

**Maureen R. Jeffreys**  
Maureen.Jeffreys@aporter.com  
+1 202.942.6608  
+1 202.942.5999 Fax  
555 Twelfth Street, NW  
Washington, DC 20004-1206

October 16, 2014

**VIA ECFS**

Marlene H. Dortch, Esq.  
Secretary  
Federal Communications Commission  
445 Twelfth Street, SW  
Washington, DC 20554

**Re: *Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations*, MB Docket No. 14-90**  
**REDACTED – FOR PUBLIC INSPECTION**

Dear Ms. Dortch:

Pursuant to the *Modified Joint Protective Order* that was issued in the above-referenced proceeding,<sup>1</sup> AT&T Inc. and DIRECTV are filing herewith, via ECFS, the **redacted** public version of the Joint Opposition of AT&T Inc. and DIRECTV to Petitions to Deny and Condition and Reply to Comments. An unredacted Highly Confidential copy of the submission is being hand delivered to your office. Additional copies of the unredacted submission are being delivered to the Commission Staff.

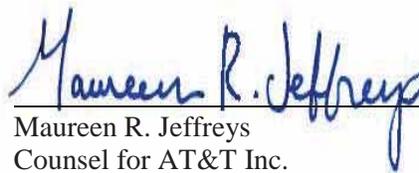
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<sup>1</sup>*Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations*, Modified Joint Protective Order, DA 14-1465 (MB rel. Oct. 7, 2014) (“*Modified Joint Protective Order*”).

Marlene H. Dortch  
October 16, 2014  
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Please contact me at (202) 942-6608 or [Maureen.Jeffreys@aporter.com](mailto:Maureen.Jeffreys@aporter.com) if you have any questions. Thank you for your assistance.

Respectfully submitted,



Maureen R. Jeffreys

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Maureen R. Jeffreys  
Counsel for AT&T Inc.

Enclosure  
cc (via email): Daniel Ball  
Jim Bird  
Brendan Holland  
Vanessa Lemmé  
Christopher Sova  
Best Copy and Printing, Inc.

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***Before the***  
**Federal Communications Commission**  
**Washington, D.C. 20554**

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

**JOINT OPPOSITION OF AT&T INC. AND DIRECTV TO  
PETITIONS TO DENY AND CONDITION AND REPLY TO COMMENTS**

D. Wayne Watts  
David R. McAtee II  
AT&T Inc.  
208 South Akard Street, Room 3303  
Dallas, TX 75202  
Telephone: (214) 757-3319

Lori Fink  
Gary Phillips  
AT&T Inc.  
1120 20<sup>th</sup> Street, NW, Suite 1000  
Washington, DC 20036  
(202) 457-3055

*Of Counsel:*  
Arnold & Porter LLP  
555 12<sup>th</sup> Street, NW  
Washington, DC 20004  
(202) 942-6608

Kellogg, Huber, Hansen,  
Todd, Evans & Figel, PLLC  
1615 M Street, NW, Suite 400  
Washington, DC 20036  
(202) 326-7902

October 16, 2014

Larry D. Hunter  
DIRECTV  
2260 East Imperial Highway  
El Segundo, CA 90245  
310-964-5000

Stacy R. Fuller  
DIRECTV, LLC  
901 F Street, Suite 600  
Washington, DC 20004  
(202) 383-6300

*Of Counsel:*  
Harris, Wiltshire & Grannis LLP  
1919 M Street, N.W., 8<sup>th</sup> Floor  
Washington, D.C. 20036-3537  
(202) 730-1350

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**I. EXECUTIVE SUMMARY**

**A. The Comments and Petitions Largely Validate the Transaction's Substantial Benefits for Consumers and Competition**

In their Public Interest Statement and related filings, AT&T and DIRECTV (the “Applicants”) demonstrated that their proposed merger will benefit consumers by combining the complementary strengths of each company: DIRECTV’s satellite video service and AT&T’s broadband networks. In particular, the marriage of these complementary assets will not only produce better bundled services for consumers, but it will also invigorate competition in a space long-dominated by cable. Indeed, *even before* factoring in a single dollar of cost savings from the transaction, the detailed econometric evidence establishes that the merger will result in lower prices for the AT&T video/broadband bundle *and* rival cable products and that overall consumer welfare will be enhanced. This evidence, which opponents do not rebut, sets this transaction apart.

Neither do opponents seriously dispute that the merger will produce significant cost savings. This concession is also significant, for the record demonstrates that, even under a conservative estimate, those cost savings will benefit the public in two powerful ways. First, they will put even greater downward pressure on video and broadband prices, generating net consumer welfare benefits in the range of \$940 million to \$1.44 billion annually. Second, combined with the addition of DIRECTV’s profitable video product outside of AT&T’s current video footprint, these cost savings will fundamentally improve the economics of AT&T’s broadband investments in urban and rural communities alike.

While DIRECTV offers an exceptional video product, the benefits of this transaction lie as much in broadband as in video. Once combined with DIRECTV, AT&T will deploy new

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high-speed broadband services to at least 15 million customer locations beyond its current plans. Within its wireline footprint, AT&T will extend its ultra-fast, fiber-to-the-premises (“FTTP”) GigaPower wireline broadband service with speeds of up to 1 Gbps to at least 2 million locations. At the same time, in rural, often underserved areas, AT&T will deploy fixed wireless local loop (“WLL”) broadband to an additional 13 million locations. Designed to perform as well as wireline broadband services advertised today at speeds of 15-20 Mbps, fixed WLL represents the nation’s best opportunity to begin bridging the growing digital divide between urban areas, which enjoy a rich variety of high-speed broadband options, and rural communities with few, if any, choices. Almost 20 percent of the locations where AT&T’s fixed WLL service would be available have no access to terrestrial broadband services, and an additional 27 percent have only one such option. To consumers in these locations especially, the benefits of this transaction cannot be overstated.

Significantly, the comments and petitions filed in this proceeding do not rebut these substantial, direct, and verifiable benefits. Most simply do not address them, and, of those that do, many confirm their existence. The Communications Workers of America (“CWA”), for example, supports the merger unequivocally, stating that “[t]he proposed AT&T/DIRECTV combination provides substantial public interest benefits for consumers, workers, and the U.S. economy” and that the combined company “will have the economic incentives to increase investment in the high-capacity broadband networks that are so essential to drive economic growth, jobs, and the social benefits enabled by high-speed digital networks.”<sup>1</sup> Likewise, the AFL-CIO asserts that “a merged AT&T/DIRECTV will provide consumers across the nation a

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<sup>1</sup> Comments of Communications Workers of America at 1, 11 (filed Sept. 16, 2014) (“CWA Comments”).

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one-stop shop for a bundled broadband/video service” and that the transaction “will improve the economics for high-speed broadband expansion, which is critical to economic growth and job creation in rural and urban communities across our nation.”<sup>2</sup> Microsoft confirms that Applicants’ commitments to offer new or enhanced wireline and wireless broadband to 15 million more locations “clearly advance[] a critical national broadband objective with respect to investment in and deployment of high-speed broadband access services across the U.S.”<sup>3</sup> Even the American Cable Association (“ACA”) concedes that these same commitments “may have significant value.”<sup>4</sup>

Perhaps predictably, some opponents contend in a conclusory fashion that the merger’s asserted benefits are, in one respect or another, overstated or unrelated to this transaction. But those claims are uniformly contrary to the record, including the detailed, unrebutted economic evidence of the transaction’s beneficial effect on price and sworn declarations demonstrating that this transaction will enable far greater broadband deployment than AT&T could otherwise justify.

**B. The Comments and Petitions Do Not Demonstrate Any Public Interest Harm from This Transaction**

Rather than dispute the substantial benefits of the transaction, opponents attempt – without success – to show a variety of alleged harms. For example, a few commenters use crude measurements of increased concentration for MVPD services to claim that the transaction will harm competition. But, as Applicants have shown, broad-brush concentration figures ignore the

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<sup>2</sup> Letter from Richard L. Trumka, President AFL-CIO at 1 (filed Sept. 11, 2014) (“AFL-CIO Letter”).

<sup>3</sup> Letter from Frederick S. Humphries Jr., Vice President, US Government Affairs, Microsoft at 2 (filed Sept. 16, 2014) (“Microsoft Letter”).

<sup>4</sup> Comments of American Cable Association at 3 (filed Sept. 16, 2014) (“ACA Comments”).

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critical fact that AT&T's broadband service and DIRECTV's video product are complements. Recognizing this market reality, Applicants have presented detailed econometric analyses from Professors Katz, Berry, and Haile that consider relevant market evidence, including the complementary nature of these assets and the differentiation among firms and products in the industry. These analyses establish that the merger will result in downward pressure on prices for the merged firm's integrated bundles *and* for the products of competing cable operators. They also make clear that consumer welfare will be preserved or enhanced, *all before* taking the undisputed efficiencies and quality improvements from the transaction into account. Again, these analyses are unrebutted. No opponent has even responded to them, much less challenged their conclusions.

Opponents are no more persuasive in arguing that the merger will cause the combined company to discriminate against over-the-top ("OTT") distributors or content.<sup>5</sup> As a threshold matter, the argument fails because DIRECTV would not bring any broadband assets to AT&T's network. As a result, the merger would not enhance AT&T's ability to discriminate against OTT content. Beyond that, however, the argument ignores the powerful incentives that the merged firm will have to continue to support and expand access to online video services. Simply put, AT&T is a company focused on broadband, and it cannot sell broadband to new customers (or retain existing customers) if it does not provide high-quality access to the full array of content that consumers want. To drive broadband adoption, AT&T has long supported unfettered access to OTT services, and it has made significant investments to ensure that customers enjoy all that the Internet has to offer. With this transaction, those investments will only increase, creating an

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<sup>5</sup> For purposes of this Joint Opposition, "OTT" encompasses online video distributors ("OVDs"), edge providers, and similar industry participants.

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even greater incentive for AT&T to deliver all the online content customers want in the way they want to consume it. Moreover, AT&T has committed to adhere to the 2010 Open Internet rules, including their prohibition on unreasonable discrimination, for three years after the merger's closing.

**C. Many Comments and Petitions Advance Alternative Agendas That Are Not Connected to the Transaction**

The remainder of opponents' filings reflect particular regulatory or business agendas that are unrelated to this transaction and provide no basis to find any harm to the public. For instance, Netflix seeks to use this proceeding to rehash misleading allegations about AT&T's prior conduct. Those claims are not only irrelevant to this transaction; they are inaccurate.

As detailed in the declaration of AT&T Senior Vice President of Network Planning and Engineering Scott Mair, AT&T did not, as Netflix asserts, allow Netflix traffic to become congested. Rather, Netflix's own business decisions caused its traffic to spike to the point where it was overtaxing the connections Netflix had selected to route its traffic to AT&T's network. To resolve this issue, AT&T and Netflix entered into a commercially reasonable long-term contract under terms favorable to Netflix. Now, even by Netflix's own account, the new arrangement is working well for Netflix and its customers. Nothing about this history suggests the need to apply conditions on this transaction.

Similarly, Cogent hopes to distort AT&T's uniform, reasonable, and industry-standard peering practices. Cogent's transparent attempt to avoid legitimate business negotiations and persuade the Commission to impose onerous, one-sided obligations on AT&T should be rejected.

In all events, there is no legal or policy basis for using this proceeding to supplant a functioning marketplace for Internet peering and interconnection with ad hoc new regulation.

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Content providers have a multitude of options to transport traffic over the Internet backbone, and this transaction will not alter that fact. In its 2010 Open Internet Order, the Commission declined to regulate these same backbone relationships, and the Commission is just beginning a new inquiry on what Netflix and Cogent concede are industry-wide issues. That new inquiry is the proper forum to decide on a future course of action, not this proceeding.

In the same way, there can be no legitimate concern with the programming matters raised by some opponents. Under Commission precedent, including the *Comcast/AT&T Broadband* decision, there is no question that the combined firm will *not* have sufficient size to exercise monopsony power in content acquisition. In addition, because Applicants own very little content, there is no reason to apply program-access requirements beyond those already contained in the Communications Act. Finally, DIRECTV's contract with the NFL to carry out-of-market Sunday football games is the sort of arm's-length agreement that the Commission has properly understood to be pro-competitive. Especially when it permits cable providers to enter into exclusive agreements for *affiliated* programming, there is no reason for the Commission to impose different rules here, where the programming is *unaffiliated*.

Other opponents raise such diverse topics as PEG programming, data roaming, and access to orbital slots. All of these claims are unrelated to this transaction. Consistent with established precedent, the Commission should reject attempts to inject these extraneous matters into this proceeding.

**D. AT&T's Voluntary Commitments Contribute to the Transaction's Pro-Consumer Benefits and Address Any Concern Over Alleged Countervailing Harms**

Finally, AT&T's voluntary commitments will independently bind the combined company and provide the Commission with further assurance that the transaction is in the public interest.

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In particular, AT&T has resolved to make the following commitments, some of which have been mentioned above:

- AT&T will expand and enhance high-speed broadband service to 15 million customer locations, mostly in underserved rural areas where AT&T does not today provide high-speed broadband service. The expansion will rely on a combination of technologies, including FTTP and fixed WLL capabilities. This commitment will be completed within four years after the transaction closes.
- In areas where AT&T currently offers wireline IP broadband service, the combined company will, for three years after closing, continue to offer standalone wireline broadband service at reasonable market-based prices, including a service with speeds of at least 6 Mbps down (where feasible) at a 12-month price no greater than \$34.95 per month (provided that the price can be increased by no more than any increase in the Consumer Price Index for All Urban Consumers (CPI-U) for Communications every 12 months starting 12 months following deal close).
- The combined company will offer, for three years after closing, standalone DIRECTV satellite video service at nationwide package prices that do not differ between customers in AT&T's wireline footprint and customers outside that footprint.
- For three years after closing, AT&T will continue its commitment to the FCC's Open Internet protections established in 2010, regardless of whether the FCC re-establishes such protections for other industry participants in the wake of the D.C. Circuit's vacatur of the 2010 rules.

AT&T expects that the competition stimulated by the transaction will itself lead to these and other pro-consumer outcomes for years to come. These commitments, however, demonstrate AT&T's conviction that the transaction will fundamentally improve the economic case for new broadband investment, reinvigorate DBS video service as a competitor to cable, and promote new, rich OTT video offerings.

**E. Conclusion**

The responses filed in this proceeding confirm that this transaction is strongly in the public interest. The transaction's benefits are real, verifiable, and largely undisputed.

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Opponents' efforts to show countervailing harm to consumers are unpersuasive and, in many cases, transparent attempts to advance parochial agendas. On this record, including AT&T's voluntary commitments, the Commission should approve the transaction swiftly.

**II. THE TRANSACTION WILL DELIVER SUBSTANTIAL, DIRECT, AND VERIFIABLE BENEFITS TO CONSUMERS**

In their Public Interest Statement and accompanying materials, Applicants demonstrated that the proposed transaction will result in improved services and better bundles of services for tens of millions of consumers.<sup>6</sup> In addition, the detailed, extensive, and unchallenged economic analyses provided by Applicants project that consumers will benefit from lower prices for bundled services from *both* the combined firm and competing cable operators, even before accounting for merger efficiencies.<sup>7</sup> AT&T will also achieve significant and verifiable content cost savings and other synergies as a direct result of the transaction. Together, these benefits will enable AT&T to expand its broadband reach to approximately 15 million additional customer locations, of which 13 million are in largely underserved rural areas.<sup>8</sup> These new customer locations are in addition to the broadband deployment that AT&T had planned prior to the transaction, as well as over and above any further expansion that would be economically feasible

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<sup>6</sup> See Description of the Transaction, Public Interest Showing, and Related Demonstrations at 29-33 (filed June 11, 2014) ("Public Interest Statement"); Declaration of John T. Stankey, Group President and Chief Strategy Officer AT&T Inc. ¶¶ 26-32 (June 10, 2014) ("Stankey Decl.").

<sup>7</sup> Declaration of Michael L. Katz ¶¶ 85-92 (June 11, 2014) ("Katz Decl."); Reply Declaration of Michael L. Katz ¶¶ 2, 10-12, 55-56 (Oct. 15, 2014) ("Katz Reply Decl."); *Quantitative Analysis of an AT&T-DIRECTV Merger*, Presentation of Steve Berry and Phil Haile at 14-18 (filed July 17, 2014) ("Berry-Haile July 15 Quantitative Analysis Presentation"); *Quantitative Analysis of an AT&T-DIRECTV Merger: Additional Discussion of Modeling Choices, Data, and Results*, Steven T. Berry and Philip A. Haile at 8 (filed Sept. 23, 2014) ("Berry-Haile Quantitative Analysis"); *Quantitative Analysis of an AT&T-DIRECTV Merger: Updated Results*, Presentation of Steve Berry and Phil Haile at 16-18 (filed Sept. 23, 2014) ("Berry-Haile Sept. 19 Quantitative Analysis Update Presentation").

<sup>8</sup> See Public Interest Statement at 32, 39-45; Stankey Decl. ¶¶ 33-55.

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without the synergies created by the transaction.<sup>9</sup> Further, the combination of AT&T's broadband network expertise and DIRECTV's video expertise and engineering resources will promote innovation in OTT products and broadband-based consumer equipment.<sup>10</sup> In short, the transaction will deliver the kind of near-term, verifiable, transaction-specific public interest benefits that the Commission regularly has credited in approving previous transactions.<sup>11</sup>

Many of the comments and petitions filed in this proceeding, including those from parties seeking conditions on the transaction, acknowledged these real and substantial benefits from the transaction. For example:

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<sup>9</sup> Stankey Decl. ¶¶ 44-46, 52-53; Katz Decl. ¶¶ 126-135; *see generally Overview of AT&T FTTP Investment Model* (filed July 28, 2014) (“FTTP Investment Model Overview”); *Additional Detail on the Demand Estimation, Merger Simulation, and Investment Model Analysis Performed by Professor Katz* (filed July 28, 2014) (“Katz Additional Detail and Analysis”); *Response of AT&T Inc. to Information and Discovery Requests Dated September 9, 2014* (filed Oct. 7, 2014) (“AT&T Information Request Narrative Response”) at 205-208, 217-218; Katz Reply Decl. ¶¶ 34-39.

<sup>10</sup> *See* Public Interest Statement at 37, 46-49; Stankey Decl. ¶¶ 56-63.

<sup>11</sup> *See Applications of Cellco Partnership d/b/a Verizon Wireless and SpectrumCo LLC and Cox TMI, LLC for Consent to Assign AWS-1 Licenses*, Memorandum Opinion and Order and Declaratory Ruling, 27 FCC Rcd 10,698, 10,758 ¶ 159 (2012) (fixed wireless deployment); *Applications filed by Qwest Communications International Inc. and CenturyTel, Inc. d/b/a CenturyLink for Consent to Transfer Control*, Memorandum Opinion and Order, 26 FCC Rcd 4194, 4211 ¶¶ 35-37 (2011) (expanded broadband deployment); *Applications of Comcast Corp., General Electric Company and NBC Universal, Inc. for Consent to Assign Licenses and Transfer Control of Licensees*, Memorandum Opinion and Order, 26 FCC Rcd 4238, 4333 ¶ 233 (2011) (expanded broadband deployment); *General Motors Corp. and Hughes Electronics Corp., Transferors, and The News Corp. Limited, Transferee, for Authority to Transfer Control*, Memorandum Opinion and Order, 19 FCC Rcd 473, 620 ¶ 344 (2004) (“News/Hughes Order”) (increased ability to innovate); *Applications for Consent to the Transfer of Control of Licenses from Comcast Corp. and AT&T Corp., Transferors, to AT&T Comcast Corp., Transferee*, Memorandum Opinion and Order, 17 FCC Rcd 23,246, 23,315 ¶¶ 178, 182 (2002) (“Comcast/AT&T Broadband Order”) (content cost savings); *Applications Filed by Frontier Communications Corp. and Verizon Communications Inc. for Assignment of Transfer of Control*, Memorandum Opinion and Order, 25 FCC Rcd 5972, 5994-95 ¶¶ 55-56 (2010) (recognizing public benefit of improved service quality to rural areas).

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- The CWA agrees that “[t]he proposed AT&T/DIRECTV combination provides substantial public interest benefits for consumers, workers, and the U.S. economy” and explains that the combined company “will have the economic incentives to increase investment in the high-capacity broadband networks that are so essential to drive economic growth, jobs, and the social benefits enabled by high-speed digital networks.”<sup>12</sup>
- Microsoft states that the “commitment [to increase FTTP and deploy fixed WLL to bring broadband to rural areas] clearly advances a critical national broadband objective with respect to investment in and deployment of high-speed broadband access services across the U.S.”<sup>13</sup>
- ACA recognizes that “the two commitments [FTTP and fixed WLL deployments] may have significant value.”<sup>14</sup>
- Cox Communications, Inc. (“Cox”) acknowledges that AT&T’s “nationwide, multiplatform reach will make it a uniquely attractive” partner for programmers.<sup>15</sup>
- The Writer’s Guild of America West, Inc. (“WGAW”) states that “it is clear that Applicants will enjoy savings from this transaction.”<sup>16</sup>
- The AFL-CIO says that “a merged AT&T/DIRECTV will provide consumers across the nation a one-stop shop for a bundled broadband/video service. In addition, the AT&T/DIRECTV merger will improve the economics for high-speed broadband expansion, which is critical to economic growth and job creation in rural and urban communities across our nation.”<sup>17</sup>
- The Free State Foundation concludes that the transaction “likely will result in significant expansion of consumer choice for bundled broadband and MVPD-related services” and “likely will accelerate investment and deployment in next-generation broadband services.”<sup>18</sup>

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<sup>12</sup> CWA Comments at 1, 11.

<sup>13</sup> Microsoft Letter at 2.

<sup>14</sup> ACA Comments at 3.

<sup>15</sup> Petition to Condition Consent of Cox Communications, Inc. at 7 (filed Sept. 16, 2014).

<sup>16</sup> Petition to Deny of Writers Guild of America West, Inc. at 27 (filed Sept. 16, 2014) (“WGAW Petition”).

<sup>17</sup> AFL-CIO Letter at 1.

<sup>18</sup> Comments of The Free State Foundation at 4-5 (filed Sept. 16, 2014) (“Free State Comments”).

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To the extent that certain opponents contest the benefits of the transaction, they suggest that the benefits are not as large as Applicants represent or that they are not merger-specific. For the reasons set forth below, these opponents are wrong.

**A. The Transaction Will Enable the Combined Company To Provide Better Video and Bundled Services**

The record demonstrates that the integration of AT&T broadband and DIRECTV video will provide consumers with more convenient access to more competitive service bundles, as well as a broader array of additional interactive services.<sup>19</sup> These packages will include attractive new integrated bundles of DIRECTV's video service with fixed WLL service, as well as a potential bundle with mobile broadband.<sup>20</sup> Moreover, AT&T's planned broadband expansion will make these improved, integrated bundles available to millions of additional

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<sup>19</sup> See, e.g., Written Testimony of John T. Stankey, Group President and Chief Strategy Officer, AT&T Inc. at 2, *At a Tipping Point: Consumer Choice, Consolidation and the Future Video Marketplace*, Hearing before the United States Senate Committee on Commerce, Science, and Technology Hearing (July 16, 2014), available at [http://www.commerce.senate.gov/public/?a=Files.Serve&File\\_id=d2db74ae-73d4-4116-8d2f-25def1182f14](http://www.commerce.senate.gov/public/?a=Files.Serve&File_id=d2db74ae-73d4-4116-8d2f-25def1182f14) (“Stankey Congressional Testimony”) (“And the consumer benefits of broadband and video integration and bundling extend well beyond passive video viewing to a broad and increasing range of interactive communications, home security, and home automation, monitoring and control systems.”).

