T's video subscriber base will increase almost three-fold as AT&T becomes the largest or second largest MVPD provider. AT&T will spend $67 billion to purchase 20 million MVPD customers, an investment that provides strong incentive to engage in behavior that limits the attractiveness of an OVD market. Online video offerings currently serve as a complement to MVPD service but as OVDs invest in high-budget original content, their growth could facilitate a decline in MVPD subscribers. In addition, a key rationale for this merger is the ability to bundle video and broadband offerings to consumers. Average revenue per user for bundled customers is higher than for customers of

[30] *Opposition*, pp. 4, 32-33.
[31] *Application*, p. 48.

standalone products and AT&T has said that bundled customers have lower churn than standalone customers.[32] Bundles of video and broadband service will remain attractive as long as alternatives such as OVDs do not develop into competitive substitutes for MVPD service. The premise of this merger, therefore, creates significant incentive to engage in behavior that limits the attractiveness of the OVD market.

The merger will significantly increase DirecTV's ability to harm the OVD market. In the *Comcast-NBC Universal Order ("Comcast-NBCU")* the Commission wrote, "While the transaction does not increase this significant share that Comcast has in distribution, that share gives Comcast an ability not possessed by pre-transaction NBCU to disadvantage rival networks that compete with NBCU networks."[33] The integration of DirecTV's MVPD business with AT&Ts broadband assets will give DirecTV an ability, not possessed prior to the transaction, to limit OVD competition.

The Commission should be concerned with the merger's effect on the online video distribution market. Like cable networks, OVDs such as Amazon and Netflix program for the widest possible national audience. They also offer a variety of original and acquired programming. Netflix and Amazon spent an estimated $1 billion on original programming in 2014.[34] Original series such as Netflix's *Marco Polo* cost an estimated $90 million to produce 10

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[32] Chris Young, "Telco video sub growth steady in Q3," *SNL Kagan*, October 28, 2014, https://www.snl.com/interactivex/article.aspx?id=29593465&KPLT=6.
[33] *Comcast-NBCU Order*, ¶ 116.
[34] Samantha Bookman, "A closer look at the billions of dollars Netflix, Amazon and Hulu are spending on original content," *FierceOnlineVideo*, June 4, 2014, http://www.fierceonlinevideo .com/special-reports/closer-look-billions-dollars-netflix-amazon-and-hulu-are-spending-original.

episodes.[35] To support this level of investment, OVDs require nationwide distribution. Given the Commission's record of establishing geographic markets based on where programming is licensed, it should likewise acknowledge a national OVD market, which will be harmed by this merger. Applicants' attempt to merge will increase the incentive of the combined company to discriminate against OVDs in order to protect the revenue generated by its video subscribers and cost-savings amassed by its scale as an MVPD.

B. Applicants Have the Ability to Institute Practices that Harm OVDs

Through the combination of Applicants' MVPD subscribers and AT&T's broadband business, the merged firm will have the ability to engage in practices that limit the competitiveness of OVDs. Such practices include negotiating restrictive distribution agreements that limit the ability of programmers to release content online, anticompetitive interconnection agreements, data caps and bundles.

1. <u>Distribution Rights</u>

As the second largest MVPD, AT&T will have significant leverage to negotiate expansive distribution rights from programmers, an outcome AT&T explicitly identifies as an objective of this merger.[36] Although AT&T frames enhanced carriage rights as creating added value for consumers and programmers, these agreements could be tailored to disadvantage competing OVDs by requiring exclusivity or limiting the window for when content can stream on competing platforms. DISH, DirecTV's closest competitor, intends to launch a virtual MVPD

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[35] Emily Steel, "How to Build an Empire, The Netflix Way," *The New York Times*, November 30, 2014, http://www.nytimes.com/2014/11/30/business/media/how-to-build-an-empire-the-netflix-way-.html?_r=0.
[36] *Stankey Declaration*, ¶¶ 6, 23.

service in 2015 and has expressed concerns in this proceeding that AT&T could use its "enlarged negotiating leverage to coerce third party programmers to grant online video rights to AT&T and to withhold these same rights from MVPDs such as DISH or online video distributors ("OVDs") like Netflix."[37]

2. Interconnection

AT&T claims that it will not handicap OVDs that its subscribers wish to access over their broadband connections. AT&T argues that subscribers would change ISPs if they had any trouble accessing OVD content.[38] However, because the wireline ISP market is dominated by local monopolists and duopolists that further employ tactics to increase switching costs, such as early termination fees, consumers have limited options for broadband service. In addition, a recent survey found that 47% of broadband users report that it would be difficult to find a broadband ISP in their neighborhood that offers the same quality as their current service.[39] As a result, ISPs can, and have, exercised their ability to degrade competing video sources.

ISPs that offer MVPD service have both the ability and incentive to degrade streaming video content. This is particularly true of ISPs that represent a significant share of broadband subscribers. The conflict between Netflix and large ISPs over interconnection demonstrates the real world ability of large ISPs to demand a toll for network traffic that its subscribers have already paid to receive.

