July 2, 2015

Via ECFS

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Applications of AT&T and DirecTV for Consent to Assign or Transfer Control of Licenses and Authorizations; MB Docket No. 14-90

Dear Ms. Dortch:

On July 2, 2015, J Lyn Findley, President and Chief Executive Officer of enTouch Systems, Inc. (“enTouch”), and Danny White, enTouch Director-Product Management, via teleconference, and Ross J. Lieberman, Senior Vice President of Government Affairs, American Cable Association (“ACA”), and the undersigned, representing ACA, met with Gigi B. Sohn, Counselor to Chairman Wheeler, and Christopher Laughlin and Matthew Diaz, Legal Interns, Office of Chairman Wheeler, to discuss the difficulty enTouch has encountered in reaching a fair deal with Root Sports Southwest, the regional sports network (“RSN”) jointly owned by AT&T and DirecTV in the Houston area, and its bearing upon the issues under consideration by the Commission in the above-referenced review.¹

During the meeting, Mr. Findley explained why he believes that enTouch is being treated in a discriminatory and unfair manner by AT&T and DirecTV in programming negotiations for Root Sports Southwest, and why he believes that treatment will get worse once they merge. Mr. Findley attributed the RSN’s demands for discriminatory and above fair market value rates from enTouch and its customers to two facts, consistent with his description of the problem in the letter (attached) he sent to Chairman Wheeler on June 30, 2015: (i) enTouch is a disruptor in the marketplace and successfully provides head-to-head competition to both AT&T U-verse and DirecTV in the Houston metropolitan area, giving the co-owners the incentive and ability to raise their rival’s costs and (ii) the RSN has granted a most favored nation clause at an artificially high price to another MVPD in the market, thereby setting a price floor that adversely affects enTouch’s ability to negotiate for fair market pricing.²

Despite facing intense competition from AT&T U-verse in about 66 percent of its market and from DirecTV across its entire market, enTouch has been able to attract 26,000 customers (out of 45,000 homes passed) through the attractiveness of its competitive offerings. Mr. Findley stated that enTouch is not afraid to compete head-to-head, but has been placed between a rock and a hard place by AT&T and DirecTV’s “take-it-or-leave-it” pricing stance for the RSN, which enTouch must

² See Applications of AT&T and DirecTV for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 14-90, Letter from J Lyn Findley to FCC Chairman Tom Wheeler (filed June 30, 2015).
have in order to retain and attract the subscribers necessary to justify its multimillion dollar investment in its fiber-to-the-home 1 Gigabit broadband network and have sufficient capital to continue to invest in deploying its 1 Gig service.

As bad as the situation is today with AT&T and DirecTV jointly owning the RSN as separate entities, Mr. Findley explained that he fears it will be that much worse once the companies are combined. Merged AT&T/DirecTV will have lower costs, higher profits and be a stronger competitor than either company standing alone. The merged entity also will be in a stronger bargaining position because it will be more likely to attract consumers away from enTouch if a carriage agreement cannot be reached than would be possible as separately run companies. In light of this, Mr. Findley stated the combined companies will negotiate for higher prices with enTouch knowing the upside of not reaching an agreement is now even better than before. Mr. Findley’s real-world account of the why the AT&T/DirecTV transaction will increase the combined company’s incentive to charge higher prices to its competitors, is fully consistent with rationale based on economic theory as described in University of North Carolina Professor Gary Biglaiser’s economic report submitted as part of ACA’s initial comments in the proceeding.\(^3\) ACA noted that the record lacks any specific response to these arguments.

Mr. Findley explained that enTouch considered, but rejected seeking relief from the Commission under the program access rules, because he felt the rules were stacked against enTouch because they either don’t cover the type of behavior he is seeing – a practice of charging uniformly high prices to the RSN’s owner as well as other distributors – or would require comparison between enTouch and an overlapping distributor when the only overlaps enTouch has are with much larger distributors, including the RSN’s owners themselves. Mr. Findley stated that he was reaching out to the Commission while it considers whether to approve the merger between AT&T and DirecTV to put it on notice that such discriminatory and unfair behavior was not only already occurring in the marketplace, but likely to intensify post-merger.