<sup>20</sup> See Katz Decl. ¶ 107 (“[T]he proposed transaction will facilitate the creation of new bundles combining AT&T's mobile wireless services with DIRECTV's video service.”); Stankey Decl. ¶ 30 (“AT&T also will be able to offer bundles of DIRECTV's MVPD service and AT&T's state-of-the-art LTE mobile wireless services.”); Press Release, AT&T, AT&T to Acquire DIRECTV (May 18, 2014), [http://about.att.com/story/att\\_to\\_acquire\\_directv.html](http://about.att.com/story/att_to_acquire_directv.html) (“This is a unique opportunity that will redefine the video entertainment industry and create a company able to offer new bundles and deliver content [nationwide] to consumers across multiple screens – mobile devices, TVs, laptops, cars and even airplanes.”).

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consumers. The evidence also establishes that consumers will benefit from the expanded offerings.<sup>21</sup>

Both experience and economics demonstrate that these benefits are real, merger-specific, and, despite the assertions of Free Press to the contrary,<sup>22</sup> unattainable through the “synthetic bundle” that Applicants currently offer. As DIRECTV has learned through its relationships with multiple broadband providers over many years, the synthetic bundle is an inherently inadequate substitute for the integrated video and broadband bundles that telcos and cable companies can offer.<sup>23</sup> The customer service experience is suboptimal, with a two-part sales process, two installation appointments usually scheduled on different days,<sup>24</sup> two bills, routine delays in crediting the appropriate discounts,<sup>25</sup> and a lack of “one call” resolution for billing and service

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<sup>21</sup> Public Interest Statement at 29-33; Stankey Decl. ¶¶ 6, 19, 26-32; Declaration of Rick L. Moore, Senior Vice President, AT&T Inc. ¶¶ 26-29 (June 10, 2014) (“Moore Decl.”); Katz Decl. ¶¶ 4, 98-99; Katz Reply Decl. ¶¶ 2-3, 26.

<sup>22</sup> Petition to Deny of Free Press at 20-23 (filed Sept. 16, 2014) (“Free Press Petition”) (arguing that the failure of DIRECTV’s synthetic bundle is a result of how it is “currently assembled”).

<sup>23</sup> Declaration of Patrick T. Doyle, Executive Vice President and Chief Financial Officer DIRECTV ¶ 25 (June 10, 2014) (“Doyle Decl.”) (“synthetic bundles have not been sufficient to enable DIRECTV to provide the truly competitive bundle of video and broadband services that consumers increasingly demand with the customer service experience they deserve”); Declaration of Lori M. Lee, Senior Executive Vice President – Home Solutions, AT&T Inc. ¶ 49 (June 10, 2014) (“Lee Decl.”) (“the synthetic bundle has proven to be an inadequate substitute for, and is increasingly uncompetitive with, integrated video and broadband bundles offered by cable competitors”); Declaration of Paul Guyardo, Executive Vice President and Chief Revenue and Marketing Officer, DIRECTV ¶ 7 (June 10, 2014) (“Guyardo Decl.”) (“our efforts to compete against integrated bundle providers with a ‘synthetic’ bundle of DIRECTV video and a third-party broadband offering have been largely unsuccessful”); *see also id.* ¶¶ 20-21, 38.

<sup>24</sup> Guyardo Decl. ¶ 32; Lee Decl. ¶ 57. Indeed, **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION] [END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** of the time, the appointment windows fall on different days. *Initial Response of DIRECTV to the Information and Discovery Request Dated September 9, 2014* at 81 (filed Oct. 7, 2014).

<sup>25</sup> Guyardo Decl. ¶ 33; Lee Decl. ¶ 57.

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issues.<sup>26</sup> These problems are inherent to all synthetic bundles offered by DIRECTV, not just bundles involving AT&T,<sup>27</sup> and customer satisfaction data confirm these systemic limitations matter to consumers. Across all of DIRECTV's broadband partners, customers of DIRECTV's synthetic bundle report having a dramatically inferior experience compared to DIRECTV's video-only customers,<sup>28</sup> and, at AT&T in particular, sales of DIRECTV video **[BEGIN AT&T AND DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T AND DIRECTV**

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The record also establishes that the flaws in the synthetic bundle cannot be overcome merely by revising the current contractual terms. For years, AT&T and DIRECTV have attempted to solve the inefficiencies of the synthetic bundle through modifications to their joint

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<sup>26</sup> Lee Decl. ¶ 57; Guyardo Decl. ¶ 34; *see also id.* ¶ 7 (“DIRECTV synthetic bundles lack the speed, price discounts and high-quality customer service available through an integrated bundle”); Doyle Decl. ¶ 24 (“DIRECTV’s synthetic bundles cannot offer the same streamlined installation, billing, and customer service experiences as cable’s organic bundles can.”); Testimony of Michael White, President, Chairman, and CEO, DIRECTV, *Proposed Merger Between AT&T and DirecTV*, Hearing Before the Regulatory Reform, Commercial and Antitrust Law Subcommittee of the House Judiciary Committee (June 24, 2014) (“White Congressional Testimony”) (“Synthetic bundles however make frankly for a bad customer experience. I hear it from our customers all the time. Customers have to talk to two sales representatives, wait for two different installers to arrive on two different appointments, pay two separate bills, and make two calls every time they have a problem.”).

<sup>27</sup> Guyardo Decl. ¶¶ 19-21.

<sup>28</sup> *Id.* ¶ 35 (citing a customer satisfaction Net Promoter Score differential of **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**); *see also* White Congressional Testimony (“when we measure the satisfaction of a bundle experience versus someone who’s just buying DIRECTV solo, it is dramatically poorer”).

<sup>29</sup> Lee Decl. ¶ 58.

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marketing arrangements.<sup>30</sup> Their efforts have failed, however, because, as Dr. Katz has explained, the economic principles of double marginalization and double moral hazard prevent the synthetic bundle from ever being priced as competitively or functioning as efficiently as the integrated bundles that the merged company can offer.<sup>31</sup> In complex relationships and in

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<sup>30</sup> Guyardo Decl. ¶¶ 36-38 (“[D]espite our efforts to address the challenges inherent in a synthetic bundle...we have been unable to match the customer service, price and speed advantages of an integrated bundle from a single provider.”); Lee Decl. ¶ 59 (“AT&T and DIRECTV have made a number of attempts to resolve the shortcomings of the synthetic bundle” but “[n]one of these efforts has made a material difference in closing the substantial competitive gap between the synthetic bundle and integrated cable bundle in terms of price, customer experience, or broadband speeds.”); Testimony of Randall Stephenson, Chairman and CEO of AT&T Inc., *The AT&T/DIRECTV Merger: The Impact on Competition and Consumers in the Video Market and Beyond*, Hearing Before the Senate Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights (June 24, 2014) (Despite the parties’ best efforts, creating a successful synthetic bundle has been “a very difficult thing to accomplish for the simple reason that we do expect to make money off our broadband product [and DIRECTV] expects to make money out of [its] TV product. So you start to stack margins for the customer.”).

<sup>31</sup> Double marginalization is the circumstance in which two firms with complementary products both add a mark-up to the final price of the combined product. Katz Decl. ¶ 67; Guyardo Decl. ¶ 27. These dual mark-ups often result in a higher price and lower output than would result if both products were owned by a single firm. Katz Decl. ¶¶ 66-69, 74; *see also* Guyardo Decl. ¶ 27. In a business arrangement hampered by double marginalization, such as the synthetic bundle, the two companies’ incentives are not aligned. Each company focuses on its contribution to the bundle and not on the jointly-optimal, or competitive, price. Katz Decl. ¶¶ 67, 69, 97, 100-02. The fact that the parties have “total control” over their pricing decisions, Free Press Petition at 21, “does not change the economic reality that each firm has incentives to set its prices at levels that...are higher than is jointly optimal because neither seller takes into account the effects of its price on the other seller.” Katz Reply Decl. ¶ 15. Relatedly, the synthetic bundle, like other arm’s-length agreements between independent companies that sell complementary products, also suffers from its susceptibility to the “double moral hazard” problem: neither company takes into account the profits that flow to the other company when setting price and making investment or other strategic decisions. Because those profits are not considered as part of the overall decision-making process, investment and output are decreased below the optimal level. Katz Decl. ¶¶ 69, 95-97. Further, the incentives of each partner to cooperate are diminished by fears that the other will take advantage of the arrangement. With integration, however, “[t]he internalization of the positive externalities each party’s actions confer on the other would lead to greater incentives to promote and market their complementary products and to provide high-quality customer care....” Katz Reply Decl. ¶ 12.

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industries that are rapidly evolving, contractual approaches such as the synthetic bundle are particularly likely to be inferior to vertical integration.<sup>32</sup> These inherent problems explain why each of DIRECTV's relationships with broadband providers, not just with AT&T, has failed.<sup>33</sup>

Nor have the parties been able to reach **[BEGIN AT&T AND DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T AND DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

The merger will address the systemic failings of the synthetic bundle. Post-integration, there will be a single sales process, a single installation appointment, a single bill, and "one call" resolution for billing and service issues. And, because the transaction creates a more efficient AT&T/DIRECTV bundle, the parties will have an incentive to lower the price and expand the output of these bundles.<sup>35</sup> Indeed, when DIRECTV decided to combine with AT&T, a driving factor was the opportunity to offer a truly integrated bundle that could compete more effectively with cable.<sup>36</sup>

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<sup>32</sup> Katz Reply Decl. ¶ 14 ("The multi-dimensional and changing nature of the services offered by the parties to the proposed merger make the use of contractual arrangements as substitutes for integration particularly difficult.").

<sup>33</sup> Guyardo Decl. ¶¶ 19-21; Katz Decl. ¶ 76 ("Despite the parties' ongoing efforts over several years to improve their joint marketing arrangement, they have not been able to obtain a contractual solution to the double marginalization problem, and there is little reason to believe that such a solution is feasible as long as the parties remain separate entities."); Katz Reply Decl. ¶ 13 (same).

<sup>34</sup> Lee Decl. ¶ 59; Guyardo Decl. ¶ 37. Even if the parties were able to reach such an agreement, it would not fully avoid the difficulties inherent in a synthetic bundle. *See* Katz Decl. ¶¶ 68-69; 100-103. *See also* Katz Reply Dec. ¶ 16.

<sup>35</sup> Public Interest Statement at 66-67; Katz Decl. ¶¶ 4, 71, 82.

<sup>36</sup> Guyardo Decl. ¶ 8. White Congressional Testimony ("[W]e've had discussions for many years about trying to find a way that would have a better value for customers" and have concluded that a merger is "[t]he only way for us to get a seamless integrated bundle."). *See also* Berry-Haile Quantitative Analysis at 31-35 (stating that results of their analysis "show that a pre-

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**B. The Transaction Will Result in Lower Content Acquisition Costs**

No party seriously disputes that the merger will enable the combined company to reduce the cost of acquiring content, which is the largest and most critical variable cost for MVPDs.<sup>37</sup>

At a minimum, AT&T projects that the transaction will enable it to reduce its per-subscriber content costs [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] Taken only across AT&T's expected base of U-verse video subscribers, these content cost savings will exceed [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] the transaction will reduce AT&T's expected per-subscriber content costs as a standalone company by at least 20 percent.<sup>40</sup>

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merger double marginalization (or joint-product pricing) problem provides an important incentive for the merger”).

<sup>37</sup> See, e.g., Free State Comments at 17 (“The increased scale of the combined entity and its increased MVPD and bundled services subscriber base will likely enable it to negotiate rights to video programming content at better bulk discount rates or to negotiate for better value in video programming content through increased choices.”); Cox Petition at 13 (“the largest MVPD’s demand and receive substantial ‘volume discounts’ that decrease their programming costs”). While acknowledging that “volume discounts for multichannel video programming undoubtedly are real,” Free Press argues that Applicants’ estimates of their projected savings may be overstated, relying on the estimates of “some analysts” in blog posts. Free Press Petition at 24.

<sup>38</sup> Moore Decl. ¶ 15; see also Stankey Decl. ¶ 22.

<sup>39</sup> Moore Decl. ¶ 16.

<sup>40</sup> *Id.* ¶ 18. AT&T has submitted for the record a detailed description of the cost savings it has projected. See AT&T Information Request Narrative Response at 240-245; Katz Additional Detail and Analysis ¶¶ 49-51. The Commission has recognized that potential cost savings on “content covered by long-term contracts” can be realized as the contracts covering the content come up for renewal. *Applications for Consent to the Transfer of Control of Licenses from XM Satellite Radio Holdings Inc., Transferor to Sirius Satellite Radio Inc., Transferee*, Memorandum

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These estimates are based on three conservative and now undisputed assumptions.

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**[END AT&T**

**HIGHLY CONFIDENTIAL INFORMATION]** Opponents do not seriously challenge these assumptions, and Dr. Katz has demonstrated that the projected content cost savings are supported by economic theory.<sup>43</sup>

Without this transaction, AT&T could not realize these cost savings. Other than through a merger such as this one, AT&T has no realistic prospect of meaningfully increasing its scale as

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Opinion and Order and Report and Order, 23 FCC Rcd 12,348, 12,392 ¶ 102 (2008). *See also* Comcast/AT&T Broadband Order, 17 FCC Rcd at 23,315-23,316 ¶¶ 178, 182 (projecting content cost savings as programming contracts expire). **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** the approach accepted by the Commission in AT&T/Comcast, where the parties assumed that the merged entity “would obtain the best rate currently received by either AT&T [or] Comcast.” *Id.* ¶ 178.

<sup>41</sup> Stankey Decl. ¶ 25; Moore Decl. ¶ 15.

<sup>42</sup> AT&T Information Request Narrative Response at 241.

<sup>43</sup> Katz Decl. ¶¶ 111-117.

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a content purchaser.<sup>44</sup> That is especially, but not exclusively, the case outside AT&T's wireline footprint, where AT&T does not have any facilities that could support a ubiquitous MVPD product. As a result, the conclusory claims by some opponents that AT&T could have organically achieved the increased scale necessary to reduce these costs<sup>45</sup> are simply not true.

Nor is it true that AT&T must commit to reduce consumer prices before these cost savings may be considered a benefit to the public interest.<sup>46</sup> To begin with, the economic evidence establishes that these cost savings will, in fact, result in lower prices.<sup>47</sup> Beyond that, however, the same evidence demonstrates that the market "will ensure that [post-merger AT&T] uses these reduced marginal costs" to "pass through some or all of the marginal cost reductions"

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<sup>44</sup> Stankey Decl. ¶¶ 11-16.

<sup>45</sup> Joint Petition to Deny of the Alliance for Community Media, the Alliance for Communications Democracy, and Common Cause (collectively, "ACM") at 12 (filed Sept. 16, 2014) ("ACM Joint Petition").

<sup>46</sup> See Free Press Petition at 25-28; WGAW Petition at 27; see also ACM Petition at 12-13 (questioning AT&T's ability to pass through cost savings while also expanding its broadband deployment).

<sup>47</sup> Katz Reply Decl. ¶¶ 20-26; see *id.* ¶ 21 ("Content costs, which are contractually structured on a per-subscriber, per-month basis, are marginal costs. It is a well-established principle taught in freshman economics courses that even a monopolist—which the merged entity manifestly would not be—has incentives to pass through marginal cost decreases to consumers in whole or in part."); *id.* ¶ 23 ("The Commission itself has concluded that the pass-through of cost savings occurs.") (citing *Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, Report on Cable Industry Prices, 24 FCC Rcd 259, 344 ¶ 19 (MB 2009)); see also Katz Reply Decl. ¶ 24 ("[Merger simulation] analysis suggests that for a [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] reduction in video costs, AT&T would pass on [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] of the cost savings to subscribers in the form of lower prices (*i.e.*, AT&T would pass on approximately [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] percent of cost savings in the form of lower prices.") (citing Berry-Haile Sept. 19 Quantitative Analysis Update Presentation at 102 and 111); Berry-Haile Sept. 19 Quantitative Analysis Update Presentation at 18).

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to subscribers.<sup>48</sup> Indeed, the econometric modeling shows that, even conservatively estimated, merger-specific content cost synergies will result in substantial economic gains to consumers.<sup>49</sup> Finally, merger-related cost savings will also result in better products, more attractive bundles, and wider availability of broadband, which all translate to a decrease in the quality-adjusted price to consumers.<sup>50</sup> In the face of this unrebutted evidence, opponents' conclusory demands for unspecified pricing commitments ring hollow.

**C. The Substantial Synergies Created by the Transaction Will Result in Enhanced and Expanded Broadband Services**

The substantial synergies created by the transaction and the addition of DIRECTV's profitable video product to its offerings will enable AT&T to expand deployment of high-speed broadband service to 15 million additional customer locations.<sup>51</sup> In addition, the incremental investment will provide superior options to consumers and place greater competitive pressure on broadband rivals, further expanding the reach of consumer benefits flowing from the

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<sup>48</sup> Public Interest Statement at 33; Katz Decl. ¶ 118; *see also id.* ¶¶ 77, 119; Katz Reply Decl. ¶ 26 (“[E]ven a small change in costs can lead to a large change in consumer welfare when the cost change...tips the balance in favor of a supplier’s undertaking a discrete investment that generates a large amount of consumer surplus.”).

<sup>49</sup> Berry-Haile Quantitative Analysis at 3, 8-9; *id.* at 8 (“With these cost savings, we estimate that the merger would yield a substantial net gain in consumer surplus of \$0.94 to \$1.44 per U.S. household per month....These substantial gains arise from merger-induced incentives for price reductions, both from the merged firm and its competitors, including cable providers.”).

<sup>50</sup> Katz Reply Decl. ¶ 26 (“[T]he lower programming costs will trigger a large increase in network investment, which will give rise to a large decrease in the quality-adjusted prices faced by millions of consumers.”).

<sup>51</sup> As described in the Public Interest Statement, AT&T has committed that it will expand and enhance high-speed broadband service to 15 million customer locations, mostly in underserved rural areas where AT&T does not today provide high-speed broadband service. The expansion will rely on a combination of technologies, including FTTP and fixed WLL capabilities. This commitment will be completed within four years after the transaction closes. Public Interest Statement at 50-51.

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transaction.<sup>52</sup> Senator Amy Klobuchar has noted that “AT&T’s promise to expand its broadband reach especially into rural areas is the compelling aspect of this proposed deal.”<sup>53</sup> Both supporters and opponents of the transaction likewise recognize the transaction-specific benefits of broadband expansion,<sup>54</sup> despite the attempts of a few opponents to diminish the significance of this public interest benefit for millions of Americans.

**1. The Expansion of GigaPower Service Is a Transaction-Specific and Verifiable Public Benefit**

The expansion of AT&T’s GigaPower deployment to an additional two million customer locations beyond what it could otherwise justify is a transaction-specific benefit.<sup>55</sup> The economics underlying this proposed expansion, as well as the evidence necessary to confirm that this expansion would not occur without this transaction, are fully developed in the record. In particular, the record contains extensive information documenting AT&T’s pre- and post-

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<sup>52</sup> Katz Reply Decl. ¶ 34.

<sup>53</sup> Opening Statement of Chair Amy Klobuchar, *The AT&T/DirecTV Merger: The Impact on Competition and Consumers in the Video Market and Beyond*, Hearing Before the Senate Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights (June 24, 2014) (“The proposed combination of AT&T and DirecTV, in many respects, appears to combine services that are largely complementary. AT&T has the broadband and wireless capabilities that DirecTV lacks, and DirecTV has the top-performing video service with the scale AT&T needs to lower its programming costs.”).

<sup>54</sup> See pages 9-10, above.

<sup>55</sup> AT&T is not alone in finding that content costs are an important factor affecting the ability to deploy broadband. The head of Google Fiber, Milo Medin, recently stated that video programming costs are “the single biggest piece of our cost structure” and the “single biggest impediment” to Google Fiber’s deployment. Brian Fung, *Here’s the Single Biggest Thing Holding Google Fiber Back*, Washington Post (Oct. 6, 2014), <http://www.washingtonpost.com/blogs/the-switch/wp/2014/10/06/video-is-holding-google-fiber-back/>.

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transaction plans,<sup>56</sup> beginning with the FTTP Investment Model AT&T uses in the ordinary course of business. AT&T employs this model to evaluate the profitability of FTTP investments in its wireline network, as described in the *Overview of AT&T FTTP Investment Model*, provided to the Commission on July 28, 2014.<sup>57</sup> Specifically, AT&T uses the FTTP investment model to determine which distribution areas (“DAs”) within the AT&T wireline footprint meet certain financial thresholds for deployment of FTTP wireline network technology.<sup>58</sup>

Prior to this transaction, AT&T used its FTTP Investment Model to commit about [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] to expand the availability of GigaPower to portions of 25 metropolitan areas, covering about [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] customer locations.<sup>59</sup> That expansion would have brought GigaPower’s planned deployment to a total of about [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] customer locations.<sup>60</sup>

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<sup>56</sup> Katz Decl. ¶¶ 126-28; *see generally* FTTP Investment Model Overview; Katz Additional Detail and Analysis; AT&T Information Request Narrative Response; Katz Reply Decl. ¶¶ 35-39.

<sup>57</sup> FTTP Investment Model Overview; *see also* AT&T Information Request Narrative Response at 160-161.

<sup>58</sup> FTTP Investment Model Overview at 4 (describing internal rate of return and other financial thresholds considered to determine DAs that are considered profitable for FTTP wireline technology investment); Katz Decl. ¶ 127.

<sup>59</sup> Stankey Decl. ¶ 43; *see also* AT&T Information Request Narrative Response at 217.

<sup>60</sup> Stankey Decl. ¶ 43; *see also* AT&T Information Request Narrative Response at 217.

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As part of its analysis of this transaction, AT&T re-ran its ordinary course FTTP Investment Model to account for the projected content cost savings.<sup>61</sup> These significant cost reductions dramatically shift the point at which it makes business sense to invest in GigaPower expansion.<sup>62</sup> The results confirm that this transaction will justify deploying GigaPower to at least 2 million additional customer locations.<sup>63</sup> It is, therefore, the merger that improves the economics and justifies that expansion.<sup>64</sup> As Dr. Katz has confirmed, “[w]hen AT&T’s modified FTTP model is run using the various combinations of parameters . . . , the results indicate that

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<sup>61</sup> Stankey Decl. ¶ 44 n.21. As Dr. Katz explains, “the appropriate comparison is the number of customer locations to which AT&T will deploy FTTP after the merger versus the number of FTTP customer locations it would deploy but-for the merger.” Katz Reply Decl. ¶ 39.

<sup>62</sup> Stankey Decl. ¶¶ 43-44. Specifically, the incremental cost savings and other synergies from the merger push these 2 million customer locations across the internal rate of return threshold. AT&T has further determined that, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** AT&T Information Request Narrative Response at 180-181.

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<sup>63</sup> Stankey Decl. ¶ 44, n.21 (“While AT&T’s preliminary analysis has focused on the business case for further FTTP expansion based on content cost savings alone, this transaction will also significantly improve the quality and scope of AT&T’s video and bundled offerings...further improving the investment economics and potentially supporting expanding FTTP even further.”).

<sup>64</sup> *Id.* ¶ 44. Any suggestion by opponents that, prior to this transaction, AT&T had already committed to deploying FTTP to the additional 2 million customer locations that will be built as a result of this transaction is incorrect. *See id.*; *see also* Katz Reply Decl. ¶¶ 36-39.