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[37] *Petition to Impose Conditions of DISH Network Corporation*, MB Docket No. 14-90, September 16, 2014, p. 15.
[38] *Opposition*, pp. 34-35.
[39] John B. Horrigan, *Consumers and choice in the Broadband and wireless markets*, November 2014, p. 2, https://www.publicknowledge.org/assets/uploads/blog/Consumers_and_choice_in_the_Broadband_and_wireless_markets.pdf.

In the case of Netflix, AT&T and Comcast refused to upgrade peering connections either directly with Netflix or with the transit providers that Netflix has used, absent payment from the respective sender of Internet packets. This development has occurred despite the fact that settlement-free peering actually saves ISPs money because that Internet traffic would otherwise have to be carried over a paid transit connection. Every IP packet that Netflix sends has been paid to be delivered over the last mile facilities of a retail ISP by broadband subscribers yet the terminating access monopolies of large ISPs, combined with their large market shares, allows them to extract further economic rent from content providers.

AT&T will have an even greater incentive to discriminate against competing video distributors if it acquires DirecTV's 20 million U.S. customers. The primary objective of this transaction is to reduce video programming costs through greater scale, so any significant reduction in Applicants' MVPD customer base due to online competition would undermine the value of this $67 billion deal.

AT&T attempts to deflect attention from its terminating access monopoly by arguing that content providers can choose from a number of Internet transit providers. However, it fails to note that these transit providers have no way of actually delivering Internet packets to AT&T subscribers without using AT&T's last mile facilities. It further attempts to obfuscate its rent-seeking behavior by pointing to traffic imbalances as the reason for not upgrading Cogent's links. However, the direction of Internet traffic is irrelevant. As OECD analyst Rudolph van der Berg explains, "It's a common misconception that the benefit an ISP derives from peering depends upon the direction of the flow of traffic…in practice, the flow of traffic is not an issue for an interconnect. Whether it goes to or from the network, companies still need the same Cisco equipment."[40] Van der Berg also points out that the ISP may save more money than a large content provider in a settlement-free peering connection:

> In practice, it is actually quite likely that the ISP side of an ISP-YouTube relationship would see the greatest savings both in absolute costs and as a percentage of total traffic costs. Most ISPs have less traffic (and buy less transit) than YouTube and its parent Google have. Their buying power therefore is less than that of YouTube/Google, so their price per Mbps/month for transit is likely to be higher. Given that the amount of traffic saved from transit is by definition equal for both YouTube and the ISP, it follows that the ISP is saving more money.[41]

Furthermore, at a meeting of the North American Network Operators Group, peering coordinators participated in a debate about peering ratios after which, "the consensus was that this metric was neither technically sound nor business rational."[42] Interconnection consultant William B. Norton explains that peering ratios can lead to sub optimal performance, inferior quality of service and higher latency.[43]

Although AT&T and other large ISPs argue that the initial access payments required of Netflix are modest, Netflix has said that they are 150% more than its combined costs for transit, hardware, engineering and collocation to deliver Comcast subscribers' data.[44] Netflix goes on to say, "This last [access] fee would be unlawful under the 2010 open Internet rules if applied for

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[40] Rudolph van der Berg, "How the 'Net works: an introduction to peering and transit," *Ars Technica*, September 2, 2008, http://arstechnica.com/features/2008/09/peering-and-transit/2/.
[41] *Ibid.*
[42] William B. Norton, "The Folly of Peering Ratios (as a Peering Candidate Discriminator)", *DrPeering.com*, http://drpeering.net/white-papers/The-Folly-Of-Peering-Ratios.html, Accessed January 7, 2015.
[43] *Ibid*.
[44] Netflix, Notice of Ex Parte Submission, *Protecting and Promoting the Open Internet*, GN Docket No. 14-28, *Applications of Comcast Corporation and Time Warner Cable Inc. for Consent to Assign or Transfer Control of Licenses and Applications*, MB Docket No. 14-57, *Applications of AT&T, Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations*, MB Docket No. 14-90, November 5, 2014, p. 5.

transport over the last mile. Yet, Comcast's access fee is functionally the same. It merely is imposed at the point of entry into Comcast's network."[45]

There is no reason to believe that ISPs will not raise such rates further in the future. As Cogent's chief executive officer, Dave Schaeffer, notes, "Once you pay it's like blackmail, they've got you, there's nowhere else to go. They'll just keep raising the price in a market where prices [for transit] are falling."[46] Now that these ISPs have established a precedent of charging edge providers, they can raise interconnection rates over time and arbitrarily much like MVPDs have done with cable TV service.

AT&T, Comcast and Time Warner Cable also have an incentive to negotiate lower cost peering rates with Netflix during the current review of their proposed mergers to avoid scrutiny from regulators. However, if the mergers are approved, Applicants in both proceedings can resume raising rates for other OVDs in an even more consolidated retail broadband market.