Finally, meeting participants discussed ACA’s request that to address harms like those described by enTouch, the Commission impose, as a condition of approval of the license transfer applications in this proceeding, a non-discriminatory access condition and a commercial arbitration condition, based on precedents developed by the Commission in the past in proceedings involving combinations of “must have” multichannel video programming distributor programming and distribution assets, with the improvements detailed by ACA in reply comments filed with the Commission in this proceeding.\(^4\) Mr. Findley affirmed that these remedial conditions absolutely would be of help to enTouch and other small providers who now effectively face only the stark options when negotiating with their direct competitors of carrying the RSN at inflated prices and losing subscribers unwilling to pay such high rates or not carrying the RSN and losing subscribers to AT&T U-verse and DirecTV, their primary competitors. Mr. Findley urged the Commission not to approve the AT&T/DirecTV transaction without adopting these conditions.

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\(^3\) Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 14-90, Comments of the American Cable Association, Exhibit A, Gary Biglaiser, The Harms of AT&T-DirecTV Merger (filed Sept. 15, 2014).

\(^4\) Applications of AT&T and DirecTV for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 14-90, Reply of the American Cable Association at 3-14 (filed Jan. 7, 2015). See also Applications of AT&T and DirecTV for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 14-90, Letter from Barbara Esbin, Counsel to the American Cable Association, to Marlene H. Dortch, Secretary (filed May 1, 2015); Letter from Barbara Esbin, Counsel to the American Cable Association, to Marlene H. Dortch, Secretary (filed June 9, 2010).
This letter is being filed electronically pursuant to section 1.1206 of the Commission’s rules.

Sincerely,

Barbara Esbin

Enclosures (1)

cc: Gigi Sohn
    Christopher Laughlin
    Matthew Diaz
June 30, 2015

VIA ECFS

The Honorable Thomas Wheeler
Chairman
Federal Communications Commission
455 12th Street, SW
Washington, DC 20544

Re: Ex Parte Submission, Applications of AT&T Inc. and DirecTV To Transfer Control of
FCC Licenses And Other Authorizations, MB Docket No. 14-90

Dear Chairman Wheeler:

I am writing this letter to bring to your attention the troubling situation my company, enTouch Systems, Inc., a Houston-area quad-play provider, is currently facing in its carriage negotiations with Root Sports Southwest, a regional sports network (RSN) jointly owned by AT&T and DirecTV. Due to the fact that my company provides robust head-to-head video competition to both AT&T U-verse and DirecTV and the fact that the RSN has granted a most favored nation (MFN) clause to another MVPD in the market, the RSN is now demanding discriminatory and above fair market value rates from enTouch and its customers. I encourage you to take account of the circumstances surrounding my company’s difficulties in reaching a fair deal with AT&T/DirecTV’s RSN as you determine whether the AT&T/DirecTV transaction should be approved, and what conditions should be adopted to mitigate the expected harms to consumers and competition.

enTouch Systems was founded in 1995 to provide residential and business customers in the Houston metropolitan area with an alternative choice for bundles of local and long distance voice, digital cable television, broadband Internet access and alarm monitoring services. Today, these services, which include a first-to-market one Gigabit broadband service,¹ are provided by enTouch over a state-of-the-art fiber-to-the-home (FTTH) network that cost the company tens of millions of dollars to deploy. Although we face fierce competition from AT&T U-verse in about 66 percent of our market and from DirecTV across our entire market, more than 26,000 customers (out of 45,000 total homes passed) have elected to choose enTouch over other providers.