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millions of customer locations that would not clear the [internal rate of return] hurdles absent the merger would clear them if the proposed merger were consummated.”<sup>65</sup>

The few opponents that challenge the merger-specificity of AT&T’s FTTP expansion<sup>66</sup> fail even to address, much less refute, the detailed record showing that the transaction will result in broadband expansion beyond AT&T’s pre-transaction plans.<sup>67</sup> The Commission should therefore reject their arguments.

**2. Deployment of Fixed WLL Broadband Service in Rural Areas in 48 States Flows Directly from Transaction-Specific Efficiencies**

Fixed WLL is a high-speed broadband product designed to use dedicated spectrum, antennas, and other equipment to deliver reliable and consistent speeds that are competitive with

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<sup>65</sup> Katz Decl. ¶ 133. In a further explanation submitted at the request of Commission staff, Professor Katz provided additional detail on the modeling. Katz Additional Detail and Analysis ¶ 70 (“As reported in the *Katz Declaration*, the results indicate that, on net, millions of additional customer locations would become profitable for FTTP deployment after the merger – *i.e.*, would clear the [internal rate of return] hurdle rate with the merger but would not without the merger. In other words, this analysis indicates that the proposed merger would lead to substantial increases in AT&T’s incentives to deploy FTTP.”). See also Katz Reply Decl. ¶ 34 (“A detailed analysis of AT&T’s ordinary course of business investment model (appropriately modified to account for potential adverse effects of the merger on investment incentives) demonstrates that the proposed merger would lead to substantial increases in the economic incentives to deploy fiber to the premises (‘FTTP’).”).

<sup>66</sup> Petition to Deny of The Greenlining Institute at 8-9 (filed Sept. 16, 2014) (“Greenlining Petition”); Petition to Deny of Public Knowledge and Institute for Local Self-Reliance at 13-14 (filed Sept. 16, 2014) (“Public Knowledge Petition”); Free Press Petition at 29-30.

<sup>67</sup> Free Press wrongly asserts that AT&T has failed to meet past merger commitments, focusing on a commitment to deploy broadband services associated with AT&T’s acquisition of BellSouth. Free Press Petition at 32-33. That commitment expressly incorporated the FCC’s then-existing definition of broadband services, *i.e.*, services with download speeds of 200 Kbps. See *AT&T Inc. and BellSouth Corporation, Application for Transfer of Control*, Memorandum Opinion and Order, 22 FCC Rcd 5662, 5807-08, Appendix F ¶ 1 (2007) (“AT&T/BellSouth Order”). The fact that technology continued to advance and the FCC has subsequently changed the definition of what constitutes “broadband” services is irrelevant. AT&T met its commitment and will likewise meet the commitments it has made in this transaction. See also AT&T Information Request Narrative Response at 222-223.

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wireline broadband 15-20 Mbps offerings.<sup>68</sup> AT&T's commitment to deploy fixed WLL to millions of rural customer locations is also a merger-specific benefit that flows directly from the efficiencies of this transaction. To support this conclusion, Applicants have produced substantial and verifiable evidence, including a detailed financial analysis of the impact that bundling fixed WLL with DIRECTV's video service will have on the "Lifetime Value" ("LTV") of the fixed WLL service.<sup>69</sup>

The Wireless Internet Service Providers Association ("WISPA") challenges this benefit on the grounds that AT&T could have deployed a fixed WLL product absent the transaction.<sup>70</sup> While it is true that AT&T has been analyzing the possibility of developing an innovative fixed WLL service for some time,<sup>71</sup> the *economic* viability of fixed WLL service as a standalone offering has long been uncertain. Prior to this transaction, AT&T had plans only [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

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<sup>68</sup> See Public Interest Statement at 43-45; Stankey Decl. ¶¶ 47-50. See also Katz Decl. ¶ 134; AT&T Information Request Narrative Response at 195, 200.

<sup>69</sup> AT&T Information Request Narrative Response at Exhibit 59.1.1. Exhibit 59.1.1 contains AT&T's financial analysis of the transaction's effect on the LTV of a fixed WLL customer. The financial analysis in Exhibit 59.1.1 estimates that the ability to bundle fixed WLL with DIRECTV video as a result of the transaction will increase the LTV of a fixed WLL customer from approximately [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] to approximately [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION].

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]. *Id.* at 214-215; see generally Stankey Decl. ¶¶ 47-55; Katz Decl. ¶¶ 134-135; AT&T Information Request Narrative Response Exhibit 59.a.1; *id.* at 206-215.

<sup>70</sup> Comments of the Wireless Internet Service Providers Association at 4-7 (filed Sept. 16, 2014) ("WISPA Comments").

<sup>71</sup> *Id.* at 7 ("No doubt, AT&T was considering and developing WLL long before it entered into its merger agreement....").

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[END AT&T HIGHLY CONFIDENTIAL INFORMATION] This transaction, which combines the broadband expertise and capabilities of AT&T with a profitable MVPD offering from DIRECTV, dramatically improves the business case for deploying fixed WLL and has led AT&T to conclude, for the first time, that fixed WLL should be funded. Moreover, AT&T's specific, binding commitment to fund deployment of this service guarantees that result.<sup>72</sup>

To rural customers looking for a robust broadband alternative, fixed WLL will be attractive. While the Commission is elsewhere considering the proper threshold for “broadband,”<sup>73</sup> there is no question that the planned fixed WLL service far exceeds the Commission's current definition (4 Mbps upstream/1 Mbps downstream).<sup>74</sup> Indeed, this service is expected to achieve download speeds of 15-20 Mbps, which are equivalent to or better than the speeds offered by existing broadband providers in the rural areas where AT&T intends to deploy this service.<sup>75</sup> This service will not only benefit millions of Americans with improved consumer options and increased competition.<sup>76</sup> As Dr. Katz explains, “[t]he availability of an

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<sup>72</sup> Stankey Decl. ¶ 52; *see also* AT&T Information Request Narrative Response at 214, Exhibit 59.1.1.

<sup>73</sup> *See Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, as Amended by the Broadband Data Improvement Act*, GN Dkt No. 14-126, Tenth Broadband Progress Notice of Inquiry ¶¶ 6-7 (rel. Aug. 5, 2014).

<sup>74</sup> *Id.* ¶ 5 (describing Commission's current broadband speed benchmark).

<sup>75</sup> Stankey Decl. ¶¶ 48-49. Contrary to Free Press's contention, Free Press Petition at 31, the speed and other attributes of the service are also substantially different from AT&T's Wireless Home Phone and Internet Service. *See* Katz Reply Decl. ¶ 42.

<sup>76</sup> *See* Stankey Decl. ¶ 55 (“Based upon NTIA data, almost 20 percent of the 13 million customer locations where AT&T's fixed WLL service would become available are locations that have no access to terrestrial broadband services today. An additional 27 percent of the 13 million

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additional broadband service also will exert important competitive pressure on rival broadband providers, which can lead to lower prices and greater investments in infrastructure that would allow for higher broadband speeds.”<sup>77</sup> As a result, the suggestion that AT&T should not be given credit for its fixed WLL product, because the product will not offer broadband speeds comparable to certain wireline alternatives<sup>78</sup> is without merit.

There is likewise no merit to claims that fixed WLL deployment is not relevant to the public interest analysis because it will be subject to data allowances.<sup>79</sup> AT&T has no incentive to invest in deployment of a service with restrictions that will make it unattractive to consumers,

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customer locations have only one terrestrial option today.”). Citing the fixed broadband offerings of its members, WISPA disputes the fact that AT&T’s fixed WLL service will serve as a new competitive broadband offering in many rural areas with only one or no terrestrial broadband competitors today. WISPA Comments at 3. As an initial matter, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** AT&T Information Request Narrative Response at 205. Moreover, many WISPA members appear to offer only slower fixed broadband speeds. *See, e.g.,* Bolt Internet, Residential, <http://www.boltinternet.com/html/residential.html> (last visited Oct. 14, 2014) (offering speeds up to 5 Mbps download); Southwestern Wireless, Products, <http://www.southwesternwireless.com/products.html> (last visited Oct. 14, 2014) (offering speeds up to 5 Mbps download); Resonance Broadband, About, <http://www.resonancebroadband.com/coverage.php> (last visited Oct. 14, 2014) (offering speeds up to 4 Mbps download); Air Advantage, Residential High Speed Wireless Internet Plans & Pricing, <http://airadvantage.net/plans-pricing/residential-plans>, (last visited Oct. 14, 2014) (offering speeds up to 5 Mbps download). In any case, those WISPA members that offer fixed broadband services only reach a combined 3,000,000 people throughout the country. WISPA Comments at 2.

<sup>77</sup> Katz Reply Decl. ¶ 44; *see also id.* ¶¶ 41-45 (rebutting additional arguments and further explaining the consumer benefits of AT&T’s fixed WLL deployment).

<sup>78</sup> WGAW Petition at 16; Free Press Petition at 31; Public Knowledge Petition at 17.

<sup>79</sup> WGAW Petition at 27; Public Knowledge Petition at 17.

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and the fixed WLL service will be offered with a usage allowance high enough to satisfy most customers' needs.<sup>80</sup>

Finally, as AT&T's Chairman and CEO Randall Stephenson has stated to Congress, AT&T does not plan to use Connect America Funds for the broadband investments enabled by this transaction, and AT&T's internal investment models do not presume any such funding.<sup>81</sup>

Applicants refer opponents raising this question to Mr. Stephenson's prior testimony.<sup>82</sup>

**III. THE COMMENTS AND PETITIONS DO NOT DEMONSTRATE ANY PUBLIC INTEREST HARM FROM THIS TRANSACTION**

**A. The Transaction Will Intensify, Not Harm, MVPD Competition**

The overriding competitive reality that should drive the Commission's assessment of this transaction is that AT&T's broadband offerings and DIRECTV's standalone video service are

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<sup>80</sup> AT&T Information Request Narrative Response at 199 ("AT&T currently expects the product to be offered with a usage allowance high enough to readily satisfy most customers' needs, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** To determine an appropriate usage allowance that would meet the needs of most customers, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**"); *see also* Stankey Decl. ¶ 49.

<sup>81</sup> Written Responses of Randall Stephenson to Questions for the Record Submitted by Chairman Amy Klobuchar for Randall Stephenson at 3, *The AT&T/DIRECTV Merger: The Impact on Competition and Consumers in the Video Market and Beyond*, Hearing Before the Senate Judiciary Committee, Antitrust Subcommittee (June 24, 2014), *available at* <http://www.judiciary.senate.gov/imo/media/doc/Stephenson%20Responses%206-24-14.pdf>. *See also* AT&T Information Request Narrative Response at 220 (stating that **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**).

<sup>82</sup> *See* ACA Comments at 29-30; WISPA Comments at 8-9.

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complements.<sup>83</sup> It is that complementarity that motivated Applicants to merge; it is that complementarity that will allow the merged firm to offer better combinations of bundled services to more consumers; and it is that complementarity that will stimulate competition from cable operators and improve overall consumer welfare.<sup>84</sup> These conclusions are not matters of opinion. They are established by extensive, detailed economic analyses.<sup>85</sup>

Opponents have not provided any evidence to rebut this detailed showing. Instead, they rely only on purported HHI concentration calculations based on purported market shares for MVPD service.<sup>86</sup> But it is uniformly understood that market shares are relatively primitive

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<sup>83</sup> Public Interest Statement at 2-4; Lee Decl. ¶ 39 (“AT&T focuses on selling broadband and offering video as part of a bundle with broadband, whereas satellite video providers focus on video and do not have broadband capabilities.”), ¶¶ 7-9 (explaining that broadband is AT&T’s most important product offering); Guyardo Decl. ¶¶ 10-11 (describing DIRECTV’s inability to meet the growing demand for broadband services and its churn rate to providers who can offer both video and broadband services).

<sup>84</sup> See Katz Decl. ¶¶ 85-90, 92-94; Katz Reply Decl. ¶¶ 2-3, 55; Berry-Haile Quantitative Analysis at 8-9; Berry-Haile July 15 Quantitative Analysis Presentation at 119. See also Free State Comments at 20 (stating the merger is “primarily a *non*-horizontal merger of complementary services”) (emphasis in original). One of AT&T and DIRECTV’s major cable competitors agrees that the improved bundles enabled by the transaction will increase competition. Cox Petition at 22 (“AT&T is undoubtedly correct that its ability to bundle its services with DirecTV’s would enhance its ability to compete.”); see also DISH Petition at 24 (the merger will “enable AT&T to provide, on a nationwide basis, a bundle of mobile, Internet access, and video services” which will be a “direct competitive threat” to DISH’s own bundles).

<sup>85</sup> See generally Katz Decl. ¶¶ 3-4, 85-95; Berry-Haile July 15 Quantitative Analysis Presentation; Katz Additional Detail and Analysis; Berry-Haile Sept. 19 Quantitative Analysis Update Presentation; Berry-Haile Quantitative Analysis; *Price Re-Centering in the Quantitative Analysis of an AT&T-DIRECTV Merger*, Steve Berry and Phil Haile (filed Oct. 1, 2014); Katz Reply Decl. ¶¶ 10-12, 55-58.

<sup>86</sup> See Free Press Petition at 9-16; Public Knowledge Petition at 5-6; see also Comments of the National Association of Broadcasters at 2 (filed Sept. 16, 2014) (“NAB Comments”) (alleging harms based on simple market share figures); Comments of Minority Cellular Partners Coalition at 19 (filed Sept. 16, 2014) (“MCPC Comments”) (alleging harms based on simple concentration figures).

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measures that represent only the starting point for any competitive analysis.<sup>87</sup> When, as is the case here, a merger involves complementary products, market share calculations are particularly uninformative.<sup>88</sup> Further, AT&T and DIRECTV compete with very different products (bundles vs. standalone video), utilize different market strategies, and target different customer segments.<sup>89</sup> In a world where consumers prefer bundles of video and broadband service

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<sup>87</sup> See 2010 Merger Guidelines note 1, § 6.1, available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.html#6a> (“Diagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration. The Agencies rely much more on the value of diverted sales than on the level of the HHI for diagnosing unilateral price effects in markets with differentiated products.”); *Applications of Western Wireless Corp. and Alltel Corp.*, Memorandum Opinion and Order, 20 FCC Rcd 13,053, 13,067 ¶46 (2005) (“Market share data are the beginning, not the end, of the competitive analysis. Such data provide useful information as to which markets need more in-depth, multidimensional analysis of potential competitive harms.”); *Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control of MCI Communications Corp. to WorldCom, Inc.*, Memorandum Opinion and Order, 13 FCC Rcd 18,025, ¶ 39 (1998) (“an HHI analysis alone is not determinative and does not substitute for our more detailed examination of competitive considerations”); Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 Antitrust L.J. 49, 68 (2010) (noting that the revised Merger Guidelines clarify the role of HHIs and acknowledge “that HHI levels typically are not very helpful diagnostics in these cases”).

<sup>88</sup> Katz Reply Decl. ¶¶ 50-52, 59 (rebutting Free Press’s concentration analysis, which does not account for the fact that the vast majority of AT&T’s customers buy service bundles that DIRECTV does not sell); see *id.* ¶ 51 (“Free Press’s simplistic approach to competitive effects is particularly troubling in the present instance because the merger involves both substitute and complementary products.”), *id.* ¶ 52 (explaining that “a simple concentration analysis [cannot predict the proposed transaction’s overall effect on prices or consumer welfare] in part because a merger that leads to improved internalization of complementarities, and thus to lower prices, also increases concentration”).

<sup>89</sup> The record is clear that, as a result of their different product offerings and strategies, AT&T and DIRECTV go to market in fundamentally different ways and do not focus their competitive energies on each other. AT&T offers very limited promotions for standalone video and spends very little money advertising standalone video. Lee Decl. ¶ 16. Instead, AT&T focuses its advertising and promotions on bundles, which more than 97 percent of all AT&T video customers purchase. *Id.* ¶ 12. DIRECTV’s marketing efforts also reflect a lack of competition between the companies. Guyardo Decl. ¶¶ 41, 43, 45. DISH, which calls itself the combined company’s “closest competitor,” DISH Petition at 20, also verifies this point.

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together,<sup>90</sup> the fact that DIRECTV lacks broadband assets means that simple measures of MVPD concentration cannot lead to an accurate prediction of the competitive effects of the transaction.

A conclusory recitation of HHIs cannot overcome Applicants' more comprehensive econometric analyses, which offer the best available predictions of the actual competitive effects of this transaction.<sup>91</sup> As Dr. Katz explained in his opening declaration, the complementarity of AT&T's and DIRECTV's products requires a more in-depth analysis and – unlike the simplistic case posited by opponents – economic theory alone cannot predict whether the transaction will cause harm to consumers.<sup>92</sup> Dr. Katz presented the results of a full merger simulation that uses a sophisticated demand estimation and economic model to assess the likely effect of the merger. That detailed modeling predicts that the merger will result in downward pressure on prices, not only for the new integrated bundles that the merged firm will be able to offer, but also for the products of the cable operators that are the dominant competitors in virtually every local area.<sup>93</sup>

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<sup>90</sup> Video subscribers who leave U-verse **[BEGIN AT&T CONFIDENTIAL INFORMATION]**  
**[END AT&T CONFIDENTIAL INFORMATION]** switch to cable operators and purchase a bundle of services including broadband from their new provider. Lee Decl. ¶ 30. At the same time, **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

**[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

Guyardo Decl. ¶ 11.

<sup>91</sup> Katz Reply Decl. ¶¶ 52-59. *See also, e.g.,* Aviv Nevo, *Mergers with Differentiated Products: The Case of the Ready-to-Eat Cereal Industry*,” RAND J. Econ., Autumn 2000, at 395, 395 (“Traditional analysis of horizontal mergers is based primarily on industry concentration measures. ... Using this approach to evaluate mergers in industries with differentiated, or closely related but not identical, products is problematic. In many cases the product offerings make it difficult to define the relevant product (or geographic) market. Even if the relevant market can easily be defined, the computed concentration index provides a reasonable standard by which to judge the competitive effects of the merger only under strong assumptions.”).

<sup>92</sup> Katz Decl. ¶ 82.

<sup>93</sup> *Id.* ¶¶ 88-89, 92.

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According to Dr. Katz's model, the overall projected impact on consumer welfare is positive, even before taking efficiencies and quality improvements into account.<sup>94</sup>

Using an even richer data set and more refined modeling, Professors Berry and Haile have performed a separate merger simulation analysis that corroborates and extends Dr. Katz's initial findings.<sup>95</sup> The analysis of Professors Berry and Haile confirms Dr. Katz's conclusions and further demonstrates that the transaction will have an annual net positive effect of between \$940 million and \$1.44 billion on consumer welfare.<sup>96</sup> In particular, simulations reflecting competition both at the DMA<sup>®</sup> level and specifically within AT&T's video footprint show that there will be substantial downward pressure on the prices of the AT&T/DIRECTV bundle post-transaction.<sup>97</sup> As prices for the AT&T/DIRECTV bundle fall, the market will exert downward pricing pressure on cable providers as well, resulting in lower prices for cable products.<sup>98</sup>

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<sup>94</sup> *Id.* ¶¶ 88-92. Cost efficiencies not accounted for in Dr. Katz's merger simulation will tend to put further downward pressure on standalone as well as bundled prices. Katz Additional Detail and Analysis ¶ 39 n.37.

<sup>95</sup> *See generally* Berry-Haile July 15 Quantitative Analysis Presentation; Berry-Haile Sept. 19 Quantitative Analysis Update Presentation; Katz Reply Decl. ¶¶ 2, 56-58.

<sup>96</sup> Berry-Haile Quantitative Analysis at 8; Berry-Haile Sept. 19 Quantitative Analysis Update Presentation at 18.

<sup>97</sup> Berry-Haile July 15 Quantitative Analysis Presentation at 101-117, 119; Berry-Haile Sept. 19 Quantitative Analysis Update Presentation at 100a-117; Katz Reply Decl. ¶¶ 2, 56-58 (describing the refined and extended framework of Professors Berry and Haile that confirms Dr. Katz's merger simulation results).

<sup>98</sup> Berry-Haile July 15 Quantitative Analysis Presentation at 101-117, 119; Berry-Haile Quantitative Analysis at 3, 8; Katz Reply Decl. ¶¶ 3, 10. Professors Berry and Haile have also demonstrated that these results are not the product of any artificial assumptions made in the modeling, but flow directly from an extensive data set reflecting actual consumer behavior. Berry-Haile Quantitative Analysis at 2 (“[I]t is the actual data pattern in this industry that determines the qualitative conclusions of our analysis; the result is not ‘baked in’ to the modeling approach.”); *see also id.* at 25-26.

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These results show that consumers will benefit from or, at a minimum, will not be harmed by, the transaction, even before taking account of the content cost savings made possible by the transaction. Then, when Professors Berry and Haile factored into their analysis a conservative estimate of video content cost reductions, they concluded that the transaction will result in even more significant downward pressure on prices of the AT&T U-verse integrated bundle.<sup>99</sup> Combined with the other efficiencies generated by the transaction, these video content cost efficiencies will create a substantial counterweight to any upward pricing pressure on the parties' standalone video products and result in a significant overall rise in consumer surplus.<sup>100</sup> As a result, the record establishes that the transaction will intensify, not harm, competition for MVPD services, whether purchased independently or as part of a bundle.

**B. The Transaction Will Not Harm Online Video Competition**

While AT&T rejects the assertion that it has any incentive to foreclose competition from online video or other edge providers, the record clearly demonstrates that the transaction would not give it any increased ability to do so. To begin with, unlike the Comcast/Time Warner Cable transaction, this merger does not add existing broadband assets to AT&T's broadband network, and thus does not increase AT&T's market presence in broadband.<sup>101</sup> Nor, unlike

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<sup>99</sup> Berry-Haile July 15 Quantitative Analysis Presentation at 101-117; Berry-Haile Quantitative Analysis at 3, 8-9, 44; *see also* Katz Reply Decl. ¶ 2.

<sup>100</sup> Berry-Haile July 15 Quantitative Analysis Presentation at 101-117, 119; Berry-Haile Quantitative Analysis at 8-9, 44.

<sup>101</sup> Katz Reply Decl. ¶ 62 (“[T]he merger would give rise to no increase in the parties’ ability to pursue a partial or complete foreclosure strategy against OVD providers. This conclusion is an immediate consequence of the fact that DIRECTV has no broadband Internet access facilities and that AT&T and DIRECTV do not control ‘must have’ content that OVD providers require to be successful.”). To the extent that the transaction will enable AT&T to expand broadband service to millions more Americans, that is unambiguously pro-competitive. Netflix’s claim that

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Comcast/NBCU, would this merger confer on AT&T control over substantial “must have” content holdings.<sup>102</sup> Therefore, contrary to some opponents’ claims,<sup>103</sup> the transaction simply does not affect AT&T’s *ability* to foreclose OTT providers.<sup>104</sup>

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this expansion will cause additional harm to edge providers defies logic. See Comments of Netflix, Inc. at 13 (filed Sept. 16, 2014) (“Netflix Comments”).

<sup>102</sup> DIRECTV currently owns and operates only two regional sports networks (“RSNs”), Root Sports Pittsburgh and Root Sports Rocky Mountain, and holds a minority interest in, and manages, the Seattle-based RSN, Root Sports Northwest. DIRECTV also has a 42 percent non-controlling interest in the Game Show Network, as well as smaller minority interests in a handful of other networks, such as the Tennis Channel. Public Interest Statement at 14; Doyle Decl. ¶ 9. AT&T has very limited ownership interests in video programming. A federal bankruptcy court is considering a plan under which AT&T and DIRECTV would jointly purchase a struggling Houston RSN. *In re Houston Regional Sports Network, LP*, Disclosure Statement Related to Chapter 11 Plan Dated August 6, 2014 in Respect of Houston Regional Sports Network, L.P., U.S. Bankruptcy Court, Southern District of Texas, Case No. 13-35998 (“*In re Houston*”).