3. <u>Data Caps</u>

AT&T's use of data caps is yet another way of discriminating against OVDs and may become more effective as video streaming in high-definition increases in popularity. This transaction will increase AT&T's incentive to use data caps in such a manner because DirecTV's subscribers represent a lucrative potential revenue stream and additional leverage to reduce programming costs. Clearly, AT&T considers the MVPD business valuable enough to spend $67

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[45] *Ibid.*
[46] Timothy B. Lee, "Comcast's deal with Netflix makes network neutrality obsolete," *The Washington Post,* February 23, 2014, http://www.washingtonpost.com/blogs/the-switch /wp/2014/02/23/comcasts-deal-with-netflix-makes-network-neutrality-obsolete/.

billion acquiring a company whose primary U.S. business is serving 20 million MVPD subscribers.

Although AT&T claims its data caps are sufficient for most of its customers' needs,[47] these usage allowances do not allow for online video substitution of the average number of hours Americans watch TV. AT&T's 250 GB cap translates into about 83 hours of HD video per month[48] but according to Nielsen, the average person watched nearly 156 hours of traditional and time-shifted TV per month in the third quarter of 2014.[49] Demand for video data will only increase as content providers begin using 4K or Ultra HD video, which has about four times as many pixels per frame as current 1080 HD.

Applicants' Opposition also fails to acknowledge that retail broadband is already sold with a form of usage based pricing. Typically consumers must pay more for higher bandwidth and ISPs use streaming video quality to market higher price tiers. Putting aside the absence of any evidence of network congestion, ISPs would be better off using bandwidth-based pricing discrimination to address congestion than data caps. This is because monthly data caps are too blunt to reduce heavy subscriber use during specific times of day when consumer use of Internet data increases.

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[47] *Opposition*, p. 39.

[48] Netflix, "How can I control how much data Netflix uses?," https://help.netflix.com/en/node/87, Accessed January 6, 2015. Netflix estimates an hour of HD video uses 3 GB of data.

[49] Nielsen, *Total Audience Report*, December 2014, p. 12, http://www .nielsen.com/us/en/insights/reports/2014/the-total-audience-report.html.

4. Bundling

Applicants claim the ability to offer bundled broadband, video and potentially mobile service as a major benefit of this transaction.[50] As evidence of consumer preference for bundles, Applicants note that 97% of AT&T's 5.7 million U-verse video customers opt to subscribe to bundled service and that 78% of basic subscribers to the six largest cable providers receive bundled service.[51] This evidence selectively cleaves the U-verse data most supportive of their proposed merger. Forty-nine percent of U-verse customers *only* subscribe to broadband service, demonstrating that about half of AT&T's U-verse subscribers either prefer standalone broadband or subscribe to video from a competing provider. As stated in our Petition, the ability to bundle video and broadband service is an effective way to discourage OVD substitution.[52]

The Commission has long shown a preference for protecting unbundled telecommunications services in order to safeguard consumer choice. In previous transactions, the FCC largely focused on breaking the telephone-broadband bundle. In the AT&T-BellSouth merger the Commission adopted AT&T's voluntary commitment to offer standalone broadband service for $19.95 a month as an enforceable condition.[53] Writing in the *AT&T-BellSouth Order ("AT&T-BellSouth")*, Commissioner Copps stated that the standalone condition

> clearly prevents the merging parties from tying their Internet access service to the purchase of traditional telephone service. Additionally the merged entity

[50] *Opposition*, pp. 11-12; and *Joint Opposition of AT&T Inc. and DirecTV to Petitions to Deny and Condition and Reply to Comments*, MB Docket No. 14-90, October 16, 2014, Reply Declaration of Michael L. Katz, ¶ 17.
[51] *Application*, p. 2.
[52] *WGAW Petition*, p. 21.
[53] *In the Matter of AT&T Inc. and BellSouth Corporation, Application for Transfer of Control,* Memorandum Opinion and Order, WC Docket No. 06-74, March 26, 2007, Joint Statement of Chairman Kevin J. Martin and Commissioner Deborah Taylor Tate, p. 167.

> commits to offer stand-alone DSL service at a more consumer-friendly price of $19.95/month. This should prove an enormous boon to customers who are happy with their wireless service and seek to "cut the cord" on wireline telephone service, or who want to take advantage of competing VoIP services that have the potential to lower consumer phone bills.[54]

Commissioner Adelstein wrote in *AT&T-BellSouth* that the "ability to purchase broadband services without having to buy a whole bundle of traditional telephone service" was a major victory for consumers.[55] In *AT&T-BellSouth* the Commission notably adopted stand-alone conditions despite the fact that consumers demonstrated little demand for unbundled telephone—local and long distance—and broadband services.