In 2012, having deployed its FTTH network, it was vital for enTouch to attract customers, particularly from other multichannel video programming distributors (MVPDs) that also offer broadband Internet access service. This meant offering a competitive video service that included the Houston RSN which airs Houston Astros baseball and Houston Rockets basketball games. At the time, the network was owned by Comcast and called Comcast SportsNet (CSN) Houston. Very few MVPDs, including DirecTV and AT&T, were willing to pay the exorbitant rates demanded by Comcast, but as a small provider seeking to provide a competitive service in the market, we felt we had no choice but to carry the network at the rate demanded. Within a few years, unable to secure carriage with other MVPDs, CSN Houston declared bankruptcy. It was acquired recently by AT&T and DirecTV in a joint venture,


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renamed Root Sports Southwest, and the AT&T U-verse and DirecTV distribution services both entered into agreements to carry the network.

enTouch’s current contract with Root Sports Southwest expires at the end of September, and we have been negotiating a renewal for the last couple of months. Despite our best efforts to reach an amicable deal, in our last discussions, the RSN continues to demand a price that we believe to be both discriminatory and above fair market value. The fee demands are excessive considering the RSN’s low average viewership in the market relative to that of other RSNs in other markets, the fact that AT&T/DirecTV recently acquired the RSN from its former owner on the cheap and the fact that the Astros and Rockets have lowered their fees for airing their games. Given these facts, one would think that the RSN would agree to rates significantly lower than those previously offered by Comcast and rejected by most MVPDs in the market, including AT&T and DirecTV themselves. That, however, is not the case. I believe there are two primary reasons why Root Sports Southwest is demanding these discriminatory and above fair market value fees from enTouch and maybe others.

First, enTouch has been very successful in the market against AT&T U-verse and DirecTV since we launched our service. To their dismay, we have been able to convince many of their customers to become enTouch customers. Before acquiring Root Sports Southwest, AT&T and DirecTV’s only means of stemming customer losses to enTouch was by offering an equally good or better quality MVPD service and offering service at an equal or lower price. However, with the acquisition of Root Sports Southwest, AT&T and DirecTV have a new means of undermining the competitive threat from enTouch. These companies can deny access to “must have” affiliated programming or, in the alternative, charge higher prices for it. We believe that AT&T, DirecTV, and Root Sports Southwest’s current negotiating tactics stem directly from their recognition that they will benefit financially from denying enTouch access to Root Sports Southwest because each MVPD will sign up unhappy enTouch customers desiring a video service that includes Root Sports Southwest. However, they also recognize that Root Sports Southwest benefits from entering into a carriage deal with enTouch because of the affiliate fee revenue such a deal generates. To reconcile these competing interests, AT&T and DirecTV can maximize their joint economic interests by simply charging head-to-head rivals, like enTouch, higher prices than non-rivals. The higher prices they charge rivals offset the lost profits they would have achieved had the programming not been sold at all. We believe this party accounts for the high prices demanded of us.

Second, we have been told that Root Sports Southwest cannot offer us rates that take into account current marketplace considerations because the network must comply with an MFN in its contract with Comcast that was negotiated at a time when Comcast had a stake in the RSN. According to court documents, when Comcasts acquired a stake in the RSN in 2010, Comcast agreed to pay an “artificially inflated price” in exchange for receiving an MFN. Under the clause, if the RSN entered into an affiliation agreement with a subsequent distributor for a lower rate, Comcast would be entitled to reduce its base rates to equal the rate of the subsequent affiliation agreement. Although Comcast agreed to pay higher than market rates, as a stakeholder in the network, the artificially higher price was mostly costless — nothing more than a pocket-to-pocket transfer. The inflated price, combined with its MFN, made it likely that other MVPDs in the market would pay no less than the artificially high price paid by Comcast because the RSN would be unlikely to enter into a deal that would reduce the revenue it receives from Comcast. As a stakeholder, Comcast thus benefited financially from its rivals paying artificially higher

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prices. This scheme permitted the RSN to charge Comcast's rivals above fair market value rates without being overtly discriminatory, thus lessening the chance of being subject to a program access complaint.