<sup>103</sup> See, e.g., Netflix Comments at 11-16, 23-42; Comments of Cogent Communications Group at 6-16 (filed Sept. 16, 2014) (“Cogent Comments”); WGAW Petition at 19-25; Public Knowledge Petition at 8-9; Free Press Petition 36-37.

<sup>104</sup> See Katz Reply Decl. ¶¶ 60-71. Nothing about this transaction should lead the Commission to accept Netflix’s argument that the Commission should define a *national* market for high-speed distribution of edge provider content. The Commission has previously defined the relevant market for residential high-speed Internet access as local, not national. AT&T/BellSouth Order, 22 FCC Rcd at 5723 ¶ 114; *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America Online, Inc., Transferors, to AOL Time Warner Inc., Transferee*, Memorandum Opinion and Order, 16 FCC Rcd 6547, 6578 ¶ 74 (2001). Netflix’s reliance on the Department of Justice’s 2000 analysis in *AT&T-MediaOne*, Netflix Comments at 9-10, is misplaced. In that case, the Department did not define a national market for residential broadband Internet access. Rather the Department was concerned with the sale of Internet portal services to Internet Service Providers (“ISPs”) and described the relevant market as “the aggregation, promotion and distribution of residential broadband content.” Competitive Impact Statement, *United States v. AT&T and MediaOne Group, Inc.*, No. 1:00-cv-01176, at 2 (D.D.C. May 25, 2000). Those portals, which had a homepage and subsequent pages containing links to Internet content and services, were owned or controlled by the merging parties and had exclusive arrangements with the merging parties and other cable operators to serve as the “portal” through which cable subscribers accessed Internet content using the cable operators’ own facilities. Such portals were a much different product than broadband Internet access service – indeed, the portals were a product sold to ISPs. Netflix’s effort to have the Commission reverse its longstanding conclusion that the residential broadband Internet access market is local does not withstand scrutiny.

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Beyond that, however, there is no merit to opponents' claims that the transaction would increase AT&T's incentive to harm OTT providers in order to "protect" its linear video from OTT competition.<sup>105</sup> These claims ignore AT&T's overriding incentives, which are, and will continue to be, to grow its broadband business, both wired and wireless.<sup>106</sup> Thus, this transaction does not produce a greater *incentive* for AT&T to discriminate either as to (1) the "last mile" broadband Internet access service provided to end users or (2) Internet backbone interconnection and peering arrangements.

**1. This Transaction Will Expand Competition for "Last-Mile" Broadband Connections and Will Not Give AT&T an Incentive to Harm OTT Providers**

As AT&T has emphasized throughout this proceeding, the opportunity to enhance its core broadband offerings is one of the principal justifications for this transaction. The reduced content costs and other efficiencies gained through the transaction will allow AT&T to offer broadband to millions more Americans, and the combination of AT&T broadband and DIRECTV video will allow the combined company to offer an integrated bundle of DBS video and broadband that will compete more effectively with cable bundles.<sup>107</sup>

To win and retain broadband customers, the combined company must continue to offer them high-quality access to the OTT options they want.<sup>108</sup> As demand for OTT and other innovative streaming services grows, video represents an increasing percentage of overall

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<sup>105</sup> See Netflix Comments 14-16, 20-25; Cogent Comments at 11-12; Public Knowledge Petition at 8-9; Comments of the National Association of Telecommunications Officers and Advisors at 5 (filed Sept. 16, 2014) ("NATOA Comments").

<sup>106</sup> See Katz Reply Decl. ¶¶ 72-78.

<sup>107</sup> See, e.g., Public Interest Statement at 23-28, 39-45.

<sup>108</sup> Stankey Decl. ¶¶ 56-63; Katz Reply Decl. ¶¶ 72-75.

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Internet and data traffic on broadband networks. Broadband providers – particularly ones like AT&T that are making significant investments in their broadband networks and seeking to win customers from market-leading cable broadband providers – can remain competitive only if they provide customers with as rich an entertainment environment as possible.<sup>109</sup> That necessarily includes seamless and high-quality access to the full range of OTT and video services that consumers demand.<sup>110</sup>

AT&T, moreover, is facing additional competitive pressure from overbuilders and other providers like Google Fiber, which is spending billions of dollars to build very high-speed fiber-based broadband networks that support robust online video.<sup>111</sup> Access to OTT video content has become an important part of what consumers expect from their broadband providers, and any provider that fails to facilitate OTT offerings would suffer a competitive disadvantage in the marketplace.<sup>112</sup> In this environment, AT&T simply cannot afford to impair customers' ability to

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<sup>109</sup> See Stankey Congressional Testimony (“[O]nline programming...is also a *complement* and an important component of the services offered by broadband network operators. Broadband competitors must work hard to ensure that they can provide their customers with as rich and as integrated a video environment as possible, drawn from all the programming sources consumers may want. For these reasons, companies that provide bundles of broadband and video will foster, rather than impede, the emergence of over-the-top programmers. This is especially true for providers like AT&T whose core business is mobile and wireline broadband services. If those companies do not provide that rich and varied video environment, they risk losing their broadband customers and their wireless customers as well. Only by embracing the reality that over-the-top services are complements of their own services, just as traditional video can be a complement, will broadband providers retain and grow their relationship with their customers.”).

<sup>110</sup> See Netflix Comments at iii (“In response to OVD innovation, users increasingly demand more Internet-delivered video that they have paid high-speed broadband providers to access. In turn, broadband providers can attract new subscribers and sell existing customers more robust Internet speeds.”).

<sup>111</sup> See *id.* at 5 (noting that “consumers have been voting with their feet, moving in large numbers from traditional DSL to [FTTN, FTTH], or cable services that offer superior services”).

<sup>112</sup> Katz Reply Decl. ¶¶ 72-75.

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enjoy their favorite shows online like *Orange Is the New Black* or *House of Cards*.<sup>113</sup> HBO's recent announcement of a standalone, online version of its subscription service to be available next year<sup>114</sup> further underscores the growing significance of high-quality broadband access to customers.

For this reason, AT&T has long embraced OTT as a way to drive broadband adoption, concluding that supporting OTT in order to sell broadband is in its business interest.<sup>115</sup> AT&T has sought to integrate third-party OTT services with its broadband service, as exemplified by the recently announced agreement to team with Amazon to bundle AT&T's broadband services with Amazon Prime membership.<sup>116</sup>

As consumers increasingly demand OTT video as part of their broadband experience, AT&T will continue to retain powerful incentives to provide a high-quality customer experience

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<sup>113</sup> See *id.* ¶ 74 (reporting that a recent survey of broadband users commissioned by Comcast shows “that 79 to 89 percent of all Internet users would be likely to switch their Internet service provider if their current provider took any of the following actions: ‘prevent access to favorite websites;’ ‘slow down Internet speeds for your favorite websites;’ or ‘slow down Internet speeds for Netflix.’”).

<sup>114</sup> See Cynthia Littleton, *HBO to Launch Standalone Over-the-Top Service in U.S. Next Year*, *Variety*, <http://variety.com/2014/tv/news/hbo-to-launch-over-the-top-service-in-u-s-next-year-1201330592/#>.

<sup>115</sup> See, e.g., Lee Decl. ¶¶ 46-48; Stankey Decl. ¶ 57 (“AT&T sees future growth in OTT services from all sources as a valuable business opportunity....AT&T therefore aims to offer services that follow these customers through wireless and wireline broadband networks that support multiple devices.”). In April 2014, AT&T entered into a \$500 million joint venture with The Chernin Group to “acquire, invest in and launch over-the-top (OTT) video services.” Press Release, AT&T, The Chernin Group and AT&T Create New Venture to Acquire, Invest In and Launch Online Video Businesses (April 22, 2014), [http://about.att.com/story/the\\_chernin\\_group\\_and\\_att\\_create\\_new\\_venture\\_to\\_acquire\\_invest\\_in\\_and\\_launch\\_online\\_video\\_businesses.html](http://about.att.com/story/the_chernin_group_and_att_create_new_venture_to_acquire_invest_in_and_launch_online_video_businesses.html).

<sup>116</sup> Amit Chowdhry, *AT&T Rolls Out New \$39 Per Month U-Verse Bundle With Amazon Prime, HBO, Basic Cable and Internet*, *Forbes* (Sept. 23, 2014), <http://www.forbes.com/sites/amitchowdhry/2014/09/23/att-rolls-out-new-39-per-month-u-verse-bundle-with-amazon-prime-hbo-basic-cable-and-internet/>.

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in order to compete for and retain broadband subscribers.<sup>117</sup> Accordingly, the parties' post-transaction plans include investing in enhanced OTT services.<sup>118</sup> As Dr. Katz explains, "if AT&T were to alienate subscribers because of issues with the quality of its broadband service, it would likely lose not only the profits associated with broadband itself, but also the profits associated with the other components, such as video and voice, of the double-play or triple-play bundles purchased by a majority of its broadband Internet access subscribers."<sup>119</sup>

The commitment AT&T has made to maintain affordable standalone broadband service is clear evidence of the importance it places on broadband. Moreover, and contrary to the Greenlining Institute's claims,<sup>120</sup> the commitment assures the Commission that this service will be available to all consumers who want it. In addition, AT&T's Open Internet commitment will ensure that AT&T adheres to the Commission's 2010 rules, which are designed to protect against

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<sup>117</sup> Netflix agrees that there is a clear nexus between the quality of a broadband subscriber's OTT viewing experience and the value of a broadband subscription to the subscriber. Netflix Comments at 22. Contrary to Netflix's claims, however, the fact that OTT service is a complement to broadband service does not mean that AT&T should provide unfettered settlement-free peering to edge providers that do not perform the role of traditional Internet peers. See discussion at Section III.B.2, below.

<sup>118</sup> Stankey Decl. ¶¶ 9, 56-64.

<sup>119</sup> Katz Reply Decl. ¶ 75.

<sup>120</sup> See Greenlining Petition at 4-8. As described in the Public Interest Statement, AT&T has committed to maintain standalone broadband service. In areas where AT&T currently offers wireline IP broadband service, the combined company will, for three years after closing, continue to offer standalone wireline broadband service at reasonable market-based prices, including a service with speeds of at least 6 Mbps downstream (where feasible) at a 12-month price no greater than \$34.95 per month (provided that the price can be increased by no more than any increase in the Consumer Price Index for All Urban Consumers (CPI-U) for Communications every 12 months starting 12 months following deal close). Public Interest Statement at 50-51. Thus, Greenlining's concerns that the transaction will reduce the availability of standalone services are without merit. Further, the specific terms offered by AT&T rebut Greenlining's suggestion that AT&T's commitment is at "whatever speed and price AT&T deigns to offer." Greenlining Petition at 10.

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unreasonable discrimination against OTT providers. In fact, AT&T has urged the Commission in its ongoing Open Internet proceeding<sup>121</sup> to restore the essence of the 2010 requirements under the Section 706 authority recognized by the D.C. Circuit.<sup>122</sup>

In this regard, arguments that usage-based pricing is a discriminatory practice that should be restricted<sup>123</sup> are contrary to the Commission’s conclusions in those same Open Internet proceedings. As the Commission recognized there, “requiring all subscribers to pay the same amount for broadband service, regardless of the performance or usage of the service *would force lighter end users of the network to subsidize heavier end users.*”<sup>124</sup> The Commission further noted that usage-based pricing “may appropriately align incentives to encourage efficient use of networks.”<sup>125</sup>

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<sup>121</sup> See *Protecting and Promoting the Open Internet*, Notice of Proposed Rulemaking, 29 FCC Rcd 5561 (2014) (“2014 Open Internet NPRM”).

<sup>122</sup> *Protecting and Promoting the Open Internet*, GN Dkt No. No. 14-28, Comments of AT&T Services Inc. (filed July 17, 2014). A few opponents note that the relevant Open Internet rules for mobile services are more flexible than the wireline rules and suggest that the Commission should alter that balance in this proceeding. See Netflix Comments at 34; Public Knowledge Petition at 8. Such arguments have nothing to do with the transaction, which does not involve the combination of mobile broadband assets. The Commission is considering appropriate rules for mobile services in the Open Internet proceeding and should address these issues in that context. See 2014 Open Internet NPRM, 29 FCC Rcd at 5583-84 ¶ 62. In any event, the mobile broadband marketplace continues to flourish with competition, investment, and innovation. These features of the marketplace will ensure that AT&T offers its mobile services in a manner that enables customers to use the applications, services, and content of their choice, consistent with reasonable network management prerogatives. See *Protecting and Promoting the Open Internet Framework for Broadband Internet Services*, GN Dkt No. 14-28, Reply Comments of AT&T, at 58-90 (filed Sept. 15, 2014). Any mobile services carrier that failed to give customers what they want would be swiftly punished in the marketplace.

<sup>123</sup> Public Knowledge Petition at 8; WGAW Petition at 22-23; DISH Petition at 26-27; Netflix Comments at 25-28.

<sup>124</sup> *Preserving the Open Internet*, 25 FCC Rcd 17,905, 17,945 ¶ 72 (2010) (emphasis added) (“Open Internet Order”); see also Katz Reply Decl. ¶ 68.

<sup>125</sup> Open Internet Order, 25 FCC Rcd at 17,945 ¶ 72 (2010).

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That analysis is at least as sound today as it was then. Given the growing importance of OTT content to consumers, a broadband provider adopting usage-based rates that significantly impinged on the ability of customers to enjoy OTT products would not be able to attract new customers or even to retain existing ones.<sup>126</sup> Consistent with that market reality, to the extent that AT&T has implemented usage-based pricing for wireline broadband, it has set data allowances at levels sufficient to accommodate the broadband needs of most customers.<sup>127</sup> As expressly permitted by the Commission, such usage-based pricing avoids forcing customers who are lighter users of broadband services to subsidize the very heaviest users and encourages more efficient use of the network. AT&T has been transparent about its policies and practices in compliance with the Commission's Open Internet rules.<sup>128</sup> AT&T also offers consumers the tools to manage their data use and choose the data plan that best suits their needs and budgets.

**2. There Is No Basis To Impose Conditions To Address Internet Peering or Interconnection**

There is likewise no basis to impose conditions relating to alleged discrimination against OTT providers or other entities through Internet peering and interconnection.<sup>129</sup> Although

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<sup>126</sup> Katz Reply Decl. ¶¶ 67-70. For the same reasons, a broadband provider has no incentive to unreasonably discriminate against OTT products through data allowances, as alleged by Netflix and others. Netflix Comments at 25-28; Public Knowledge Petition at 8; WGAW Petition at 22-23; DISH Petition at 26-27. Moreover, as noted above, the 2010 Open Internet rules that AT&T has committed to follow prohibit unreasonable discrimination by wireline broadband providers.

<sup>127</sup> See AT&T, Broadband Usage FAQ, <http://www.att.com/esupport/article.jsp?sid=KB409045&cv=812#fbid=ro5k-ROIfIK> (last visited Oct. 14, 2014).

<sup>128</sup> See AT&T, AT&T High Speed Internet Terms of Service, <http://www.att.com/shop/internet/att-internet-terms-of-service.html#fbid=yaGcvWE58FS> (last visited Oct. 14, 2014); AT&T, Broadband Usage FAQ, <http://www.att.com/esupport/article.jsp?sid=KB409045&cv=812#fbid=ro5k-ROIfIK> (last visited Oct. 14, 2014).

<sup>129</sup> Netflix Comments at 33-34; Cogent Comments at 18-22.

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Netflix and Cogent seek to inject their own disputes into this proceeding, their claims about alleged prior AT&T conduct are both inaccurate and irrelevant to this transaction.

OTT providers are free to use any of the large number of backbone service providers to reach AT&T's end-user customers. AT&T has peering arrangements with 23 partners.<sup>130</sup> It also has commercial peering and transit connections with many Content Delivery Networks ("CDNs"), such as [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] and with other ISPs.<sup>131</sup> OTT providers, including Netflix, can choose any combination of these services to send their traffic to AT&T, without any need for a direct connection or relationship with AT&T.<sup>132</sup> Indeed, Netflix, like other content providers, has the flexibility to manage these services in real time to direct its traffic to providers that can deliver the traffic most efficiently.<sup>133</sup>

For these reasons, the Commission's long-established conclusion that it should not regulate in this area remains correct. As the Commission has explained, "settlement-free peering and degradation-free transit arrangements have thrived" in a market environment in which "interconnection between Internet backbone providers has never been subject to direct government regulation."<sup>134</sup> Consistent with that understanding, in 2010, the Commission made

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<sup>130</sup> Declaration of Scott Mair, Senior Vice President of Technology Planning and Engineering AT&T Services, Inc. ¶¶ 4, 10 (Oct. 15, 2014) ("Mair Decl.").

<sup>131</sup> *Id.* ¶¶ 10, 15, 18.

<sup>132</sup> *Id.* ¶¶ 4, 10.

<sup>133</sup> *Id.* ¶¶ 4, 20-21.

<sup>134</sup> *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, 20 FCC Rcd 18,290, 18,362-63, ¶ 132 (2005); *see also Federal-State Joint Board on Universal Service*, Report to Congress, 13 FCC Rcd 11,830, 11,531 ¶¶ 62-63 (1998) (distinguishing services offered by Internet backbone providers and Internet access providers); Jason Oxman, *The FCC and the Unregulation of the Internet*, FCC Office of Plans and Policy, Working Paper

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clear that its Open Internet rules did not apply to backbone interconnection and peering.<sup>135</sup> The Commission, moreover, has tentatively concluded this year that it should maintain that aspect of its prior determination.<sup>136</sup> To be sure, the Commission staff continues to gather data to learn more about Internet interconnection.<sup>137</sup> If the Commission identifies any issues during that process, those issues should be addressed on an industry-wide basis, consistent with established Commission precedent.<sup>138</sup> Indeed, even in this proceeding, Cogent and Netflix acknowledge that the concerns they raise implicate industry-wide issues.<sup>139</sup> Thus, it should come as no surprise

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No. 31 at 23 (1999), *available at* <http://www.fcc.gov/working-papers/fcc-and-unregulation-internet> (“[T]he Internet backbone is treated as an unregulated information service.”); Michael Kende, *The Digital Handshake: Connecting Internet Backbones*, FCC Office of Plans and Policy, Working Paper No. 32 at 2, 16 (2000), *available at* [http://transition.fcc.gov/Bureaus/OPP/working\\_papers/oppwp32.pdf](http://transition.fcc.gov/Bureaus/OPP/working_papers/oppwp32.pdf) (stating that “in the absence of a dominant backbone, market forces encourage interconnection between backbones and thereby protect consumers from any anti-competitive behavior on the part of backbone providers” and “there are no domestic or international industry-specific regulations that govern how Internet backbone providers interconnect to exchange traffic”).

<sup>135</sup> See Open Internet Order, 25 FCC Rcd at 17,944 ¶ 67 n.209 (“We do not intend our rules to affect existing arrangements for network interconnection, including existing paid peering arrangements.”).

<sup>136</sup> 2014 Open Internet NPRM, 29 FCC Rcd at 5582 ¶ 59.

<sup>137</sup> Press Release, FCC, Statement by FCC Chairman Tom Wheeler on Broadband Consumers and Internet Congestion (June 13, 2014), [https://apps.fcc.gov/edocs\\_public/attachmatch/DOC-327634A1.pdf](https://apps.fcc.gov/edocs_public/attachmatch/DOC-327634A1.pdf).

<sup>138</sup> See, e.g., *Application of AT&T Inc and Qualcomm Inc. for Consent to Transfer Control of Licenses and Authorizations*, Order, 26 FCC Rcd 17,589, 17,622 ¶ 79 (2011) (“[M]any of these additional requests for relief pertain to industry-wide issues that have been raised or addressed in other, broader contexts, including issues relating to handset exclusivity, Universal Service Fund reform, spectrum for unlicensed devices, Open Internet and open access, special access, and backhaul. We find these issues are better addressed in the context of these industry-wide proceedings.”).

<sup>139</sup> Cogent Comments at 19; Netflix Comments at 14 (identifying AT&T as already one of four Internet access providers that allegedly have the ability to “extract terminating access fees”).

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that Netflix, Cogent, and their allies make many of the same arguments in the industry-wide Open Internet proceeding that they do here.<sup>140</sup>

As we now explain, neither Netflix or Cogent offers any reason to bypass the Commission's broader inquiry.

a. Netflix

Netflix's argument rests fundamentally on the assertion that AT&T has the ability to use its peering connections to "congest" Netflix's services and that AT&T has done so in the past.<sup>141</sup> However, the only way a "degradation by congestion" strategy could possibly work would be if AT&T congested or blocked *all* of its interconnection points.<sup>142</sup> If AT&T congested only some of these points – say, Cogent's – Netflix could switch to one of the many remaining backbone providers that deliver traffic to AT&T with no need to deal directly with AT&T.<sup>143</sup>

Consistent with these facts, the congestion that Netflix previously experienced was the avoidable result of its own routing decisions.<sup>144</sup> Netflix could readily have avoided that

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<sup>140</sup> See, e.g., *Protecting and Promoting the Open Internet*, GN Dkt No. 14-28, Comments of Netflix, at 10-15, 17-18 (filed July 15, 2014); *id.*, Comments of Cogent at 20-21 (filed July 15, 2014); *id.*, Comments of Level 3 Communications at 14-16 (filed July 15, 2014).

<sup>141</sup> Because Netflix's argument deals with interconnection and peering, its repeated assertions that AT&T holds a "terminating access monopoly" are misleading.

<sup>142</sup> Mair Decl. ¶ 24. Obviously, if AT&T congested all of its interconnection points, that would degrade *all* Internet traffic heading to AT&T customers, which would harm the performance of the broadband Internet services that are a crucial part of AT&T's business. *Id.* ¶¶ 5, 24. See Katz Reply Decl. ¶ 64 ("AT&T would have to degrade its interconnection with multiple transit providers and CDNs in order to degrade interconnection with a specific edge provider, or class of edge providers. Otherwise, the edge provider could easily make an 'end run' around the specific point of degraded interconnection.").

<sup>143</sup> Mair Decl. ¶ 24.

<sup>144</sup> See David Clark *et al.*, *Measurement and Analysis of Internet Interconnection and Congestion*, (Aug. 15, 2014), available at [http://www.caida.org/publications/papers/2014/measurement\\_analysis\\_internet\\_interconnection/measurement\\_analysis\\_internet\\_interconnection](http://www.caida.org/publications/papers/2014/measurement_analysis_internet_interconnection/measurement_analysis_internet_interconnection)

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congestion for its customers by using a different mix of backbone providers.<sup>145</sup> By contrast, the receiving network (here, AT&T) has no control over how the traffic comes into its backbone facilities.<sup>146</sup> AT&T thus cannot prevent a content provider like Netflix from pushing a large amount of traffic over a small set of interconnection links.<sup>147</sup>

Netflix's unilateral business decision to deliver traffic in this manner provides no support for its extreme position that AT&T should be required to provide backbone services and associated facilities upgrades for free. The backbone marketplace has functioned extraordinarily well for many years on the principle that services are provided for *compensation* – either in the form of negotiated rates, or through the *in-kind* exchange of traffic in a rough balance.<sup>148</sup> Under existing agreements, the costs to provide backbone services are appropriately recovered from the

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.pdf (“content providers or CDNs have additional degrees of freedom to control congestion, by hosting content (e.g. web pages, video, streaming music) at locations close to its consumers, and strategically selecting from which source to transmit the content, in order to affect congestion, improve performance, or reduce the cost of the transmission”).