More recently, in its approval of the Comcast-NBC Universal merger, the Commission adopted conditions to protect standalone broadband. In its approval of the merger, the Commission held that Comcast had the ability to require consumers to subscribe to bundled services or raise the price of standalone broadband "thereby effectively tying its cable and broadband services by making the bundled option the consumer's only reasonable economic choice."[56] The Commission offered that the standalone service condition could help mitigate Comcast's ability to use its vertical properties to harm competing video distributors, writing, "[T]his threat would be reduced and future competition in video distribution markets would be protected by ensuring that consumers have the flexibility to choose an MVPD provider that is separate from their broadband provider."[57] Although AT&T is acquiring few vertical assets in

[54] *In the Matter of AT&T Inc. and BellSouth Corporation, Application for Transfer of Control,* Memorandum Opinion and Order, WC Docket No. 06-74, March 26, 2007, Concurring Statement of Commissioner Michael J. Copps, p. 171.
[55] *In the Matter of AT&T Inc. and BellSouth Corporation, Application for Transfer of Control,* Memorandum Opinion and Order, WC Docket No. 06-74, March 26, 2007, Concurring Statement of Commissioner Jonathan S. Adelstein, p. 178.
[56] *Comcast-NBCU Order,* ¶ 101.
[57] *Ibid.*, ¶ 102.

the proposed transaction, the magnitude of horizontal growth, which will confer bargaining leverage over programmers, in addition to its explicit interest in bundling services, creates a set of concerns that parallels the issues raised in Comcast-NBC Universal.

Furthermore, Applicants admit that the price of standalone services may increase as a result of this transaction, but offer that significant downward pressure on the price of bundled service will outweigh any price increases to standalone service.[58] WGAW rejects the notion that bundled service is, in itself, a public interest benefit. As Cox wrote in reply comments, "[T]he FCC should recognize that every customer deserves a fair choice and does not have to take a bundled service product from one service provider."[59] The Commission's preference for unbundled services promotes competition among distributors, allowing consumers to choose the services and providers that best meet their needs. The emergence of online video distribution has led to the development of new video applications and platforms, new creative and economic opportunities for creators, and more choices for consumers. That OVDs are becoming viable alternatives to MVPD service increases the importance of access to high-speed, affordable and standalone broadband.

VI. BROADBAND DEPLOYMENT IS NOT TRANSACTION-SPECIFIC

Applicants have stated that this merger will allow AT&T to expand fiber to the premise ("FTTP") broadband to at least 2 million customer locations and wireless local loop ("WLL") broadband to 13 million homes. Applicants claim that only this merger justifies such expansion[60] and that without scale as a video distributor, AT&T has little incentive to expand its broadband

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[58] *Opposition*, p. 6.
[59] *Cox Reply to Joint Opposition*, MB Docket No. 14-90, November 5, 2014, p. v.
[60] *Opposition*, pp. 20, 24-25.

service beyond Project Velocity IP ("Project VIP") commitments.[61] In doing so, Applicants imply that video revenues subsidize broadband deployment[62] because the ability to offer MVPD services over the same network facilities creates the return on investment necessary to justify deployment of broadband services.

Applicants' reasoning conveniently ties network investment to approval of this merger, but several other factors offer compelling evidence that the broadband deployment is not a transaction-specific benefit because it is likely to occur without the merger. First, Project VIP, announced in 2012, is a $14 billion investment in upgrading and extending AT&T's wireline and wireless broadband networks, undertaken without the need for a larger MVPD business or lower programming costs. In addition, AT&T intends to decommission its Time Division Multiplexing ("TDM") systems by 2020[63] and transition to an all-IP infrastructure. TDM is the network architecture of traditional, copper phone service. AT&T's IP commitment and ongoing network investment suggests that AT&T will replace or upgrade legacy network systems, regardless of whether this transaction is approved. And, while a wired MVPD may use its video business to fund broadband delivered over the same wires, it is difficult to comprehend how a company that, in 2013, earned $128 billion in revenue and had net income of $18 billion,[64] lacks the capital

[61] *Application*, pp. 24-29, 48.
[62] *Application*, p. 19 ("Thus as the Commission has recognized, 'broadband deployment and entry into the MVPD business are "inextricably linked."'" (internal citations omitted)); and *Stankey Declaration*, ¶ 7 ("[A national video footprint] will fundamentally and permanently shift the economics of investing in broadband."); and *Opposition*, pp. 22-23.
[63] *AT&T Proposal for Wire Center Trials, In the Matter of Technology Transitions and AT&T Petition to Launch a Proceeding Concerning the TDM-to-IP Transition*, GN Docket No. 13-5, 12-353, February 27, 2014, p. 12. The IP transition will impact 4,700 of AT&T's wire centers throughout the country.
[64] AT&T Inc., FY 2013 Form 10-K for the Period Ending December 31, 2013, (filed Feb. 21, 2014), from AT&T website, http://phx.corporate-ir.net/phoenix.zhtml?c=113088&p=irol-SECText&TEXT=aHR0cDovL2FwaS50ZW5rd2l6YXJkLmNvbS9maWxpbmcueG1sP2lwYWd

necessary to expand its broadband facilities absent a $67 billion acquisition of a competitor that has *no* network infrastructure.