This "soak the competitor" philosophy exhibited by Comcast ultimately was not as successful as Comcast and other network stakeholders had hoped, but demonstrates the perverse incentives of vertically integrated operators and programmers. It also demonstrates that even failed attempts by vertically integrated entities to act on incentives to disadvantage rivals can harm competition and consumers. Specifically, some MVPDs, like enTouch, that carried the network for years now realize they and their customers were charged artificially higher rates for this programming. Other MVPDs, who refused to carry the network, ended up losing subscribers to MVPDs, like Comcast, that were carrying the network. Disappointingly, this philosophy has been retained by AT&T and DirecTV, who similarly claim now in our negotiations over Roots Sports Southwest that they can't give us a materially better rate for our subscribers because they can't afford to give that same rate to Comcast as required by the existing MFN. Even after Root Sports Southwest's contract expires with Comcast, we fear that AT&T and DirecTV will have the same incentives as Comcast to enter into a similar scheme of paying Roots Sports Southwest above fair market value rates and securing for themselves an MFN that establishes a price floor on carriage fees for other MVPDs that interferes with what should be otherwise be arm's length negotiations.

enTouch has considered filing a complaint under the program access rules, but does not believe that relief can be obtained due to flaws in the process. First, to the extent that the largest cable operator in the market is paying an artificially high rate due to an MFN clause, it may reflect that Roots Sports Southwest is engaging in a uniform pricing strategy, which would make filing a complaint about price discrimination ineffective. Second, even if there is no uniform pricing strategy, the rules do not permit enTouch to bring a complaint comparing itself to another similarly sized MVPD. enTouch would have to compare itself to a head-to-head competitor that carries the RSN, which today includes only AT&T, DirecTV, Comcast, and Consolidated. Since each of these companies serves many more customers than enTouch, it would be difficult, if not impossible, to demonstrate to the Commission whether enTouch is facing the type of discrimination that the program access rules prohibit.

We are concerned about the AT&T and DirecTV merger because once the two companies combine, they will be more profitable than either standing alone, giving them an increased incentive and ability to charge even higher prices for their jointly owned RSN programming than if they remained separate companies. For this reason, we urge the Commission not to approve the pending merger involving these companies unless conditions are imposed that mitigate this and other merger-specific harms. It is our understanding that the Commission is considering adopting two types of conditions, with improvements for smaller operators, that were previously adopted by the Commission to address the problems similar to those facing enTouch: a non-discriminatory access condition (enforced through the program access complaint process) to protect against discriminatory practices and a commercial arbitration remedy to protect against the imposition of above-fair market value pricing through a uniform price increases strategy. We also understand the Commission is considering a condition that would prevent AT&T and DirecTV from entering into an agreement with their RSNs that would interfere with a company like enTouch from entering into an agreement with third-party programmers at fair rates. We hope the Commission would adopt all of these conditions because these remedies, if adopted, would definitely benefit competition and consumers by tempering the anticompetitive activities of AT&T and DirecTV.

I note that enTouch isn't the first operator to face difficulties negotiating non-discriminatory and fair market value deals with cable-affiliated RSNs, and not even the first with Root Sports. Setting aside the very public difficulties that MVPDs have had securing carriage of RSNs in Los Angeles, there is irrefutable evidence that DirecTV's Root Sports Pittsburgh demanded rates above fair market value from
the small cable operator Armstrong Utilities. Luckily, since DirecTV was subject to a non-discriminatory access condition and a baseball style arbitration remedy under the terms of the FCC’s transfer of control of DirecTV from News Corp. to Liberty Media, Armstrong had the right to take DirecTV to arbitration for its unreasonable demands. It exercised its right, and after a long and costly battle that few if any other smaller operators today would endure, an arbitrator ruled against DirecTV – a decision that was affirmed by the FCC in 2014.

In closing, if AT&T and DirecTV, as joint owners of Root Sports Southwest are willing to treat enTouch unfairly in our negotiations while they are under scrutiny by the Commission in this proceeding, then I suspect they will treat other MVPDs in the same way in their future negotiations as they and other vertically-integrated programmers have done in the past. To protect consumers and competition, I hope the Commission will not approve the AT&T and DirecTV transaction unless there are sufficient conditions to address the problems that enTouch is facing in its current negotiations.

Thank you for your consideration.

Sincerely,

J Lyn Findley
President and Chief Executive Officer