<sup>145</sup> Accordingly, Netflix's assertion that congestion issues left it “no choice” but to seek a direct interconnection agreement with AT&T is simply false. See *Applications of Global Crossing Limited and Level 3 Communications, Inc. for Consent to Transfer Control*, Memorandum Opinion and Order and Declaratory Ruling, 26 FCC Rcd 14,068, 14,068 ¶ 27 (2011) (finding foreclosure concerns unfounded because “if the combined entity were to engage in connection degradation or price increases,” its interconnection customers “would be able to transition easily to another provider”).

<sup>146</sup> Mair Decl. ¶ 20.

<sup>147</sup> *Id.* ¶¶ 20-21. Netflix argues that AT&T intentionally congested its network to degrade Netflix service, citing a December and January congestion peak as significant because it “represent[ed] some of Netflix's busiest times because members spend more time at home over the holidays and therefore request more streaming video from Netflix and other OVDs.” Netflix Comments at 24. But all four large ISPs experienced similar traffic congestion during similar timeframes, a fact that points to Netflix's own failure to properly manage its traffic during peak viewing months. See Netflix, USA ISP Speed Index Archive, <http://ispspeedindex.netflix.com/results/usa/archives> (last visited Oct. 14, 2014).

<sup>148</sup> See Mair Decl. ¶¶ 6, 9.

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participants in the backbone marketplace that send the traffic (such as Netflix). Those parties thus properly internalize the costs of their routing decisions and consequently have incentives to use those facilities efficiently. There is no sound economic reason to permit Netflix to shift the recovery of backbone costs onto the shoulders of those who do not use Netflix's services.

Against this backdrop, Netflix has not identified any possible *merger-specific* peering-related harms. To the contrary, before AT&T even announced its merger with DIRECTV,

Netflix entered into a long-term **[BEGIN AT&T HIGHLY CONFIDENTIAL**

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**INFORMATION]** contract with AT&T.<sup>149</sup> Under that contract, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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**INFORMATION]** The arrangement is quite favorable to Netflix.<sup>151</sup> Indeed, AT&T provides Netflix everything in this contract that Netflix claims AT&T has an "anticompetitive incentive" to withhold. For example, AT&T has **[BEGIN AT&T HIGHLY CONFIDENTIAL**

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**INFORMATION]** the new arrangement is working well for Netflix and its customers. Netflix's

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<sup>149</sup> Mair Decl. ¶¶ 7, 25.

<sup>150</sup> *Id.* ¶ 25.

<sup>151</sup> *Id.*

<sup>152</sup> *Id.* ¶¶ 26-28.

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performance for AT&T broadband customers is expected to improve more in the coming months as the new arrangement continues to be optimized.<sup>153</sup>

b. Cogent

Cogent's arguments are similarly unfounded. At bottom, Cogent is complaining that AT&T did not allow Cogent to continue to act in a manner that violated AT&T's long-standing and publicly available peering policy.<sup>154</sup> Like other backbone providers, AT&T has a policy that offers a standard set of terms to govern peering.<sup>155</sup> Under AT&T's policy, peering is permitted

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<sup>153</sup> *Id.* ¶ 29. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** *Id.* ¶ 28.

<sup>154</sup> Cogent has a long history of disputes with peers over traffic imbalances. *See, e.g.*, David Young, *Unbalanced Peering, and the Real Story Behind the Verizon/Cogent Dispute*, Verizon Policy Blog (June 19, 2013), <http://publicpolicy.verizon.com/blog/entry/unbalanced-peering-and-the-real-story-behind-the-verizon-cogent-dispute>; Rich Miller, *Sprint, Cogent Resume Peering, Keep Arguing*, Data Center Knowledge (Nov. 2, 2008), <http://www.datacenterknowledge.com/archives/2008/11/02/sprint-cogent-resume-peering-keep-arguing/>; Rich Miller, *Cogent Unplugs Telia in Peering Dispute*, Data Center Knowledge (Mar. 16, 2008), <http://www.datacenterknowledge.com/archives/2008/03/16/cogent-unplugs-telia-in-peering-dispute/>; Press Release, Cogent Communications, Level 3 and Cogent Reach Agreement on Equitable Peering Terms (Oct. 28, 2005), <http://www.cogentco.com/en/news/press-releases/225-level-3-and-cogent-reach-agreement-on-equitable-peering-terms>.

<sup>155</sup> *See, e.g.*, CenturyLink, CenturyLink's North America IP Network Peering Policy, [http://www.centurylink.com/legal/peering\\_na.html](http://www.centurylink.com/legal/peering_na.html) (last visited Oct. 14, 2014) (requiring a 1.5:1 traffic ratio); AS3257, Peering Policy for AS3257, <https://www.as3257.net/peering-policy/> (last visited Oct. 14, 2014) (requiring a 1:2 traffic ratio); Level 3, IP Traffic Exchange Policy, <http://www.level3.com/en/legal/ip-traffic-exchange-policy/> (last visited Oct. 14, 2014) ("The backbone cost burden associated with settlement-free peering traffic exchange should be equitably shared."); Verizon, Verizon Business Interconnection Policy for Internet Networks, <http://www.verizonenterprise.com/terms/peering/> (last visited Oct. 14, 2014) (requiring a 1.8:1 traffic ratio); XO Communications, Settlement-Free Interconnection Policy, <http://www.xo.com/WorkArea/DownloadAsset.aspx?id=10737418819> (last visited Oct. 14, 2014) ("The total 95th percentile aggregate traffic in/out ratio shall not exceed 2.0 to 1.").

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so long as the ratio of incoming to outgoing traffic does not exceed 2:1 (and AT&T's other peering requirements are met).<sup>156</sup> If traffic modestly exceeds the 2:1 ratio, AT&T will work with the peer to establish more efficient routing arrangements or, in appropriate cases, a shift to a paid arrangement (or at least payment for upgrades).<sup>157</sup> These basic requirements are typical of peering policies in the industry (and more generous than some).<sup>158</sup> They are based solely on the balance of traffic, not, as Cogent suggests, the *origin* and *type* of traffic that may be involved.<sup>159</sup> Traffic imbalances greater than 2:1 violate both AT&T's peering policy and the industry norm calling for equal exchanges of traffic for "peering," whether such imbalances involve OTT traffic or any other type of traffic.<sup>160</sup>

Cogent first asked AT&T to upgrade its peering links in [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

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<sup>156</sup> AT&T, AT&T Global IP Network Settlement-Free Peering Policy, <http://www.corp.att.com/peering> (last visited Oct. 11, 2014) ("Peer must maintain a balanced traffic ratio between its network and AT&T. In particular, a new peer must have: a. No more than a 2.00:1 ratio of traffic into AT&T: out of AT&T, on average each month. b. A reasonably low peak-to-average ratio.").

<sup>157</sup> Mair Decl. ¶ 13.

<sup>158</sup> *Id.*

<sup>159</sup> *Id.* ¶ 41.

<sup>160</sup> *Id.* ¶¶ 12-13, 41.

<sup>161</sup> *Id.* ¶ 34.

<sup>162</sup> *Id.*

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**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** Under these conditions, AT&T expeditiously upgraded (at substantial expense) the number of 10 Gigabit Ethernet connections it had with Cogent from **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** In subsequent months, however, Cogent delivered ever greater amounts of traffic to AT&T and its traffic imbalance rocketed to more than **[BEGIN AT&T HIGHLY CONFIDENTIAL**

**INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

AT&T made clear to Cogent on numerous occasions that AT&T was willing to **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

In sum, Cogent, by delivering traffic grossly in excess of ratios that represent a balanced exchange, was improperly attempting to obtain backbone services and investments from AT&T for free.<sup>163</sup> Moreover, the “free” upgrades that Cogent sought would cost far more than Cogent’s \$10,000 estimate: as explained in the Declaration of AT&T Senior Vice President of Technology Planning and Engineering, Scott Mair, each new 10 Gigabit Ethernet connection

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<sup>163</sup> *Id.* ¶¶ 35-36.

<sup>164</sup> *Id.* ¶ 37.

<sup>165</sup> *Id.* ¶ 39.

<sup>166</sup> *Id.* ¶¶ 34-40.

<sup>167</sup> *Id.* ¶¶ 38-40.

<sup>168</sup> *Id.* ¶ 40.

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requires AT&T to augment its fiber facilities and router capacity, which would typically cost about [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] Cogent's estimate.<sup>169</sup>

As a result, these claims have nothing to do with this transaction. Indeed, they predate the announcement of the transaction by about a year.<sup>170</sup> Moreover, as explained above, the Commission has begun an inquiry into backbone peering and interconnection, and Cogent will have ample opportunity to argue in favor of its proposed policies in that context.

Beyond that, Cogent's proposed conditions vividly demonstrate that it is seeking to obtain subsidies for itself, not to remedy any supposed transaction-specific harm (which does not exist here). For instance, Cogent suggests that AT&T be required to maintain settlement-free peering for seven years for all parties – unsurprisingly, including Cogent – that have such an arrangement on May 18, 2014.<sup>171</sup> Thus, in Cogent's view, AT&T should be required to subsidize Cogent, and potentially some other members of a closed group of current peers, for years on end, regardless of potentially drastic changes in traffic balances, the terms of those parties' freely negotiated agreements, and the existence of numerous alternative backbone providers. Similarly, Cogent suggests that the Commission impose a condition that requires

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<sup>169</sup> *Id.* ¶ 42. Notably, no party has offered any credible claim that AT&T would or ever has blocked particular types of traffic at Cogent's links, and the Commission need not address such claims because Cogent's contract with AT&T [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]. *Id.* ¶ 41 (citing ATT-FCC-01517291).

<sup>170</sup> *Id.* ¶ 34.

<sup>171</sup> Cogent Comments at 21.

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AT&T to perform free upgrades whenever existing links reach 70 percent capacity.<sup>172</sup> As explained above,<sup>173</sup> such a condition would radically change the accepted norms in the backbone industry, encourage inefficient routing, and impose enormous uncompensated costs on AT&T.<sup>174</sup> Netflix's proposal seeking free access for content providers to AT&T's network would likewise be contrary to industry norms and would be extremely costly to AT&T and its customers.<sup>175</sup> In short, there is no basis for the Commission to impose conditions that would, in effect, supplant marketplace outcomes with inefficient regulation that forces AT&T, and only AT&T, to provide such arrangements at no charge.<sup>176</sup>

**C. Opponents' Asserted Harms to Programmers and MVPD Access to Programming Are Meritless and Conditions Are Unnecessary**

**1. The Transaction Will Expand the Supply of Video Programming Without Increasing MVPD Costs**

A few opponents contend that the significant content cost savings resulting from this transaction will either reduce the variety of content<sup>177</sup> or raise competitors' costs of content.<sup>178</sup> These assertions are not supported by facts or economic logic and provide no basis on which to impose conditions.

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<sup>172</sup> *Id.* at 21.

<sup>173</sup> *See* Section III.B.2.a, above.

<sup>174</sup> Mair Decl. ¶¶ 44-49. Moreover, such a condition would create large unnecessary excess capacity that would create significant security risks. *Id.* ¶¶ 46-47.

<sup>175</sup> *Id.* ¶ 50.

<sup>176</sup> *Id.* ¶¶ 43-52.

<sup>177</sup> WGAW Petition at 13-14 (reduced content payments will result in "harm to both content creators and consumers as investment, innovation and choice in programming will be reduced").

<sup>178</sup> DISH Petition at 10-14; Cox Petition at 13-16; ACA Comments at 19-20.

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Content providers control unique and differentiated products that are a critical input to MVPD services.<sup>179</sup> As many have said, “content is king.”<sup>180</sup> An MVPD service requires content, and MVPDs have been forced to deal with a shrinking number of firms that control the most popular content that consumers demand.<sup>181</sup> Thus, programmers have had far greater bargaining power than video distributors, as is clear from the rapid rise in the fees charged to MVPDs for cable network programming, retransmission consent, and sports programming.<sup>182</sup>

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<sup>179</sup> See, e.g., *Applications for Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corp., Assignors, to Time Warner Cable Inc., Assignees, Adelphia Communications Corp., Assignors and Transferors, to Comcast Corp., Assignees and Transferees, Comcast Corp., Transferor, to Time Warner Inc., Transferee, Time Warner Inc., Transferor, to Comcast Corp., Transferee*, Memorandum Opinion and Order, 21 FCC Rcd 8203, 8227 ¶ 42 (2006) (“Adelphia Order”) (stating that “an MVPD’s ability to compete effectively with an incumbent cable operator is significantly harmed if it is denied access to ‘must have’ vertically integrated programming, for which there is no good substitute”).

<sup>180</sup> See CNBC, Press Release, CNBC Exclusive: CNBC Transcript: CNBC's David Faber Speaks with CBS Corporation President & CEO Leslie Moonves, “Closing Bell” Transcript (Sept. 10, 2014), <http://www.cnbc.com/id/101989964#> (CBS CEO Les Moonves stating, “Nobody can exist without the CBS content on their air. Yes, Comcast is going to get bigger. AT&T [is] going to get bigger. We are going to have to negotiate with both of them. They can’t live without our content. They can’t live without the NFL, they can’t live without The Big Bang Theory, they can’t live without NCIS.”); Bill Carter, *CBS Returns, Triumphant, to Cable Box*, N.Y. Times (Sept. 2, 2013), <http://www.nytimes.com/2013/09/03/business/media/cbs-and-time-warner-cable-end-contract-dispute.html> (“The outcome [of the programming dispute] underscored the leverage that the owners of important television content...retain over distributors like cable systems.”).

<sup>181</sup> For example, AT&T estimates that, in 2014, roughly **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** of U-verse content costs will be attributable to only five content aggregators. Public Interest Statement at 35 n.100; Lee Decl. ¶ 21.

<sup>182</sup> See Public Interest Statement at 34-35, n.99; Lee Decl. ¶ 18; see also WGAW Petition at 11, Table 2 (programming costs increased at a rate of 10 percent in 2012 and 2013, up from an 8 percent increase in 2010); S. Derek Turner, Free Press, *Combating the Cable Cabal* at 20 (May 2013), [http://www.freepress.net/sites/default/files/resources/Combating\\_The\\_Cable\\_Cabal\\_0.pdf](http://www.freepress.net/sites/default/files/resources/Combating_The_Cable_Cabal_0.pdf) (“The broadcast industry as a whole has seen retransmission revenues increase more than 10-fold in just the past six years, from \$215 million in 2006 to \$2.4 billion in 2012.”); Robin Flynn, *U.S. Multichannel Subscriber Update and Programming Cost Analysis*, SNL Kagan Special Report at

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The transaction will not alter relative bargaining power in any way that will reduce the quantity and variety of programming content providers are able to offer.<sup>183</sup> Distributors like AT&T will continue to need a wide and ever-changing variety of high-quality content to satisfy consumer demand. While Applicants anticipate being able to reduce significantly the per-subscriber cost of the programming they purchase, those savings will not result from the exercise of monopsony power. In *Comcast/AT&T Broadband*, the Commission concluded that a merger of the then-largest and third largest cable operators in the nation would not enable the combined entity “to exercise monopsony power over programming markets or raise rival MVPDs’ costs.”<sup>184</sup> Here, as in that case, the combined firm will serve considerably less than 30 percent of all MVPD subscribers nationwide.<sup>185</sup> Moreover, the addition of a vibrant and expanding OTT

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3 (June 2013), <http://go.snlfinciallc/images/SNL-Kagan-US-Multichannel-Subscriber-Update-Programming-Cost-Analysis.pdf> (estimating that the average MSO will see a 10 percent cost increase for ESPN programming from 2012 to 2013, and that combined programming expenses for the top three cable operators were up 6.5 percent in 2012, an increase from a 4.7 percent rise in 2011); *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Fifteenth Report, 28 FCC Rcd 10,496, 10,657 ¶ 331 (2013) (“Fifteenth Video Competition Report”) (“SNL Kagan estimates that programming costs for 12 nationally distributed English and Spanish-language broadcast networks increased from approximately \$12.7 billion in 2010 to \$13.5 billion in 2012.”).

<sup>183</sup> Katz Reply Decl. ¶¶ 30-33 (explaining that WGAW’s claims “rest on a misunderstanding of economic theory and are not supported by evidence”).

<sup>184</sup> Comcast/AT&T Broadband Order, 17 FCC Rcd at 23,269 ¶ 65. In contrast to the Comcast/AT&T Broadband merger, the proposed AT&T/DIRECTV transaction does not involve the merger of two broadband providers.

<sup>185</sup> Thirty percent was the then-applicable cap on the number of subscribers a cable operator could serve under FCC rules. *Id.* at 23,259, 23,265 ¶¶ 39, 54. Although that cap was subsequently struck down, the Court of Appeals indicated that, in light of increasing video competition, even an MVPD with more than 30 percent of subscribers nationwide was not, for that reason alone, large enough to cause competitive harm. *Comcast Corp. v. FCC*, 579 F.3d 1, 8 (D.C. Cir. 2009). Further, antitrust precedent confirms that a market share below 30 percent is not sufficient to confer market power. *See Commercial Data Servers, Inc. v. International Business Machines Corp.*, 262 F. Supp. 2d 50, 74-75 (S.D.N.Y. 2003) (“Courts have consistently

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segment – including, for example, the fact that Netflix has “over 50 million members in more than 40 countries”<sup>186</sup> – has only added to what the D.C. Circuit described as the “ever increasing competition among video providers.”<sup>187</sup>

In addition, as Dr. Katz has explained, the very nature of the content market ensures that this transaction will not create any potential monopsony concerns:

The enhancement of bargaining power through increased scale and share will not give rise to the standard monopsony output-reduction effects. The nature of the contracting in this industry is such that the parties negotiate a price and the buyer then chooses a quantity. Hence, when the buyer succeeds in negotiating a lower price it has incentives to purchase more of the input and expand its output, the direct opposite of the monopsony restriction.<sup>188</sup>

As a result of this transaction, AT&T will be able to offer content providers a better MVPD product, with access to multiple screens, greater advertising reach, more flexibility, and more options.<sup>189</sup> The increased scale and efficiency of AT&T will help expand the avenues for consumption of content, thus allowing the content providers, and AT&T, to offer more competitive, cost-effective, and integrated services to consumers. These improved products will

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held that firms with market shares of less than 30% are presumptively incapable of exercising market power.”) (citing *Union Carbide Corp. v. Montell N.V.*, 27 F. Supp. 2d 414, 417 (S.D.N.Y. 1998)).

<sup>186</sup> Netflix Comments at 1.

<sup>187</sup> *Comcast Corp. v. FCC*, 579 F.3d at 8.

<sup>188</sup> Katz Decl. ¶ 111 n.195; *see also* Katz Reply Decl. ¶¶ 30-33 (“[T]he standard monopsony model does not apply to the bargaining context in which content providers sell programming to MVPDs.”). For the same reason that AT&T will not have the ability to increase rivals’ programming costs, AT&T will not have the leverage to require third-party programmers to withhold or restrict access to their programming by other video distributors, *see* DISH Petition at 14-16, whether those distributors are traditional MVPD rivals or online competitors.

<sup>189</sup> *See* Stankey Decl. ¶¶ 22-25.

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generate greater revenue opportunities and benefit both AT&T and the content providers.<sup>190</sup> And the expansion of broadband networks made possible by the merger will further expand demand for content.<sup>191</sup> In this context, content cost savings generated by the transaction will not lead to reductions in the quantity or quality of video content that will be available to the public, as WGAW asserts,<sup>192</sup> but rather increased content provider revenues will likely lead to “increased ‘investment, innovation, and choice in programming.’”<sup>193</sup>

There is also neither factual support for, nor any economic logic to, the contention that the savings realized by Applicants will come out of the pockets of their competitors.<sup>194</sup> Programmers already negotiate aggressively to obtain the best possible rates from each individual MVPD based on that MVPD’s size and the value it brings to the programmer. That will not change as a result of the transaction. In effect, opponents are making the illogical claim that program suppliers are charging them less today than the programmers otherwise could because AT&T is paying more as a purchaser of the same content. As Dr. Katz has explained, “content providers will negotiate with other MVPDs based on the specific circumstances, including the value of the content to the MVPD, the incremental advertising revenues that the content provider and MVPD can obtain from distribution of the content, and the content

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<sup>190</sup> See Katz Reply Decl. ¶ 33 (“[T]he proposed merger is likely to increase the monetization opportunities of content providers because a larger video service provider can offer a content owner greater distribution, which enhances the value that it can offer advertisers.”).

<sup>191</sup> *Id.*

<sup>192</sup> WGAW Petition at 13-14.

<sup>193</sup> Katz Reply Decl. ¶ 33 (citing WGAW Petition at 14).

<sup>194</sup> See ACA Comments at 19 (claiming that as a response to AT&T’s reduced content costs, programmers “will make it up by charging higher prices to those smaller providers who lack the bargaining leverage to resist”); Cox Petition at 14 (“Forcing smaller MVPDs to subsidize the lower prices paid by the largest MVPDs results in” harm to MVPDs and customers.); DISH Petition at 13.

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provider's opportunity cost of licensing to the MVPD."<sup>195</sup> Thus, "[t]here is no basis in the economics of bargaining to conclude that a better deal for AT&T should result in a worse deal for other MVPDs."<sup>196</sup> In any event, programmers will have no need to make up "lost" revenues by extracting more from other MVPDs because, as just noted, the transaction will actually create new revenue opportunities for content providers.

**2. Program Access Conditions Are Unnecessary, as DIRECTV and AT&T Have Very Few Content Holdings**

Unlike transactions such as Comcast/NBCU that involved substantial vertical integration, neither AT&T nor DIRECTV has substantial content holdings.<sup>197</sup> Thus, the requests by some opponents for various program access conditions are unfounded.<sup>198</sup>

Several parties nevertheless raise issues relating to DIRECTV's RSNs. AT&T's U-verse service is not available in any of the areas served by DIRECTV's existing RSNs (Pittsburgh, Seattle, and Denver), so there will be no increased subscriber share in the footprints of these RSNs. In these circumstances, there can be no argument that the transaction has changed the combined company's incentive to make such programming available to its rivals.<sup>199</sup> Further,

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<sup>195</sup> Katz Reply Decl. ¶ 29.

<sup>196</sup> *Id.*

<sup>197</sup> See n.102, above, describing DIRECTV's RSN holdings.

<sup>198</sup> See ACA Comments at 2-3; Comments of Cequel Communications, LLC D/B/A Suddenlink Communications at 8 (filed Sept. 16, 2014) ("Cequel Comments"); Cox Petition at 4, 17-21.

<sup>199</sup> See Adelphia Order, 21 FCC Rcd at 8261-62 ¶ 128 ("It is the combination of RSN ownership and MVPD market share that makes anticompetitive strategies possible."); *Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act Sunset of Exclusive Contract Prohibition*, Report and Order, 17 FCC Rcd 12,124, 12,140 ¶ 38 (2002) ("The number of subscribers that a vertically integrated cable programmer serves is of particular importance in calculating the benefits of withholding

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DIRECTV continues to operate under the program access requirements pursuant to a condition imposed in a prior transaction.<sup>200</sup>

Petitioners' case for conditions is not strengthened by the fact that AT&T and DIRECTV have proposed in bankruptcy proceedings to acquire a Houston area RSN ("CSN Houston"), which operates in an area where U-verse is available.<sup>201</sup> CSN Houston failed even though it was partly owned by Comcast, the largest MVPD in the Houston area, because it could not achieve enough carriage within its footprint.<sup>202</sup> Assuming court approval for the acquisition, the combined company will have especially strong economic and business incentives to seek carriage on as many distribution platforms as possible to strengthen the RSN's economic viability. It would make no economic sense for AT&T and DIRECTV to invest millions of dollars into an RSN that went bankrupt *because it lacked wide distribution* and then try to restrict its availability and suppress potential revenues.