A. Broadband Expansion Would Likely Occur Absent the Merger

AT&T's ongoing investment in broadband networks and its intent to decommission its TDM systems are strong indicators that broadband expansion would likely occur without the merger. AT&T's Project VIP is a $14 billion investment in the company's wired and wireless broadband network.[65] AT&T has reported that it will extend U-verse video, phone and Internet services to an additional 8.5 million locations bringing its fiber footprint to 33 million locations.[66] The project includes expansion of U-verse IPDSLAM (Internet protocol-digital subscriber line access multiplexer) phone and Internet service to 24 million customer locations and speed upgrades.[67] In addition, AT&T announced that $8 of the $14 billion would be spent to extend its 4G LTE wireless network to cover 300 million people.[68] AT&T made this investment, without significantly increasing its video business, because it must upgrade its broadband networks to remain competitive.

AT&T's U-verse service combines fiber to the node ("FTTN") and VDSL over copper lines to the premise to deliver speeds of up to 45 Mbps.[69] AT&T's IPDSLAM offering can

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lPTk0MTM4NDQmRFNFUT0wJlNFUT0wJlNRREVTQz1TRUNUSU9OX0VOVElSRSZzdWJzaWQ9NTc%3d, Accessed January 5, 2014.

[65] AT&T Press Release, "AT&T to Invest $14 Billion to Significantly Expand Wireless and Wireline Broadband Networks, Support Future IP Data Growth and New Services," November 7, 2012, http://www.att.com/gen/press-room?pid=23506&cdvn=news&newsarticleid=35661&mapcode=.

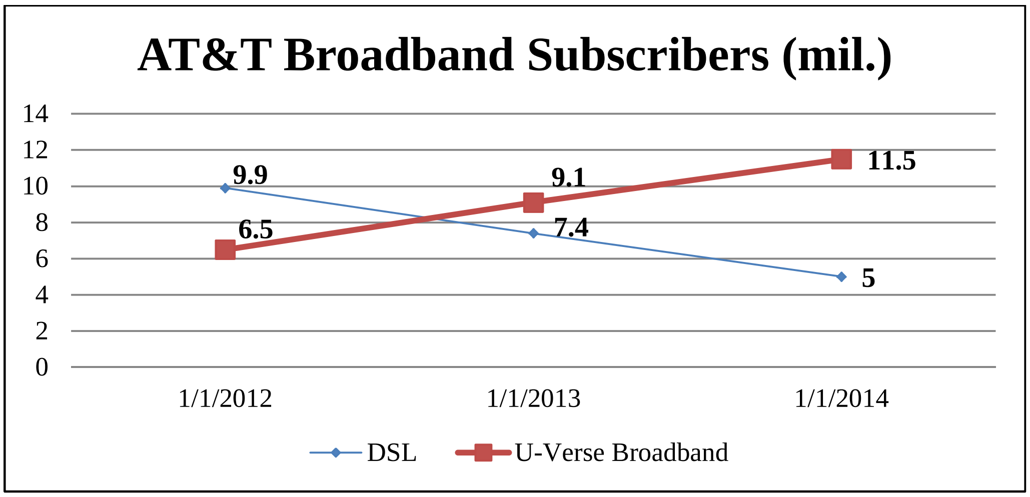
[66] *Ibid.*

[67] *Ibid.*

[68] *Ibid.*

[69] *Application*, p. 11.

deliver speeds of 18 Mbps over copper lines but cannot support MVPD service.[70] AT&T also continues to offer legacy DSL service in some markets but households must be within 3 miles of the telephone office and can only receive speeds of 6 Mbps.[71] AT&T fiber-based networks are driving its broadband growth, demonstrated by its subscriber trends.[72] In January 2012, AT&T had 10 million legacy DSL subscribers. By January 2014, AT&T had lost *half* of those DSL subscribers. During the same period U-verse broadband subscribers increased from a little over 6.5 million to 11.5 million.



While customers have displayed a clear preference for AT&T's U-verse broadband over its DSL service, AT&T must continue to invest in its networks. Cable ISPs already offer speeds of 100 Mbps and greater and fiber providers like Google now offer speeds of 1 Gbps. AT&T must continue to upgrade speeds and extend its FTTN and FTTP offerings to remain

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[70] *Ibid.*, p. 12.
[71] *Ibid.*, p. 12, fn. 14.
[72] AT&T Inc., 2013 Annual Report, Feb. 10, 2014, p.17, http://www.att.com /Investor/ATT_Annual/2013/downloads/ar2013_annual_report.pdf. In describing wireline operating results, the report states, "As we transition from basic voice and data services to sophisticated, high-speed, IP-based alternatives, we expect continued growth in our more advanced IP date products while traditional data an DSL revenues continue to decline."

competitive. These incentives exist absent the transaction, which means that the wired network upgrades offered in the context of this merger would likely occur without AT&T's purchase of DirecTV.