In sum, very little content is at issue here, the transaction will not result in any increase in subscriber share in areas within DIRECTV's RSN footprints, and DIRECTV remains subject to program access conditions with respect to that programming. The merger will not diminish MVPD access to those RSNs. Moreover, AT&T is subject to the Commission's existing

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programming from rival MVPDs....Other things being equal, then, as the number of subscribers rises, so does the likelihood that withholding would be profitable.").

<sup>200</sup> See *Liberty Media Corp., Transferor, DIRECTV, Transferee*, Order, 25 FCC Rcd 7502, 7504 ¶ 5, n.14 (IB, WTB 2010) (discussing continuing applicability of program access conditions, which remain in effect so long as the program access rules remain in effect).

<sup>201</sup> See ACA Comments at 9-11; Cequel Comments at 3-5.

<sup>202</sup> *In re Houston* at 13, 16-17.

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program access rules, thus providing another layer of protection for other MVPDs.<sup>203</sup> For all these reasons, there is no transaction-specific harm that even arguably warrants programming conditions.

**3. There Is No Basis To Prevent the Combined Company From Entering Into Exclusive Arrangements With Unaffiliated Third Parties**

Despite the fact that DIRECTV has had exclusive rights to NFL Sunday Ticket for years, DISH and Cox ask the Commission to scrutinize this agreement.<sup>204</sup> Cox goes even further and asks the Commission to prohibit the combined company from entering into or continuing exclusive contracts for any local and national sports programming.<sup>205</sup> Concerns about NFL Sunday Ticket plainly have nothing to do with this transaction, and the Commission should reject any such conditions on that basis alone.

The Commission has repeatedly rejected analogous requests in prior transaction reviews involving DIRECTV. In *News/Hughes*, although the Commission prohibited DIRECTV from entering into exclusive arrangements with affiliated programmers, the Commission specifically *excluded* from the conditions imposed any prohibition of the type sought here. As the Commission stated: “DirecTV may continue to compete for programming that is lawfully offered on an exclusive basis by an unaffiliated program rights holder (*e.g.*, NFL Sunday Ticket).”<sup>206</sup> The Commission again rejected similar arguments in *DIRECTV/Liberty*, finding that

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<sup>203</sup> 47 U.S.C. § 548(j); 47 C.F.R. § 76.1004. The program access rules state that a cable operator with an attributable interest in programming may not “engage in unfair methods of competition or unfair or deceptive acts or practices, the purpose or effect of which is to hinder significantly or prevent any [MVPD] from providing [applicable] programming to subscribers or consumers.” 47 C.F.R. § 76.1001(a); *see also* 47 U.S.C. § 548.

<sup>204</sup> Cox Petition at 7-13; DISH Petition at 16-18.

<sup>205</sup> Cox Petition at 12-13.

<sup>206</sup> *News/Hughes Order*, 19 FCC Rcd at 532 ¶ 127.

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“this transaction would not give DIRECTV market power or provide DIRECTV with an unfair advantage in obtaining programming on an exclusive basis” and that “other MVPDs have had exclusive agreements with non-vertically integrated programmers or are equally capable of securing them.”<sup>207</sup>

Those prior determinations in transaction reviews reflect established Commission policy. The Commission has long concluded that, “[a]s a general matter, the public interest in exclusivity in the sale of entertainment programming is widely recognized.”<sup>208</sup> Moreover, in its recent decision declining to extend its prohibition on exclusive arrangements even between cable operators and *affiliated* programmers, the Commission specifically found that “exclusive contracts may result in the procompetitive benefit of allowing MVPDs to differentiate their service offerings.”<sup>209</sup> And Congress has specifically called for regulation of exclusive arrangements only in cases that involve both market power (*i.e.*, cable operators) and vertical integration (*i.e.*, programmers “affiliated with” cable operators).<sup>210</sup>

Consistent with the Commission’s prior conclusions, the exclusive arrangement DIRECTV has struck with the NFL – a sophisticated and *unaffiliated* rights holder – is an arm’s length transaction that increases competition and has allowed DIRECTV to differentiate its

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<sup>207</sup> *News Corp. and The DIRECTV Group, Inc., Transferors, and Liberty Media Corp. Transferee; For Authority to Transfer Control*, Memorandum Opinion and Order, 23 FCC Rcd 3265, 3319-20 ¶ 118 (2008) (“DIRECTV/Liberty Order”).

<sup>208</sup> *Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity in Video Programming Distribution and Carriage*, First Report and Order, 8 FCC Rcd 3359, 3384 ¶ 63 (1993).

<sup>209</sup> *Revision of the Commission’s Program Access Rules*, Report and Order, 27 FCC Rcd 12,605, 12,631 ¶ 37 (2012). See also Fifteenth Video Competition Report, 28 FCC Rcd at 10,539 ¶ 93 (“To differentiate its service, DIRECTV offers the NFL Sunday Ticket....”).

<sup>210</sup> 47 U.S.C. §§ 548(c)(2)(C) (for areas unserved by a cable operator), 548(c)(2)(D) (for areas served by a cable operator).

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service in order to stay competitive with other MVPDs.<sup>211</sup> DIRECTV's agreement is not, as DISH and Cox argue,<sup>212</sup> anti-competitive. Simply put, the deal has helped DIRECTV compete against the dominant cable incumbents, and going forward it will provide the same pro-competitive benefit to the combined company.<sup>213</sup> The Commission has no basis to disturb the business decision of the NFL to award those rights on an exclusive basis.

For similar reasons, the Commission should reject Cox's attempt to bar the combined company from entering into any exclusive programming agreement.<sup>214</sup> There is no reason that the combined company should be the *only* MVPD unable to enter into exclusive arrangements with unaffiliated programmers. As noted above, the Commission has rejected any such bar for cable companies (including Cox itself) even as to affiliated programmers.<sup>215</sup> It would be

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<sup>211</sup> Of course, DIRECTV does not hold the exclusive license to all NFL games, which are widely available on FOX, CBS, NBC, ESPN, and the NFL Network – all channels that are regularly carried by MVPDs. Further, the NFL RedZone channel, which provides live simulcast coverage and highlights of all Sunday afternoon games, is readily available from many MVPDs, including Comcast, FiOS, and DISH, among others. *See* Verizon FiOS, NFL RedZone, [http://www.verizon.com/home/MLP/NFLRedZone.html?CMP=DMC-CVZ\\_ZZ\\_ZZ\\_E\\_ZZ\\_N\\_X00013](http://www.verizon.com/home/MLP/NFLRedZone.html?CMP=DMC-CVZ_ZZ_ZZ_E_ZZ_N_X00013) (last visited Oct. 14, 2014); Comcast Xfinity, Your Home for the Most Live Sports, <http://www.mostlivesports.com/nfl/> (last visited Oct. 14, 2014); DISH, NFL RedZone, <http://www.mydish.com/redirects/promotion/redzone/> (last visited Oct. 14, 2014).

<sup>212</sup> Cox Petition at 7-11; DISH Petition at 16-18.

<sup>213</sup> To the extent Cox and DISH raise concerns about theoretical future exclusive arrangements for the distribution of NFL content to AT&T mobile customers, Cox Petition at 8-9 and DISH Petition at 17-18, such arrangements are also pro-competitive for the reasons stated above. In addition, Cox and DISH fail to note that Verizon currently is in the midst of a four-year contract, expiring after the 2017 season, to offer NFL games and content to mobile customers. *See* Adam Stites, *Verizon, NFL Announce Extension to Stream Games*, SBNation (June 4, 2013), <http://www.sbnation.com/nfl/2013/6/4/4394986/verizon-nfl-extension-stream-games>.

<sup>214</sup> Cox seeks a condition to “[p]rohibit AT&T/DirecTV from entering into or extending any exclusive programming agreements, particularly exclusive programming agreements for major sports programming.” Cox Petition at 4.

<sup>215</sup> *See* n.209, above.

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illogical and inequitable to apply a broader and asymmetrical rule to the post-merger entity alone.

**IV. THE COMMISSION SHOULD REJECT NON-TRANSACTION-SPECIFIC CLAIMS AND UNNECESSARY CONDITIONS**

A number of opponents raise various other issues that are the subject of pending Commission proceedings or that are unrelated to this transaction.<sup>216</sup> It is well-established that merger reviews are not the proper forum to resolve such matters.<sup>217</sup> Consistent with this precedent, the Commission should reject all these improper attempts to gain regulatory advantages through the merger-review process.<sup>218</sup> As discussed in the sections below, moreover, none of these proposed conditions can be justified.

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<sup>216</sup> See, e.g., Cox Petition at 25 (asking for commitments related to Section 251 and 252 interconnection obligations); *id.* at 26-27 (requesting cable basic service tier requirements be applied to AT&T/DIRECTV); NAB at 3-7 (asking the Commission to update the broadcast ownership rules); Public Knowledge Comments at 8, 12 (requesting conditions related to customer billing, wireline interconnection, and the IP transition).

<sup>217</sup> See, e.g., Comcast/AT&T Broadband Order, 17 FCC Rcd at 22,637 ¶ 11 (2002) (“merger review is limited to consideration of merger-specific effects”); Verizon/Alltel Order, 23 FCC Rcd at 17,463 ¶ 29 (The Commission “will not impose conditions to remedy pre-existing harms or harms that are unrelated to the transaction.”); *Applications of AT&T Inc. and Centennial Communications Corporation for Consent to Transfer Control of Licenses, Authorizations, and Spectrum Leasing Arrangements*, Memorandum Opinion and Order, 24 FCC Rcd 13,915, 13,969 ¶ 133 (2009) (The Commission will “impose conditions only to remedy harms that arise from the transaction (*i.e.*, transaction-specific harms)...”).

<sup>218</sup> See, e.g., *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Southern New England Telecommunications Corporation to SBC Communications, Inc.*, Memorandum Opinion and Order, 13 FCC Rcd 21,292, 21,306 ¶ 29 (1998) (refusing to address “matters that are the subject of other proceedings before the Commission because the public interest would be better served by addressing the matter in the broader proceeding of general applicability”); *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America Online, Inc., Transferors, to AOL Time Warner Inc., Transferee*, Memorandum Opinion and Order, 16 FCC Rcd 6547, 6633 ¶ 209 (2001) (“[T]he issues raised by [commenters] are already under consideration in pending Commission proceedings of general applicability. The conditional

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**A. This Transaction Will Have No Adverse Effect on the Availability of PEG Programming**

Although some commenters seek to impose PEG conditions on the combined company, they uniformly fail to explain how the proposed transaction will adversely affect PEG programming. In fact, this transaction will have no effect on AT&T's PEG programming or obligations. AT&T will, as it must, continue to adhere to existing state and local PEG obligations. And, DIRECTV, which as a nationwide satellite system is not subject to PEG requirements, will, as it must, continue to adhere to its separate public interest obligations under 47 U.S.C. § 335.

The National Association of Telecommunications Officers and Advisers ("NATOA") and ACM nevertheless suggest that, because DIRECTV is subject to public interest obligations rather than PEG requirements, AT&T could offload its video services to DIRECTV's systems to limit or eliminate the combined company's PEG obligations.<sup>219</sup> That suggestion is baseless. AT&T has previously stated that it will maintain both satellite and U-verse video services,<sup>220</sup> and, in any event, each service has its own legal and regulatory obligations with which the combined company must comply.

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requirements suggested by [commenters] should be addressed in those proceedings, and not within the confines of the merger analysis.").

<sup>219</sup> NATOA Comments at 2-3; ACM Petition at 24-25. The Commission should reject any suggestion of extending PEG obligations to DIRECTV's satellite platform, *see* ACM Petition at 4, as the spot beams used to support local programming already face significant capacity constraints and would not be able to support this additional burden. *See* n.242, below.

<sup>220</sup> *See* Public Interest Statement at 72 ("both AT&T and DIRECTV video services will remain available on a standalone basis"); Testimony of Randall Stephenson, *Proposed Merger Between AT&T and DirecTV*, Hearing Before the Regulatory Reform, Commercial and Antitrust Law Subcommittee of the House Judiciary Committee (June 24, 2014) ("[Y]es, U-verse will continue. And, in fact, we'll continue to expand our U-verse offering.").

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To the extent that opponents take issue with AT&T's *current* provision of PEG programming,<sup>221</sup> that issue is not only irrelevant to this merger, but also the subject of a separate Commission proceeding.<sup>222</sup> There is thus no reason to address that matter here.

In any case, as AT&T has explained in that proceeding, it remains fully committed to providing robust PEG offerings to its U-verse customers. Although differences in network architecture mean that AT&T does not offer PEG in the same way that cable companies do, AT&T in fact provides access to far more PEG programming than do cable providers. In particular, unlike cable providers, AT&T makes available *all* PEG programming for a particular DMA<sup>®</sup> to every subscriber in that DMA<sup>®</sup>, and it does so in a manner that is fully accessible.<sup>223</sup> Moreover, and again unlike cable providers, AT&T and DIRECTV have extremely limited

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<sup>221</sup> See ACM Petition at 19-20; Northampton Community Television Comments at 2 (filed Sept. 16, 2014); Alysha Schlundt-Bodien Comments at 2 (filed Sept. 16, 2014); NATOA Comments at 2-3; Comments of San Jose Community Media Access Corporation, DBA "CreaTV San Jose" at 2 (filed Sept. 15, 2014).

<sup>222</sup> Issues relating to AT&T's provision of PEG programming are fully presented in MB Dkt No. No. 09-13. In multiple filings in that docket, AT&T has demonstrated that it is not a cable provider subject to legacy cable regulations, including PEG requirements. See *Petition for Declaratory Ruling of the City of Lansing, Michigan, on Requirements for a Basic Tier and for PEG Channel Capacity Under Sections 543(b)(7), 531(a), and the Commission's Ancillary Jurisdiction Under Title 1*, MB Dkt No. 09-13, Comments of AT&T at 19-21 (filed Mar. 9, 2009) ("AT&T PEG Opp."); *id.*, AT&T Ex Parte, MB Dkt No. 09-13 (filed June 11, 2009); see also *The Impact and Legal Propriety of Applying Cable Franchise Regulations to IP-Enabled Video Services* at 1, 12-28 (attached to Letter from James C. Smith to Marlene H. Dortch, WC Dkt No. 04-36 (filed Sept. 14, 2005)); *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Dkt No. 12-203, Reply Comments of AT&T Inc. at 3 (filed Oct. 10, 2012).

<sup>223</sup> See AT&T PEG Opp. 52-66; *Petition for Declaratory Ruling Regarding Public, Educational and Governmental Programming*, MB Dkt No. 09-13, AT&T Ex Parte (filed Aug. 17, 2010); *id.*, MB Dkt No. 09-13, AT&T Ex Parte (filed Apr. 1, 2011); *id.*, MB Dkt No. 09-13, AT&T Ex Parte (filed Apr. 8, 2011); *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Dkt No. 12-203, Reply Comments of AT&T Inc. at 3-4 (filed Oct. 10, 2012).

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programming holdings and therefore do not have an incentive to favor affiliated content over PEG programming. This transaction thus will not affect AT&T's commitment to make PEG programming available to U-verse video subscribers, and opponents provide no reason to believe otherwise.<sup>224</sup>

**B. This Proceeding Is Not the Appropriate Forum To Change Applicants' Obligations Under Section 629**

In its comments, TiVo Inc. ("TiVo") requests that the Commission impose various set-top box conditions related to conditional access and security functions.<sup>225</sup> Similarly, Public Knowledge asserts that the combined company should be required to make its MVPD programming available to third-party devices in an industry-standard method.<sup>226</sup> These proposed conditions have no connection to this transaction review. By definition, any request to impose an "industry standard" on the parties raises issues of general applicability. Appropriately, moreover, these issues are being considered and should be addressed, if at all, in the "AllVid" proceeding.<sup>227</sup>

In any case, industry participants, including AT&T and DIRECTV, already are achieving the goals set by Congress in Section 629, which instructs the Commission to "adopt regulations to assure the commercial availability...[of] equipment used by consumers to access multichannel

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<sup>224</sup> ACM *et al.* argue that unspecified "capacity demands" on AT&T's video/broadband network due to the addition of DIRECTV's programming package content will give AT&T the incentive to discriminate against PEG channels in favor of this newly acquired content. ACM Petition at 21-22. There is no basis in the record for any such concerns.

<sup>225</sup> Comments of TiVo Inc. at 7-9 (filed Sept. 16, 2014).

<sup>226</sup> Public Knowledge Petition at 10-11.

<sup>227</sup> See *Video Device Competition, Implementation of Section 304 of the Telecommunications Act of 1996, Commercial Availability of Navigation Devices, Compatibility Between Cable Systems and Consumer Electronics Equipment*, Notice of Inquiry, 25 FCC Rcd 4275 (2010).

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video programming and other services offered over multichannel video programming systems.”<sup>228</sup> Competition in the video device and set-top box market is more vibrant than it has ever been. Consumers can receive video content on their televisions through a wide and growing variety of additional devices, such as smart TVs, Blu-ray players, and video game consoles, as well as Apple TV, Roku, Google Chromecast, and Amazon Fire TV equipment.<sup>229</sup> Moreover, to compete with those options, MVPDs today offer subscribers set-top boxes with innovative new features, including apps for YouTube and Pandora, as well as set-top boxes developed in partnership with other innovators, such as DIRECTV’s TiVo HD DVR.<sup>230</sup>

U-verse and DIRECTV both have worked to make their services available on a variety of tablets, smartphones, and other devices, where their apps appear alongside those of other content providers such as Netflix and Hulu.<sup>231</sup> As a leading member of the RVU Alliance,<sup>232</sup> DIRECTV

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<sup>228</sup> 47 U.S.C. § 549(a).

<sup>229</sup> The Commission has recognized this trend, stating that “many of the leading OVDs make their services available via a wide variety of consumer electronics products...[and t]he converse is also true – many consumer electronics products give consumers access to a variety of OVD services.” Fifteenth Video Competition Report, 28 FCC Rcd at 10,678 ¶ 366.

<sup>230</sup> DIRECTV, TiVo HD DVR, [http://www.directv.com/technology/tivo\\_receiver](http://www.directv.com/technology/tivo_receiver) (last visited Oct. 14, 2014); *see also* DIRECTV, Genie HD DVR, [http://www.directv.com/technology/genie\\_receiver](http://www.directv.com/technology/genie_receiver) (last visited Oct. 14, 2014).

<sup>231</sup> *See* U-verse, U-verse App, <http://uverse.com/uverse/uverseapp> (last visited Oct. 14, 2014); DIRECTV, Mobile Apps, [http://www.directv.com/technology/mobile\\_apps](http://www.directv.com/technology/mobile_apps) (last visited Oct. 14, 2014). In addition, as Netflix explains, “OVDs such as Netflix have re-imagined the way in which a consumer accesses and enjoys video content – enabling her to access through an intuitive user interface a rich library of content at times and locations of her choosing.” Netflix Comments at iii; *see also id.* at 2 (noting that Netflix “is available on a broad array of consumer electronics devices, including Internet-connected TVs and set-top boxes, game consoles, computers, tablets, and mobile phones”).

<sup>232</sup> *See* RVU Alliance, <http://rvualliance.org/> (last visited Oct. 14, 2014). The RVU Alliance is a consortium of leading content service provider, consumer electronics and technology companies that have come together to advance Remote User Interface (RUI) technology for home networked television entertainment. *Id.*

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has also helped pioneer open standards that have been implemented by multiple television manufacturers. With an RVU-enabled television set, a DIRECTV subscriber need no longer have additional set-top boxes with each television set in the home. Furthermore, far from diminishing this already-vibrant competition, the transaction will improve AT&T's and DIRECTV's set-top box offerings,<sup>233</sup> allow the combined company to obtain more flexible digital rights to deliver content to additional devices,<sup>234</sup> and stimulate demand for new and innovative devices through the expanded broadband deployment enabled by the transaction's efficiencies.<sup>235</sup>

In sum, the set-top box conditions proposed by TiVo and Public Knowledge are both unnecessary and not transaction-specific. Moreover, as set forth more completely in the AllVid proceeding, they would create complex technical issues for both AT&T<sup>236</sup> and DIRECTV<sup>237</sup> in

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<sup>233</sup> See Stankey Decl. ¶ 20. In his Declaration, Dr. Katz noted that “the development of new customer premises equipment...is subject to strong economies of scale” and that as a result “the proposed merger would increase the [combined company's] incentive to invest in improved software and hardware,” including set-top boxes. Katz Decl. ¶ 5; see also *id.* ¶ 123 (stating that “the combined company will be better positioned to develop more sophisticated interactive services and a more advanced user interface than would either company alone”).

<sup>234</sup> Public Interest Statement at 48; Stankey Decl. ¶¶ 9, 23, 59; Katz Decl. ¶ 121.

<sup>235</sup> See Section II, above.

<sup>236</sup> Unlike legacy cable systems (which were designed to operate as one-way, passive distribution systems that broadcast their entire content stream to all subscribers over coaxial cable), AT&T's U-verse service employs an IP-based, interactive client-server architecture that requires constant communication between a subscriber's CPE and the network in order to transmit the specific programming or other content the subscriber selects (and only that content) at a particular time, together with encryption keys necessary to decrypt that content. *Implementation of Section 304 of the Telecommunications Act of 1996; Commercial Availability of Navigation Devices; Compatibility Between Cable Systems and Consumer Electronic Equipment*, Letter from Christopher Heimann, AT&T, to Marlene H. Dortch, Secretary, FCC, CS Dkt No. 97-80, at 3 (filed Nov. 16, 2007). That architecture requires multiple, distributed server groups (including authentication servers, operational and business support servers, media acquisition servers, and media delivery servers) to work together with client devices at the subscriber's premises, linked

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light of their particular service architectures, while also raising challenges to the protection of the intellectual property rights of content providers and the privacy rights of subscribers. In these circumstances, the Commission should reject the proposed conditions.

**C. There Is No Basis for Imposing a Universal Local-Into-Local Carriage Mandate for DIRECTV**

Broadcasters once again seek to condition a DIRECTV transaction on a universal local carriage mandate.<sup>238</sup> The last time broadcasters did so, the Commission “decline[d] to impose a universal local-into-local condition.”<sup>239</sup> The Commission found “no evidence in the record that such a condition is necessary to remedy a transaction-specific harm” and saw no merit in the claim that the “transaction [would] diminish DIRECTV’s incentive or ability to expand the rollout of local broadcast service.”<sup>240</sup> Instead, the Commission has appropriately relied on an

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through common software and middleware (which must regularly be updated) that resides both in the network and on client devices, to provide subscribers access to the content they want. *Id.*; see also *Video Device Competition, Implementation of Section 304 of the Telecommunications Act of 1996, Commercial Availability of Navigation Devices, Compatibility Between Cable Systems and Consumer Electronics Equipment*, MB Dkt No. 10-91, Comments of AT&T Inc. at 27 n.31 (filed July 13, 2010). As a consequence, the set-top box conditions proposed by TiVo and Public Knowledge would require AT&T to fundamentally re-design its U-verse architecture.