Project VIP's 4G LTE expansion, combined with AT&T's plans to decommission its TDM systems by 2020 also suggests that AT&T's WLL offering would happen regardless of whether this transaction is approved. Project VIP was announced the same day that AT&T petitioned the FCC to launch a proceeding on the TDM-IP transition. AT&T framed its Project Velocity investments as a response to its "traditional DSL broadband technology approach[ing] the end of its life cycle."[73]As AT&T wrote in the TDM-to-IP Transition proceeding,

> Providers are not simply infusing new technologies into their legacy network (such as last-mile copper sub-loop facilities used in FTTN architectures). Rather providers are replacing legacy networks and their associated services with new facilities and wholly new services… The end result will be the culmination of a twenty-year trend toward technological convergence.[74]

The record in the TDM-IP Transition proceeding and public statements about Project VIP clearly demonstrate that AT&T had already been planning an LTE Internet solution for households that it did not, or would no longer, provide wired service to. AT&T is well-positioned to do so—it owns most of the necessary infrastructure already including the cell towers that will host the base stations that transmit data and the spectrum that data will be sent over. In fact, AT&T's CEO of Mobility recently stated that fixed WLL is "ready to go" and that

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[73] *In the Matter of AT&T Petition to Launch a Proceeding Concerning the TDM-to-IP Transition*, GN Docket No. 12-353, November 7, 2012.
[74] *Comments of AT&T Inc., In the Matter of AT&T Petition to Launch a Proceeding Concerning the TDM-to-IP Transition, and Petition of the National Telecommunications Cooperative Association for a Rulemaking to Promote and Sustain the Ongoing TDM-to-IP Evolution*, GN Docket No. 12-353, January 28, 2013, p. 2.

AT&T envisions a 2015 launch of the service.[75] The culmination of this evidence not only suggests that AT&T's fixed wireless service is *not* a transaction-specific outcome, but that provisioning WLL allows AT&T to meet multiple policy objectives—retire TDM networks by 2020 and gain regulatory approval for the acquisition of DirecTV.

B. AT&T Does Not Need to Acquire DirecTV's Mature Video Business to Deploy Broadband

In this proceeding AT&T has claimed that acquiring DirecTV's MVPD subscribers transforms its incentive to invest in broadband because "the economic case for deploying at least some advanced broadband services, such as fiber-based architectures, has depended on the ability to provide MVPD services over those same facilities."[76] If AT&T were acquiring a wireline MVPD, this argument could make sense. However, AT&T is acquiring an MVPD without the ability to offer broadband over its satellite facilities.

AT&T has also stated that its lack of scale as an MVPD and high content costs necessitates its purchase of DirecTV. Testifying before the Senate Judiciary Committee last June, AT&T CEO Randall Stephenson stated that content costs represent 60% of U-verse video revenues, making U-verse video, as a standalone service, unprofitable.[77] While AT&T's programming costs are higher, as a percent of video revenue, than larger MVPDs, they are in line with similarly sized MVPDs. In 2013, programming expenses, as a share of video revenue, were

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[75] Todd Spangler, "AT&T Eyes Late 2015 to Launch DirecTV, High-Speed Wireless Broadband Bundle," *Variety*, September 12, 2014, https://variety.com/2014/digital/news/att-eyes-late-2015-to-launch-directv-high-speed-wireless-broadband-bundle-1201304451/#.
[76] *Application*, p. 19. (citations omitted).
[77] *The AT&T/DirecTV Merger: The Impact on Competition and Consumers in the Video Market and Beyond, Hearing Before the Senate Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights*, 113th Cong. 3 (2014) (Statement of Randall Stephenson, Chairman, CEO, and President, AT&T Inc.).

44% for Comcast, 46% for TWC and 47% for DirecTV. However, for MVPDs that are comparable in size to AT&T, such as Cablevision (2.8 million subscribers) and Charter (4.1 million), programming represented a much higher share of revenue. In 2013, programming costs were 84% of video revenue for Cablevision and 52% for Charter.

Applicants' assertion that a profitable MVPD business is necessary for a firm to have the incentive to deploy broadband is not relevant here. For most MVPDs, their primary business has been providing cable television service to customers. Because the newer technology of broadband Internet could also be offered over the wired cables that provide MVPD service, these companies used the profits of their more mature business to invest in a growth segment. But AT&T is not primarily an MVPD, having launched its video service only in 2006. Rather, a majority of AT&T's revenue comes from its wireless business. AT&T used profits from its legacy phone business to expand into the wireless industry, wired broadband and eventually MVPD service. Applicants use correlation in an attempt to prove that a profitable MVPD business is necessary for broadband, but the reality is that firms use the profits of existing businesses to fund new investments.

AT&T has no shortage of funds that could be used for broadband deployment. It is the largest communications firm by revenue and one of the most profitable. With $128 billion in revenue in 2013, AT&T eclipses the combined earnings of Comcast, TWC and DirecTV.

Comparison of Communications Firms, FY 2013[78] ($ in mil.)			
Company	Revenue	Net Income	Net Income Margin
AT&T	$128,752	$18,553	14%
Verizon	$120,550	$23,547	20%
Comcast	$64,657	$7,135	11%
DirecTV	$31,754	$2,885	9%
TWC	$22,120	$1,954	9%
CenturyLink	$18,095	($239)	-1%
Dish	$13,765	$790	6%
Cablevision	$6,232	$466	7%
Windstream	$5,988	$241	4%
Frontier	$4,762	$115	2%

In addition, there are strong indicators that demand for broadband will exceed demand for MVPD services in the coming years. According to Leichtman Research Group ("LRG") broadband subscribers grew by almost 3 million customers in the last year, to total 86.6 million broadband subscribers.[79] While there are currently more MVPD subscribers, 95.3 million according to LRG, MVPD subscriptions are beginning to decline.[80] Broadband is attractive to both consumers and ISPs. David Heger, an analyst at Edward Jones & Co. recently said, "From the point of view of a cable company, you really want to see broadband growth more so than

[78] Company Annual Financial Reports.
[79] Jim O'Neill, "As pay-TV slips, broadband in U.S. continues to grow; up 135% in Q3," *Ooyala*, November 18, 2014, http://www.ooyala.com/videomind/blog/pay-tv-slips-broadband-us-continues-grow-135-q3.
[80] Janko Roettgers, "Pay TV penetration continues to decline as new households don't get cable," *GigaOm*, September 3, 2014, https://gigaom.com/2014/09/03/pay-tv-penetration-continues-to-decline-as-new-households-dont-get-cable/.

cable-TV growth because it's much more profitable."[81] According to top Wall Street telecom analyst Craig Moffett, the gross profit margins on broadband are about 97%, a figure he has described as “almost comically profitable.”[82] AT&T’s broadband business is already larger than its video business, with subscriber data showing that about half of U-verse customers only subscribe to broadband service.[83] This low video-adoption rate counters the notion that video revenues subsidize broadband for AT&T.

While traditional cable MVPDs had to have a profitable video business in order expand into broadband service, the argument does not extend to new entrants such as AT&T, which operates profitable businesses in numerous other communications segments. In addition, consumer demand for faster broadband, popularity of OVDs, and the need to compete with other ISPs are strong incentives that will exist absent this transaction, and will require AT&T to continue investing in its broadband networks.

VII. CONDITIONS

Applicants dedicate much of their Opposition to referencing the analysis of hired economists to demonstrate that the merger will result in public interest benefits such as lower prices and wider availability of broadband. What Applicants fail to do, however, is make a firm commitment to any of these theoretically modeled outcomes. Should the Commission choose to approve this transaction, it must adopt strong, enforceable conditions that protect upstream

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[81] “Comcast shedding cable subscribers – but broadband growth more than compensates,” *Bloomberg News*, October 23, 2014, http://www.oregonlive.com/silicon-forest/index.ssf/2014/10/comcast_shedding_cable_subscri.html.

[82] David Talbot, “When Will the Rest of Us Get Google Fiber?,” *MIT Technology Review*, February 4, 2013, http://www.technologyreview.com/news/510176/when-will-the-rest-of-us-get-google-fiber/.

[83] *Application*, p. 13.

content providers as well as competition in the MVPD and broadband markets, preserve affordable services for consumers and require Applicants to deliver the benefits they claim will result from this merger. Such conditions should be in force for a period of no less than 10 years from the close of the transaction. These conditions will help mitigate some of the foreseeable harms arising from this merger but are not exhaustive and may prove inadequate to address the full spectrum of harms raised in this proceeding.

A. Competitive Pricing for Video Services Condition

As a voluntary condition, AT&T offers to maintain DirecTV's standalone video service at nationwide prices for a period of three years. AT&T offers this commitment to ensure that consumers inside AT&T's U-verse footprint continue to have access to competitively priced satellite service.[84] The Commission should adopt this as a formal condition of the merger, but require Applicants to offer standalone satellite video service for a period of ten years. As Public Knowledge suggests, the price of DirecTV video service in U-verse markets should not be allowed to exceed prices in more competitive markets.[85] Ensuring the availability of competitively priced service will provide some compensation for the reduction in competition.

B. Program Carriage and Distribution Conditions

Applicants' merger, along with the proposed merger of Comcast and Time Warner Cable, will increase MVPD buyer power in the video marketplace, driving prices below fair market values. In order to address this problem, the Commission should require binding arbitration when Applicants and programmers fail to reach a carriage agreement. Arbitration would be fair to both

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[84] *Application*, p. 80.
[85] *Petition to Deny of Public Knowledge and Institute for Local Self-Reliance,* MB Docket No. 14-90, September 16, 2014, p. 7.

parties and is commonly used to settle disputes over pricing when private negotiation fails. As Public Knowledge and New American Foundation have written, “When two parties cannot feasibly exist without the other but cannot agree on the fair market value of their services, arbitration reliably provides a workable compromise.”[86]

This merger also increases the incentive and ability of Applicants to demand distribution rights in program carriage negotiations that may limit the ability of programmers to license content to OVDs. To protect competition in the OVD market, Applicants must be prohibited from demanding exclusive distribution rights for online, mobile or other technologies from programmers or from negotiating provisions that restrict the ability of programmers to distribute content by alternative methods. Applicants should also be required to make linear programming available via third-party set-top boxes.