<sup>237</sup> Because DIRECTV’s satellite system does not have a return path, it must use customer premises equipment as a “headend in the home” through which to replicate interactive functions and offerings, such as video on demand, Common Sense Media Ratings, NFL SuperFan, and an interactive programming guide. Without such highly intelligent equipment in the home, DIRECTV would not be able to provide its most innovative services that its subscribers expect and would be at an even greater disadvantage in competing effectively with cable. See *Video Device Competition, Implementation of Section 304 of the Telecommunications Act of 1996, Commercial Availability of Navigation Devices, Compatibility Between Cable Systems and Consumer Electronics Equipment*, MB Dkt No. 10-91, Comments of DIRECTV, Inc. at ii-iii, 10-12 (filed July 13, 2010) (describing concerns and challenges presented by AllVid proposal).

<sup>238</sup> NAB Comments at 7-8.

<sup>239</sup> DIRECTV/Liberty Order, 23 FCC Rcd at 3330 ¶ 137.

<sup>240</sup> *Id.*

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industry-wide proceeding, where the Commission has carefully balanced the interests of local broadcast stations and DBS providers.<sup>241</sup>

The Commission should once again reject the proposed condition. Nothing about the proposed transaction will change the combined company's incentive or ability to provide local-into-local service. The key factors affecting local-into-local service are DIRECTV's satellite capacity and the significant infrastructure costs of collecting and uplinking broadcast signals. Neither of those factors will be affected by this transaction. Despite these challenges, DIRECTV already provides local-into-local service in 198 of the nation's 210 local markets (with local HD channels in 197 markets). Those markets already cover more than 99 percent of U.S. television households and represent an increase of 42 markets in the last five years alone.

DIRECTV has achieved this rollout despite the challenges, recognized by the Commission, that DBS providers face in providing service to the smallest local areas,<sup>242</sup> and in the absence of a requirement that it do so.

In sum, broadcasters have not articulated any reason why the proposed transaction would change DIRECTV's incentives to provide satellite-delivered local service. As the Commission has found in previous transactions, there is accordingly no basis for imposing a "universal local-into-local" condition.

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<sup>241</sup> See *Carriage of Digital Television Broadcast Signals: Amendment to Part 76 of the Communications Rules; Implementation of the Satellite Home Viewer Improvement Act of 1999: Local Broadcast Signal Carriage Issues and Retransmission Consent Issues*, Second Report and Order, Memorandum Opinion and Order, and Second Further Notice of Proposed Rulemaking, 23 FCC Rcd 5351 (2008). Any request to modify the combined company's obligations under those rules should be considered in an industry-wide proceeding.

<sup>242</sup> See *id.* at 5355 ¶ 7 (2008) ("We recognize that satellite carriers face unique capacity, uplink, and ground facility construction issues that must be factored into the timing of any HD 'carry-one, carry-all' requirement.").

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**D. The Transaction Will Not Harm DISH's Entry into the Wireless Business, and Roaming Will Continue To Be Available to DISH and Others in Compliance with the Roaming Rules**

The Commission should reject DISH's request for roaming conditions that would benefit its as-yet undeployed terrestrial wireless network and reduce DISH's incentive to construct that long-talked-about broadband alternative.<sup>243</sup> DISH rests its argument for these conditions on the tenuous premise that, because DISH's "plans *could* include the provision of fixed-wireless video, data and voice, and mobile video, data and voice," the combined company will view DISH as a competitive threat and seek to thwart it.<sup>244</sup>

As even DISH recognizes,<sup>245</sup> however, the Commission's data roaming rules *already* make certain that entities like DISH can obtain data roaming agreements on commercially reasonable terms and conditions. Indeed, the Wireless Telecommunications and International Bureaus found just last year that

the Commission's general roaming policies and rules should ensure that entities can obtain roaming agreements on reasonable terms and conditions. In the event that a service provider . . . encounters difficulties in obtaining desired roaming services under our rules and policies, it can file complaints with the Commission pursuant to our established roaming rules.<sup>246</sup>

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<sup>243</sup> DISH Petition at 23-25, 30-31. The Commission also should reject the self-serving and unsubstantiated request to require AT&T to offer its U-verse broadband on a wholesale basis. *Id.* at 27-28.

<sup>244</sup> *Id.* at 24 (emphasis added).

<sup>245</sup> *Id.*

<sup>246</sup> *Applications of AT&T Inc. and Atlantic Tele-Network, Inc. for Consent to Transfer Control of and Assign Licenses and Authorizations*, Memorandum Opinion and Order, 28 FCC Rcd 13,670, 13,702-03 ¶ 59 (WTB IB 2013) ("AT&T/ATNI Order"). Again as noted by DISH, DISH Petition at 25 n.69, there is a pending declaratory ruling proceeding addressing the very same roaming issues DISH seeks to resolve through conditions here. *Petition for Expedited Declaratory Ruling of T-Mobile USA, Inc., Reexamination of Roaming Obligations of Commercial Mobile Radio Service Providers and Other Providers of Mobile Data Services*, WT Dkt No. 05-265 (filed May 27, 2014).

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As it has done in many other transactions with far greater nexus to wireless service than this one,<sup>247</sup> even before the Commission had adopted data roaming rules to address this issue, the Commission should reject DISH's proposed AT&T-specific roaming conditions.

**E. There Is No Basis for Appropriating DIRECTV's Orbital Slots for the Benefit of DISH**

DIRECTV is currently authorized to operate using three DBS channels<sup>248</sup> at the 110° WL orbital location. DISH asserts that DIRECTV has "underutilized" these valuable resources, will have less incentive to use them intensively once it has access to AT&T's distribution capabilities, and thus should be forced to divest them to DISH.<sup>249</sup> These assertions have nothing to do with the present transaction. Rather, the situation DISH describes long predates this proposed merger. There is no reason it should be addressed here.

In any event, DISH's allegations are demonstrably untrue. DIRECTV has operated satellites at the 110° W.L. orbital location continuously since 1999.<sup>250</sup> Contrary to DISH's

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<sup>247</sup> See, e.g., *Applications of Cricket License Company, LLC, et.al, Leap Wireless International, Inc., and AT&T Inc. for Consent to Transfer Control of Authorizations*, Memorandum Opinion and Order, 29 FCC Rcd 2735, ¶ 107 (2014) (rejecting request for roaming conditions that were not transaction-specific); *AT&T/ATNI Order*, 28 FCC Rcd at 13,702-03 ¶ 59 (same); *AT&T/Centennial Order*, 24 FCC Rcd at 13,969 ¶ 133 (same); *Sprint Nextel Corp. and Clearwire Corp. Applications for Consent to Transfer Control of Licenses, Leases, and Authorizations*, Memorandum Opinion and Order, 23 FCC Rcd 17,570, 17,606 ¶ 92 (2008) (same).

<sup>248</sup> Each DBS "channel" is 24 MHz of spectrum defined under the international plan set forth in Appendix 30/30A of the International Radio Regulations.

<sup>249</sup> DISH Petition at 18-23.

<sup>250</sup> See *DIRECTV Enterprises, Inc.*, Order and Authorization, 15 FCC Rcd. 6738, (IB 1999) (authorizing relocation of DIRECTV 1 satellite to 110° WL location). DIRECTV 1 was replaced by DIRECTV 6 in July 2003, which was in turn replaced by DIRECTV 5 in October 2005.

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claim,<sup>251</sup> DIRECTV began service from this location with the DIRECTV 1 satellite, which provided service from this slot for four years. DIRECTV has used capacity on that satellite to provide a wide array of services, from launching HD programming in 1999 to supporting Spanish language (DIRECTV Mas) and Asian programming (DIRECTV Jade). At present, the DIRECTV 5 satellite uses this capacity to meet an urgent need to support service to subscribers in Puerto Rico. The DIRECTV 5 satellite not only transmits 30 channels of programming, but also provides the Program Guide and set-top box boot information, which is required for subscribers in Puerto Rico to receive combined DBS and Ka-band services.<sup>252</sup> This slot is fully integrated into DIRECTV's long-term spectrum planning for growth and development of its service throughout the United States.<sup>253</sup>

In sum, DISH's assertions are erroneous, unrelated to the transaction, and designed solely to benefit DISH and its business plans. They should be rejected.

**F. The Transaction Will Enhance, Not Harm, Competition for Consumers Who Reside in MDUs**

The conditions requested by Independent Multifamily Communications Council ("IMCC") and Cox regarding Multiple Dwelling Units ("MDUs") either implicate issues of

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<sup>251</sup> DISH Petition at 21.

<sup>252</sup> The DIRECTV 14 satellite to which DISH refers, *see* DISH Petition at 22 n.58, will be capable of providing Ka-band service to Puerto Rico. However, because that satellite is not even scheduled to be launched until later this year, it is misleading for DISH to assert that DIRECTV has refused to use targeted capacity on this satellite for service to Puerto Rico. DISH Petition at 22.

<sup>253</sup> DIRECTV's antennas can receive transmissions from multiple slots, and its set-top boxes can decode transmissions from all of them. From a subscriber's perspective, there is no difference between content transmitted from a DIRECTV DBS satellite at 101° W.L., 110° W.L., or 119° W.L., or even from one of its Ka-band satellites at 99° W.L. or 103° W.L. DIRECTV's equipment can capture all of those signals and present it as a seamlessly integrated offering. DISH is well aware of this fact, as it also provides its service from multiple orbital locations.

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general industry applicability<sup>254</sup> or seek to amend the terms of existing contracts between DIRECTV and private cable operators (“PCOs”).<sup>255</sup> They have nothing to do with this transaction. In both instances, moreover, opponents seek to prevent the combined company from providing fair and robust competition to the opponents’ services or offerings. The Commission should reject these requests.<sup>256</sup>

IMCC asks the Commission to rewrite the terms of contracts between DIRECTV and its members, who act as dealers for DIRECTV.<sup>257</sup> The terms IMCC seeks to have the Commission amend, however, far predate this transaction and are unaffected by it.<sup>258</sup> In any event, IMCC members generally obtain **[BEGIN DIRECTV HIGHLY CONFIDENTIAL**

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<sup>254</sup> Cox Petition at 28-29, 34-35 (asking that AT&T/DIRECTV be prohibited from entering exclusive agreements to serve MDU buildings and requesting conditions related to the Commission’s inside wiring rules). Tellingly, Cox acknowledges that there are rules of general applicability addressing exclusive agreements to serve MDUs. *Id.* at 28.

<sup>255</sup> IMCC Comments at 12-13 (requesting that the FCC revise various contract terms related to contract period, termination rights, and compensation, among others).

<sup>256</sup> AT&T/BellSouth Order, 22 FCC Rcd at 5759 ¶ 195 (“As the Commission has noted previously, “[o]ur statutory duty is to protect efficient competition, not competitors.” (internal quotations omitted)).

<sup>257</sup> These dealers do not, as IMCC claims, negotiate wholesale “programming contracts” with DIRECTV with which to sell their own service. IMCC Comments at 6 (referring to “Programming Contracts” between IMCC members and DIRECTV). Rather, they negotiate for the right to resell DIRECTV service in a particular building, with either the building owner or the residents therein paying DIRECTV for its programming.

<sup>258</sup> For example, IMCC seeks modification of: **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

**[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** IMCC Comments at 8, 10-12.

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**INFORMATION]**

**[END DIRECTV**

**HIGHLY CONFIDENTIAL INFORMATION]** In such circumstances, it is entirely reasonable to seek corresponding protections.

These provisions and the others cited by IMCC were each privately negotiated with DIRECTV. They will remain in effect according to their terms regardless of this transaction,<sup>259</sup> and there is no basis for the Commission to disturb them here.<sup>260</sup>

Cox's arguments are equally parochial. Cox argues that the rule prohibiting cable exclusive arrangements in MDUs should apply to DIRECTV as well.<sup>261</sup> This, of course, remains an open question in a proceeding of general applicability<sup>262</sup> – one in which both Cox<sup>263</sup> and

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<sup>259</sup> Post-closing, AT&T will continue to honor the terms of DIRECTV's existing contracts with such providers.

<sup>260</sup> *In the Matter of Applications of AT&T Inc. and Centennial Communications Corp.*, 24 FCC Rcd 13915, 13976, ¶ 152 (2009) (“[W]e agree with the Applicants that the Agreement constitutes a private contractual matter...that is beyond the Commission's jurisdiction.”); *In the Matter of Application of Wireless US, LLC, Assignor, Nextel of California, Inc., Assignee, for Consent to Assignment of 851.1625 MHz from Station WNXG805*, 22 FCC Rcd 8643, 8646 ¶10 (2007) (“we would not ordinarily act on matters stemming from private contracts”).

<sup>261</sup> Cox Petition at 28 (citing 47 C.F.R. § 76.2000).

<sup>262</sup> *See Exclusive Service Contracts for Provision of Video Services in Multiple Dwelling Units and Other Real Estate Developments*, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd 20,235 (2007).

<sup>263</sup> *See Exclusive Service Contracts for Provision of Video Services in Multiple Dwelling Units and Other Real Estate Developments*, MB Dkt No. 07-51, Comments of Cox Communications, Inc. (filed Feb. 6, 2008).

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DIRECTV<sup>264</sup> participated extensively. Cox makes no serious effort to explain how this transaction relates to these issues, or why they are not properly addressed in that rulemaking.<sup>265</sup>

**G. Concerns and Conditions Related to IP Transition Are Not Related to the Merger**

Public Knowledge claims that this transaction raises issues “similar to those the Commission is facing in its work on the ‘IP Transition.’”<sup>266</sup> In particular, Public Knowledge suggests that AT&T’s fixed WLL deployment will lead to a shift of customers from wireline to fixed wireless service.<sup>267</sup> However, the vast majority of the fixed WLL deployment – approximately 85 percent – will be *outside* of AT&T’s wireline region,<sup>268</sup> and thus does not even arguably raise any such issue. Moreover, Public Knowledge concedes that “by itself, the deployment of fixed wireless service *within AT&T’s service area* is not a problem.”<sup>269</sup> Thus, even as to this minority of customers, the commitment to deploy broadband facilities – a strong benefit to consumers – does not create the issue Public Knowledge fears.

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<sup>264</sup> See *id.*, Further Comments of DIRECTV, Inc. (filed Feb. 6, 2008); *id.*, Reply Comments of DIRECTV, Inc. (filed Mar. 7, 2008).

<sup>265</sup> Cox’s only attempt to link this argument to the merger is to state that the merger “creates a number of opportunities and incentives for the merged entity to act anti-competitively in the market for MDU customers.” Cox Petition at 28. Cox also argues that DIRECTV has interfered with Cox’s broadband service by attaching diplexers to inside wiring subject to the Commission’s inside wiring rules. *Id.* at 29-30; 47 C.F.R. §§ 76.801 *et seq.* It therefore wants Applicants to run their own wiring in any building where Cox provides broadband service (and yet turn this wiring over to Cox if Cox later seeks to provide service over it). Cox Petition at 35. These assertions are baseless. Any “interference” between its diplexers and Cox’s equipment is the fault of Cox, not DIRECTV. In fact, Cox has refused all of DIRECTV’s efforts – consistent with the Commission’s rules – to cooperate to avoid disruption of service. See 47 C.F.R. § 76.804(a)(5).

<sup>266</sup> Public Knowledge Comments at 2.

<sup>267</sup> *Id.* at 11-12.

<sup>268</sup> See Stankey Decl. ¶ 54.

<sup>269</sup> Public Knowledge Comments at 11 (emphasis added).

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Further, as Public Knowledge itself emphasizes,<sup>270</sup> the Commission has open dockets to address the concerns that Public Knowledge raises, such as the contention (unsupported by any evidence in Public Knowledge’s petition) that AT&T will decrease service quality or repair times for homes served by copper wireline facilities.<sup>271</sup> Those dockets are the appropriate place to address any such concerns. Indeed, Public Knowledge only weeks ago filed a letter in those dockets raising, on an industry-wide basis, many of the same concerns it does here.<sup>272</sup>

**H. Contractual Disputes Related to Cellular Partnerships Are Not Related to the Merger**

The Minority Cellular Partners Coalition (“MCPC”) contends that AT&T’s behavior with regard to a dispute involving wireless cellular licenses and partnerships weighs against the Commission approving the current transaction.<sup>273</sup> The MCPC alleges that AT&T violated its fiduciary duties in supposedly “squeezing out” the minority partners in certain partnerships. These state law corporate and partnership governance issues are unrelated to the current proceeding and are already being heard in Delaware Chancery Court, as MCPC acknowledges.<sup>274</sup> There is no reason for the Commission to address them here.<sup>275</sup>

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<sup>270</sup> See *id.* at 1-2.

<sup>271</sup> See *Pleading Cycle Established on AT&T and NTCA Petitions*, Public Notice, 27 FCC Rcd 15,766 (2013); *Technology Transitions Policy Task Force Seeks Comment on Potential Trial*, Public Notice, 28 FCC Rcd 6346 (2013).

<sup>272</sup> See *Comment Sought on the Technological Transition of the Nation’s Communications Infrastructure*, *Technology Transitions Policy Task Force*, GN Dkt Nos. 12-353, 13-5, Letter from Jodie Griffin, Public Knowledge, to Marlene Dortch, Secretary, FCC, at 2 (Sept. 17, 2014) (“Public Knowledge...urged the Commission to act to address complaints that have arisen across the country indicating carriers are forcing consumers off traditional copper-based service.”).

<sup>273</sup> MCPC Comments at 13-19.

<sup>274</sup> *Id.* at 2-3.

<sup>275</sup> *Applications of Craig O. McCaw, Transferor and American Telephone and Telegraph Company, Transferee*, Memorandum Opinion and Order, 9 FCC Rcd 5836, ¶ 123 (1994) (“[W]e

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Nor does MCPC's assertion that AT&T improperly filed *pro forma* transfer notices<sup>276</sup> with the Commission provide any basis to act in this proceeding. AT&T publicly filed the notices (which are attached to MCPC's Comments) as long ago as 2010, along with an explanation as to why that course of action was appropriate.<sup>277</sup> If MCPC, or anyone else, believed AT&T's filing was incorrect or that another course of action was required, it should have raised that issue years ago.

In any event, MCPC's arguments are incorrect. AT&T properly filed *pro forma* notices because, consistent with 47 C.F.R. § 1.948(c), AT&T controlled the relevant entity both before and after the transaction, as AT&T fully explained at the time of filing (in the very documents MCPC attaches to its filing). In claiming otherwise, MCPC rests on the assertion that, because all general partnership interests are deemed to be *de jure* controlling, these transactions amounted to substantial changes of control, requiring plenary – not *pro forma* – processes.<sup>278</sup> MCPC, however, overlooks precedent that *de facto* noncontrolling general partnership interests may be transferred using *pro forma* processes.<sup>279</sup> The transactions in question fit squarely within

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will not consider arguments in this proceeding that are better addressed in other Commission proceedings, or other legal fora..."); *Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation for Consent to Transfer Control of Licenses and Authorizations*, Memorandum Opinion and Order, 19 FCC Rcd 21,522, 21,551, ¶ 56 n.222 (2004) (rejecting argument that transfer should be denied on grounds that it violated partnership agreements; "these are private contractual disputes that are not relevant to our public interest analysis and are best resolved in courts of competent jurisdiction").

<sup>276</sup> MCPC Comments at 15-17.

<sup>277</sup> *See id.* at Attachments 4-10.

<sup>278</sup> *Id.* at 15-16.

<sup>279</sup> *See Wireless Telecommunications Bureau Assignment of License Authorization Applications, Transfer of Control of Licensee Applications, De Facto Transfer Lease Applications and Spectrum Manager Lease Notifications Action*, Public Notice, Rep. No. 1756, at 14 (Feb. 25,

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that precedent. MCPC thus lacks any support for its attempt to inject a years-old and wholly unrelated issue into this proceeding.

In sum, as noted in the Public Interest Statement, the FCC repeatedly has found that AT&T has the qualifications required under the Communications Act to control Commission authorizations.<sup>280</sup> The baseless accusations from MCPC do nothing to change these conclusions.

**V. CONCLUSION**

For the reasons set forth above, in the Public Interest Statement and related filings in the record, the Commission should dismiss or deny the filings made in opposition to the proposed transaction and promptly grant the Applications without conditions.

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2004) (approving ULS File No. 0001529630); *Wireless Telecommunications Bureau Assignment of Authorization and Transfer of Control Applications Accepted for Filing*, Public Notice, Rep. No. 1695, at 25 (Dec. 17, 2003) (approving ULS File No. 0001534079); *see also Wireless Telecommunications Bureau Complete Review of Proposed Investment by Teléfonos de México, S.A. de C.V. in Parent of Cellular Communications of Puerto Rico*, Public Notice, 15 FCC Rcd 1227, 1227-28 (WTB, IB 1999) (concluding that a transfer of an interest that is defined under the Commission's rules as a controlling interest only requires a *pro forma* notification if the interest holder, by contract, cannot exercise control).

<sup>280</sup> Public Interest Statement at 15.