C. Broadband Deployment Condition

Applicants claim that as a result of this merger, AT&T will bring “new or enhanced high-speed broadband to at least 15 million customer locations,”[87] two million of which will get FTTP wireline broadband and 13 million of which will get fixed wireless Internet. The Commission should adopt this voluntary offer as an enforceable condition of this merger, and require completion of such upgrades and new service within three years of the closing date of the transaction. It is necessary for the Commission to make this an enforceable condition because AT&T recently announced it would stop investing in fiber broadband because of concerns

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[86] *Reply Comments of Public Knowledge and The New America Foundation*, MB Docket No. 10-71, June 25, 2011, p. 8.
[87] *Application*, p. 5.

regarding net neutrality regulations,[88] which raises the question of whether Applicants will follow through with promises made in this proceeding.

D. Broadband Access Conditions

Applicants have made clear that this merger is about their ability to offer bundled video and broadband service. In addition, through this merger, Applicants will become the second largest MVPD, smaller only than a merged Comcast-TWC. This significantly enhances the incentives of AT&T to protect the video business and discourage substitution of unaffiliated OVD services for its MVPD offerings. Because AT&T is one of the largest broadband providers, the Commission must adopt conditions to protect upstream OVDs and consumers from potential anticompetitive behavior by Applicants.

1. Standalone Broadband

AT&T should be required to offer a standalone broadband service of at least 10 Mbps down and 3 Mbps up for no more than $25 a month. Applicants must further agree that fixed wireless broadband will be made available as a standalone service.

2. Data Caps

Applicants should not be allowed to place data caps or implement usage-based billing other than the typical bandwidth-based tiering on its broadband services, including its fixed wireless service.

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[88] Jeff Gamet, "AT&T Stops Fiber Upgrade Over Net Neutrality Fight," *The Mac Observer,* November 12, 2014, http://www.macobserver.com/tmo/article/att-stops-fiber-upgrade-over-net-neutrality-fight.

3. Interconnection

Applicants should not be permitted to charge an access fee for peering and must agree to quickly upgrade any interconnection point that reaches 70% capacity.

4. Competitive Access to Applicants' Broadband Networks

As noted throughout our Reply, this transaction will give AT&T the market power to negotiate expansive licensing rights from programmers. The combination of traditional media rights, AT&T's OVD affiliates and expansive broadband holdings will give AT&T increased incentive to harm independent OVDs. The Internet as an open platform is best protected by having multiple ISPs, rather than having market power vested in a few large providers. To promote competition in the broadband market, the combined company must offer competitively priced, wholesale open access of its broadband facilities to competitive ISPs. AT&T must also agree not to interfere with or discriminate against data transmitted over its network to subscribers of an unaffiliated ISP.

E. Net Neutrality Condition

As our Reply has demonstrated, Applicants will have increased incentive and ability post-transaction to discourage substitution of MVPD service with OVD offerings, through anticompetitive interconnection agreements, data caps and bundling. The Commission should require Applicants to abide by the 2010 Open Internet Rules until new rules are adopted by the FCC. This condition should not be time limited and should only be superseded by stronger Commission rules, such as reclassification. AT&T must agree to abide by the new rules even if they are contested in court.

VIII. CONCLUSION

The merger of AT&T and DirecTV will reduce competition in the MVPD market, harming consumers and upstream content producers. It will also threaten competition in the burgeoning online video market. While the harms presented by this transaction are clear, the benefits are elusive. Applicants expound the virtues of bundled service and their ability to lower operating costs through their enhanced scale as a distributor. However, these benefits will substantially flow to the merged entity and not to consumers. WGAW also believes that AT&T will have the same incentives to invest in broadband regardless of whether this transaction is approved. In the case of fixed wireless, AT&T will be able to use WLL to move consumers off of aging copper networks. In competitive markets like Los Angeles and Austin, AT&T must upgrade to FTTP systems in order to compete with fiber providers such as Verizon and Google. For these reasons, the FCC should deny the Applicants' petition. However, if the Commission decides to approve the transaction, it should adopt the aforementioned conditions in order to protect consumers and promote competition.

Respectfully submitted,

____________/s/__________________
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DECLARATION

I declare under penalty of perjury that the facts contained within the foregoing Reply are true and correct to the best of my information, knowledge, and belief.

Executed on January 7, 2015

____________/s/_________________
Marvin Vargas
Senior Research & Policy Analyst
Writers Guild of America, West

CERTIFICATE OF SERVICE

I, Marvin Vargas, Senior Research and Policy Analyst for the Writers Guild of America, West, Inc., certify on this 7th day of January, 2015, I caused true and correct copies of the foregoing letter and Petition to Deny to be served via electronic mail on the following parties listed below:

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