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Respectfully submitted,

By: /s/ D. Wayne Watts

D. Wayne Watts  
David R. McAtee II  
AT&T Inc.  
208 South Akard Street, Room 3303  
Dallas, TX 75202  
Telephone: (214) 757-3319

By: /s/ Larry D. Hunter

Larry D. Hunter  
DIRECTV  
2260 East Imperial Highway  
El Segundo, CA 90245  
310-964-5000

Lori Fink  
Gary L. Phillips  
AT&T Inc.  
1120 20<sup>th</sup> Street, NW, Suite 1000  
Washington, DC 20036  
(202) 457-3055

Stacy R. Fuller  
DIRECTV, LLC.  
901 F Street, NW  
Suite 600  
Washington, DC 20004  
(202) 383-6300

*Of Counsel:*

Arnold & Porter LLP  
555 12<sup>th</sup> Street, NW  
Washington, DC 20004  
(202) 942-6608

*Of Counsel:*

Harris, Wiltshire & Grannis LLP  
1919 M Street, N.W., 8<sup>th</sup> Floor  
Washington, D.C. 20036-3537  
(202) 730-1350

Kellogg, Huber, Hansen,  
Todd, Evans & Figel, PLLC  
1615 M Street, N.W., Suite 400  
Washington, D.C. 20036  
(202) 326-7902

Dated: October 16, 2014

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**CERTIFICATE OF SERVICE**

I hereby certify that on this 16<sup>th</sup> day of October, 2014, I caused true and correct redacted copies of the foregoing Joint Opposition of AT&T Inc. and DIRECTV, LLC To Petitions To Deny and Condition and Reply To Comments to be served by electronic mail (\*), by FedEx (~), and by hand delivery (+) upon:

Best Copy and Printing, Inc.\*  
fcc@bcpweb.com

Brendan Holland, Esq.\*  
Industry Analysis Division  
Media Bureau  
Federal Communications Commission  
Brendan.Holland@fcc.gov

Christopher Sova, Esq.\*  
Competition Policy Division  
Wireline Competition Bureau  
Federal Communications Commission  
Christopher.Sova@fcc.gov

Mr. Daniel Ball\*  
Spectrum and Competition Policy Division  
Wireless Telecommunications Bureau  
Federal Communications Commission  
Daniel.Ball@fcc.gov

Jim Bird, Esq.\*  
Office of the General Counsel  
Federal Communications Commission  
TransactionTeam@fcc.gov

Barbara Esbin, Esq.\*  
Cinnamon Mueller  
1875 Eye Street, NW, Suite 700  
Washington, DC 20006  
besbin@cinnamonmueller.com  
*Counsel to American Cable Association*

Tillman L. Lay, Esq.\*  
Spiegel & McDiarmid LLP  
1875 Eye Street, NW, Suite 700  
Washington, DC 20006  
tim.lay@spiegelmc.com  
*Counsel to Alliance for Community Media*

Charles Naftalin, Esq.\*  
Holland & Knight LLP  
800 Seventeenth Street, NW, Suite 1100  
Washington, DC 20006  
Charles.Naftalin@hklaw.com  
*Counsel to ReelzChannel, LLC*

Carl E. Kandutsch\*  
Kandutsch Law Office  
2520 K Avenue, Suite 700-760  
Plano, TX 75074  
carl@kandutsch.com  
*Counsel to the Independent Multifamily Communications Council*

Lauren M. Wilson, Esq.\*  
Policy Counsel  
Free Press  
1025 Connecticut Avenue, NW, Suite 1110  
Washington, DC 20036  
lwilson@freepress.net

Andrew W. Guhr, Esq.\*  
Steptoe & Johnson LLP  
1330 Connecticut Avenue, NW  
Washington, DC 20036  
aguhr@steptoe.com  
*Counsel to Netflix, Inc. and DISH Network Corp.*

**REDACTED - FOR PUBLIC INSPECTION**

Christopher Mitchell\*  
Community Broadband Networks Initiative  
Institute for Local Self-Reliance  
2001 S Street, NW, Suite 570  
Washington, DC 20009  
christopher@newrules.org

Paul Goodman, Esq.\*  
Legal Counsel  
The Greenlining Institute  
1918 University Avenue, 2<sup>nd</sup> Floor  
Berkeley, CA 94704  
paulg@greenlining.org

Eric J. Branfman, Esq.\*  
Bingham McCutchen LLP  
2020 K Street, NW  
Washington, DC 20006  
eric.branfman@bingham.com  
*Counsel to RCN*

David J. Wittenstein\*  
Cooley LLP  
1299 Pennsylvania Ave., NW, Suite 700  
Washington, DC 20004  
dwittenstein@cooley.com  
*Counsel to Cox Communications, Inc.*

Emily Sokolski~  
Writers Guild of America, West, Inc.  
7000 West Third Street  
Los Angeles, CA 90048

Russell D. Lukas\*  
Lukas, Nace, Gutierrez & Sachs, LLP  
8300 Greensboro Drive, Suite 1200  
McLean, VA 22102  
rlukas@fcclaw.com  
*Counsel for the Minority Cellular Partners  
Coalition*

John Bergmayer, Esq.\*  
Senior Staff Attorney  
Public Knowledge  
1818 N Street, NW, Suite 410  
Washington, DC 20036  
john@publicknowledge.org

Robert A. Cooper, Esq.\*  
Boies, Schiller & Flexner LLP  
5301 Wisconsin Avenue, NW  
Washington, DC 20015  
rcooper@bsflp.com  
*Counsel to Cogent Communications Group*

Stephen Traylor\*  
NATOA  
3213 Duke Street, #695  
Alexandria, VA 22314  
straylor@natoa.com

Stephen E. Coran\*  
Lerman Senter, PLLC  
2000 K Street, NW, Suite 600  
Washington, DC 20006  
scoran@lermansenter.com  
*Counsel to the Wireless Internet Service  
Providers Association*

Matthew P. Zinn~  
TiVo Inc.  
2160 Gold Street  
Alviso, CA 95002

James N. Horwood\*  
Spiegel & McDiarmid LLP  
1875 Eye Street, NW, Suite 700  
Washington, DC 20006  
james.horwood@spiegelmc.com  
*Counsel for the Alliance for Community  
Media and the Alliance for Communications  
Democracy*

**REDACTED - FOR PUBLIC INSPECTION**

Craig L. Rosenthal~  
Suddenlink Communications  
520 Maryville Centre Drive, Suite 300  
St. Louis, MO 63141

Debbie Goldman\*  
George Kohl  
Communication Workers of America  
501 Third Street, NW  
Washington, DC 20001  
dgoldman@cwa-union.org

Richard L. Trumka\*  
President AFL- CIO  
815 Sixteenth Street, NW  
Washington, DC 20006

Alysha Schlundt-Bodien~  
Alliance for Community Media, MI Chapter  
Grace A. Dow Library  
1710 W. St. Andres Road  
Midland, MI 48640

Suzanne St. John-Crane~  
CreaTV San Jose  
255 West Julian Street #100  
San Jose, CA 95110  
suzanne@creatvsj.org

Jane E. Mago+  
National Association of Broadcasters  
1771 N Street, NW  
Washington, DC 20036

Frederick S. Humphries, Jr.\*  
Vice President, US Government Affairs  
Microsoft Innovation and Policy Center  
901 K Street, NW 11<sup>th</sup> Floor  
Washington, DC 20554

Randolph J. May\*  
Seth L. Cooper  
Free State Foundation  
P.O. Box 60680  
Potomac, MD 20859

Al Williams~  
Northampton Community Television  
380 Elm Street  
Northampton, MA 01060  
nctv@northamptontv.org

/s/ Lauren E. Manning  
Lauren E. Manning

**DECLARATION OF SCOTT MAIR  
SENIOR VICE PRESIDENT OF TECHNOLOGY PLANNING AND ENGINEERING  
AT&T SERVICES, INC.**

I, Scott Mair, hereby declare the following:

**I. QUALIFICATIONS**

1. My name is Scott Mair. I am Senior Vice President of Technology Planning and Engineering, AT&T Services, Inc. I have held that position since March 2014. I am responsible for (1) network planning and engineering for AT&T's wireless and wireline networks and (2) design solutions throughout AT&T's entire network infrastructure, including AT&T's Internet backbone infrastructure. I previously served as AT&T's Senior Vice President – Wireless Performance and Network Operations Centers; Vice President – U-verse Operations; and Vice President – Global Network Operations, among other positions. In these positions, I have been responsible for Network Operations Centers; IP and Infrastructure Security and Advanced Technical Support; and U-verse Network Operations. I hold a bachelor's degree (Communications) and a master's degree (Industrial Technology) from the University of Wisconsin – Platteville.

**II. PURPOSE AND SUMMARY**

2. Netflix and Cogent have suggested to the Federal Communications Commission that AT&T has the incentive and ability to cause congestion on its Internet backbone peering links in order to degrade the quality of over-the-top (“OTT”) video services. They allege that AT&T has done so in the past, and that the AT&T/DIRECTV transaction will increase AT&T's incentives to do so in the future. Netflix asserts that, by insisting that Cogent abide by the terms of AT&T's peering policy, AT&T has “forced” Netflix to pay AT&T for direct interconnection with AT&T's network.

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3. These contentions are wrong. The Netflix and Cogent claims are fundamentally inconsistent with the actual course of conduct between the parties, the architecture and operation of peering and backbone networks, and the competitive marketplace for Internet interconnection.

4. There are many routes into AT&T's network. AT&T has nearly 400 10 Gbps domestic peering links with 23 peering partners, each of which interconnects with AT&T at up to nine locations. Numerous Content Delivery Network ("CDN") and other customers also have direct connections, and offer ingress, to AT&T's network. Content providers like Netflix decide which of these peering or CDN routes to use, and they can dynamically change their routing choices without the need for any direct relationship with AT&T. AT&T could not "force" Netflix to do anything by declining to augment capacity on AT&T's peering links with Cogent, because Netflix could easily obtain an alternate route to avoid any resulting congestion on those peering links.

5. Nor could any broader "congestion" strategy make sense. Congestion on a peering link affects all traffic routed through the congested port. AT&T has invested (and continues to invest) billions of dollars in its networks to improve the performance of its broadband services and would inflict far more harm on itself than on Netflix if AT&T stranded that investment and degraded the quality of the broadband services it provides to millions of consumers and businesses.

6. Netflix and Cogent seek to upend the longstanding norms in the peering and backbone marketplace. Interconnection within the backbone marketplace has always been provided for compensation – either monetary payments or, in the case of peering, an in-kind exchange of traffic (in which the peers' balance of traffic remains roughly equivalent). By insisting that AT&T should carry Cogent traffic for no compensation – on an unlimited basis,

regardless of the balance of traffic – Cogent and Netflix are trying to force AT&T to provide services for free, in a manner that is inconsistent with universal industry practice.

7. There is likewise no basis to conclude that AT&T could or would harm Netflix in the future through unfavorable Internet access terms. Netflix already has a long-term agreement for direct access to AT&T’s network on very favorable terms. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** AT&T is providing its U-verse customers much faster Netflix download speeds; indeed, AT&T is rapidly closing in on the fastest average download speeds among all large U.S. ISPs for Netflix traffic. This contract thus demonstrates both that AT&T is interested in ensuring that Netflix receives the level of Internet access necessary to provide a good experience for AT&T customers that use Netflix’s service, and that Netflix has a means of recourse if AT&T failed to do so.

8. The remainder of my declaration is organized as follows. In Part III, I explain the various ways that AT&T and others interconnect and exchange Internet traffic, and the many ways to route traffic to AT&T’s network. In Part IV, I show that the congestion experienced by Netflix at the Cogent peering links was the result of Netflix’s own routing decisions; Netflix

could easily have re-routed that traffic to any of the many other points of ingress to AT&T's network where there was available capacity. I also describe the long-term contract between AT&T and Netflix. In Part V, I describe AT&T's course of dealings with Cogent, including Cogent's refusal to negotiate a compensation-based approach to interconnection even after its balance of traffic with AT&T spiked to more than **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** in gross violation of AT&T's peering policy (and industry peering norms). Finally, in Part VI, I explain why the conditions Netflix and Cogent propose are unnecessary, would undermine incentives to invest in Internet backbone facilities, and would harm consumers.

**III. AT&T EXCHANGES TRAFFIC WITH OTHERS PURSUANT TO A WIDE VARIETY OF ARRANGEMENTS FOR COMPENSATION.**

9. The marketplace for Internet interconnection is highly competitive. For decades, AT&T has worked cooperatively with others to establish commercially negotiated arrangements for the interconnection of networks and the exchange of traffic in mutually beneficial ways that reflect the very substantial investments that AT&T and other providers have made to build and operate Tier 1 backbone networks. Today, there are a wide variety of arrangements in the marketplace. In all cases, participants obtain these arrangements for *compensation* – they either pay negotiated rates to the backbone provider or they pay for services *in kind* by exchanging roughly equivalent amounts of traffic.

10. AT&T today has 23 domestic peering agreements and many more Internet Access Service agreements, which are arrangements that allow CDNs, Internet Service Providers (“ISPs”) and other entities direct connection with AT&T's network. Any content provider can thus reach AT&T's network through many different routes. A content provider may choose to

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have a direct business relationship (paid or otherwise) with AT&T, but it need not do so to route traffic to AT&T's network.

11. *Peering.* Large ISPs often interconnect with AT&T through peering. Peering is a private commercial arrangement under which two "peer" ISPs connect and exchange traffic. Each peer provides the other with access only to its own customers – not to the entire Internet.

12. Although peering arrangements are "settlement-free," in the sense that the two parties typically do not exchange monetary payment, peering is not "free." These arrangements are barter transactions under which each peer network agrees to exchange roughly equal amounts of traffic, and comply with certain other terms (relating, for example, to traffic volumes and the number and locations of points at which they will exchange traffic). When the ratio of traffic exchanged between the parties is roughly equal (and other criteria are met), these relationships benefit both parties by enabling them to avoid the cost of billing each other for transporting and terminating roughly equivalent traffic.

13. AT&T's peering policy is typical of those in the industry (and more generous than some). AT&T's policy allows a peer to transmit up to two times more traffic to AT&T than it receives from AT&T. It thus allows peering even where there is a substantial traffic imbalance in favor of AT&T's peer. For existing peers, even if the imbalance modestly exceeds 2:1, AT&T's peering policy provides that it will work with the peer to find other ways to make the settlement-free peering arrangement equitable and sustainable, such as implementing routing arrangements that reduce AT&T's costs of carrying the additional traffic. But where the imbalance of traffic substantially exceeds 2:1, an Internet access service or other type of paid arrangement is more appropriate.

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14. *Transit.* A company seeking to deliver traffic to and from AT&T's network can enter into a "transit" arrangement with one of AT&T's peers. For example, a content provider seeking to deliver traffic to AT&T's network can enter into a transit agreement with Verizon, under which Verizon will deliver that company's content to AT&T's network over the Verizon-AT&T peering links. Under this arrangement, the company would pay Verizon a fee for that transit service. A company can thus use transit arrangements to deliver its traffic to AT&T without ever having to enter into any direct relationship with AT&T. Transit arrangements are very common, and, as noted, each of AT&T's 23 peers interconnects with AT&T at up to nine different peering locations in the U.S. (and peers often have multiple links at each location), for a current total of 379 10 Gbps peering links that provide ingress to (and egress from) AT&T's network.

15. *Internet Access Services.* A company seeking to deliver traffic to AT&T's network can also purchase direct connections from AT&T. AT&T sells an Internet access service called "Managed Internet Service" ("MIS") that allows customers to choose the capacity of their connections and to deliver as much traffic to AT&T's network as those connections will permit. AT&T's MIS service is used by large content providers **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** CDNs **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** enterprises, and large and small businesses. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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16. Internet Access Services, including AT&T's MIS service, can be "on-net" services or transit services. An on-net service provides access only to AT&T's customers. Transit services are Internet Access Services in which AT&T will deliver traffic to virtually any point on the Internet (through its peering arrangements with other ISPs).

17. *Content Interconnect Platform ("CIP")*. AT&T has developed an Internet Access Service specifically for CDNs. AT&T's CIP service allows customers to collocate servers in AT&T's network at locations closer to the AT&T end users who will be accessing the content on those servers. CIP customers purchase the space, power, cooling, transport, and other capabilities needed to operate their servers in AT&T's network. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

18. *Third-Party Purchasers of MIS and CIP*. AT&T's MIS and CIP customers may use those connections to provide third parties with access to AT&T's network, and many do so. For example, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** deliver traffic to AT&T's network from third-party content providers.

AT&T understands that **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** customers include many large providers of video content.

**IV. AT&T's Dealings With Netflix**

**A. Netflix's Many Options For Routing Traffic To AT&T**

19. As discussed, Netflix has a wide variety of options to route traffic to AT&T's network to deliver content to AT&T broadband subscribers. Netflix can use, and has used, a variety of these routing options, in combination, to send its traffic to AT&T. It is my understanding that Netflix has paid, among others, Akamai, Limelight, Level 3, Tata, NTT, XO, Telia, and Cogent to deliver its traffic to AT&T.<sup>1</sup>

20. Netflix can avoid congestion by using these many options to make real-time routing decisions. Netflix can adjust its routing decisions on a minute-by-minute basis depending on cost, the measured performance of each interconnection, and other considerations. Again, Netflix can employ those routing options without entering into any direct relationship with AT&T, and, as the receiving network, AT&T cannot control which traffic is routed to it at which peering links. Rather, Netflix chooses which routes to use, whether to split its traffic over several (or many) different indirect routes, or whether to send it via a direct interconnection arrangement (if it has one).

21. Just as Netflix has the flexibility to shift its traffic to different providers to *avoid* congestion, if it concentrates its traffic on too few links, it can *create* congestion. That is precisely what Netflix has done. Over the past several years, Netflix has concentrated the traffic it sends to AT&T's network among a relatively small number of AT&T's peers, and thus among

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<sup>1</sup> See, e.g., Press Release, Akamai, Akamai Selected as Netflix Content Distribution Network Partner (March 22, 2010), *available at* [http://www.akamai.com/html/about/press/releases/2010/press\\_031610.html](http://www.akamai.com/html/about/press/releases/2010/press_031610.html); Dan Rayburn, *Akamai To Lose Netflix As A Customer, Limelight and Level 3 Pick Up The Business*, Business Insider (Nov. 9, 2010), <http://www.businessinsider.com/akamai-to-lose-netflix-as-a-customer-level-3-and-limelight-pick-up-the-business-2010-11>.

a small number of ingress points into AT&T's network. These interconnection points were not designed to handle the very large traffic volumes Netflix was attempting to send through them and, predictably, congestion began to occur.

22. As explained in more detail below, AT&T worked cooperatively with Cogent (and other peers) to augment the capacity of those connections to the extent that the balance of traffic complied with AT&T's peering policies. However, the amount of traffic flowing through AT&T's links with Cogent continued to increase rapidly, so that the ratio of traffic from Cogent to AT&T rose far above levels permitted by AT&T's peering policy. As a result, Cogent no longer qualified for settlement-free peering augmentations.

23. Netflix could have eliminated this congestion by adopting a more efficient approach to delivering traffic to AT&T. Netflix has stated that it purchases transit from only six AT&T peers: Cogent, Level 3, NTT, TeliaSonera, Tata and XO.<sup>2</sup> There are many other transit providers that peer with AT&T from which Netflix could also have purchased access to AT&T's network. Netflix also could have delivered traffic to AT&T through a CDN (or other MIS or CIP customer) that has direct connections to AT&T's networks [**BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**].

24. At all relevant times, there was sufficient aggregate capacity into and on AT&T's network to handle the volumes that Netflix was attempting to deliver to AT&T through Cogent. Contrary to Netflix's assertions, AT&T has no incentive and no practical ability to congest

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<sup>2</sup> See *Applications of Comcast Corp. and Time Warner Cable Inc. for Consent to Transfer Control of Licenses and Authorizations*, MB Dkt No. 14-57, Petition to Deny of Netflix, Inc., Declaration of Ken Florance, Vice President of Content Delivery, Netflix, Inc., dated Aug. 25, 2014, ¶ 48 (filed Aug. 27, 2014).

peering links in an attempt to degrade the quality of Netflix's services. Netflix can switch its traffic among any (or all) of hundreds of different peering and interconnection links through which AT&T exchanges traffic (and can do so without notice to AT&T). Accordingly, AT&T could not practically execute the "degradation by congestion" strategy that Netflix posits without limiting capacity across *all* of its interconnection points. Such a strategy would degrade the quality of all of AT&T's customers' traffic and thereby harm the performance of the critically important broadband Internet services AT&T sells to its end-user customers.

**B. Netflix's Contract With AT&T**

25. [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] AT&T and

Netflix explored a number of provisioning scenarios and ultimately agreed to an [BEGIN

AT&T HIGHLY CONFIDENTIAL INFORMATION] [END

AT&T HIGHLY CONFIDENTIAL INFORMATION] in early May 2014. The resulting

contract provides very favorable terms to Netflix.

26. [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

**[END AT&T HIGHLY**

**CONFIDENTIAL INFORMATION]** and Netflix has publicly stated that its recent interconnection deals, like the one with AT&T, are not negatively affecting its margins.<sup>3</sup>

27. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL**

**INFORMATION]**

29. Netflix's most recent USA ISP Speed Index confirms that the new arrangement is working well for Netflix and its customers. According to Netflix, its customers served by AT&T U-verse broadband achieved average download speeds of 2.77 Mbps in September, only 0.4

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<sup>3</sup> Thomson Reuters StreetEvents Edited Transcript, "NFLX – Q2 2014 Netflix Inc Earnings Call," July 21, 2014, *available at* <http://files.shareholder.com/downloads/NFLX/0x0x770177/eda92767-92b8-483b-ba53-ad97597b91f5/NFLX-Transcript-2014-07-21.pdf> ("Well on a short-term basis, I think there's great assurances in the sense that we've been able to sign these immediate interconnect deals, and *still able to achieve our margin targets, and our guidance implies those costs are embedded.*" (emphasis added)).

Mbps slower than the fastest ISP (as measured by Netflix).<sup>4</sup> Netflix's performance for AT&T broadband customers is expected to improve more in the coming months as the new arrangement continues to be optimized.<sup>5</sup>

30. Netflix suggests that it was unreasonable for AT&T to decline to agree to a Netflix "Open Connect" arrangement for no compensation. In fact, the parties discussed a number of different scenarios. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T**

**HIGHLY CONFIDENTIAL INFORMATION]**

**V. AT&T's Dealings With Cogent**

**A. AT&T's Dispute With Cogent**

31. AT&T has had a peering relationship with Cogent, a large Tier 1 backbone provider, for many years.

32. As explained above, many CDNs such as Akamai, Limelight, and Amazon compete to deliver content from content providers to end-user customers. These CDNs are not Tier 1 peers, and they purchase Internet Access Service as inputs to their service.

33. If Cogent could overcome the traffic and other balance requirements in its peers' peering policies, it could create a competitive advantage over CDNs. Cogent could push traffic from content-heavy customers directly to its Tier 1 peers (such as AT&T) on a settlement-free

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<sup>4</sup> See Netflix, USA ISP Speed Index (Sept. 2014), <http://ispspeedindex.netflix.com/usa>.

<sup>5</sup> See *Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations*, MB Dkt No. 14-90, Comments of Netflix, Inc., at 25 (filed Sept. 16, 2014).

basis, rather than having to purchase transiting or other services (as CDNs have to do) to deliver that additional traffic to other networks.

34. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

35. AT&T and Cogent discussed ways to address this issue. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** Peers typically use “hot potato” routing, under which each peer hands traffic to the other at the first possible interconnection point. The result is that the receiving peer may have to carry the traffic long distances (sometimes across the country) to deliver the traffic to the end user. By contrast, a peer using “best exit” routing delivers traffic at the interconnection point closest to the end user, thus reducing the distance the traffic must be carried on the receiving peer’s network.<sup>6</sup>

36. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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<sup>6</sup> Although best-exit routing can offset the burdens associated with certain levels of unbalanced traffic, it is not a panacea, and is not sufficient when traffic imbalances continue to rise.

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

37. After beginning negotiations with Cogent, AT&T, at substantial expense, implemented significant upgrades to its peering links with Cogent. AT&T added **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** 10 Gbps circuits, increasing the total number of such circuits from **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** by the summer of 2013 – more than a **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

38. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY**

**CONFIDENTIAL INFORMATION]**

39. Cogent's traffic volumes continued to increase rapidly in subsequent months. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T**

**HIGHLY CONFIDENTIAL INFORMATION]** AT&T further stated that, consistent with industry norms, the proper approach for addressing this traffic imbalance was for Cogent to purchase additional capacity from AT&T. AT&T and Cogent have been at an impasse ever since. However, since Netflix began delivering traffic directly to AT&T's under its new contract, the congestion on Cogent's links with AT&T has dramatically declined.

40. In sum, it was Cogent, together with Netflix, that caused the congestion in Cogent's peering links with AT&T. Cogent sought to have AT&T add Terabits of capacity to its peering links with AT&T for free. Cogent refused to negotiate an agreement to compensate AT&T for upgrading those links – in violation of AT&T's peering policy and well-established industry norms. Those actions led to the congestion about which Cogent complains.

41. Nor, contrary to Cogent's assertions, did AT&T intentionally allow congestion for the purpose of degrading traffic from Netflix. AT&T's decision not to provide Cogent with further free upgrades had nothing to do with the origin and type of traffic that Cogent was seeking to deliver to AT&T. As discussed above, the problem was the extreme overall *volume* of traffic, which caused congestion for all traffic in and out of the Cogent peering links. In all events, AT&T's contract with Cogent **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END**

**AT&T HIGHLY CONFIDENTIAL INFORMATION]** Cogent has not raised any issue relating to AT&T's performance of this aspect of the contract.

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<sup>7</sup> ATT-FCC-01517291.

**B. Cogent's Augmentation Cost Assertions Are Incorrect.**

42. Cogent's assertion that the cost of augmenting capacity to handle all of the traffic it was attempting to route through those links would have been minimal (\$10,000 per 10 Gigabit link) is inaccurate. It typically costs AT&T about [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] that amount to add 10 Gbps of capacity. First, in the carrier hotel, AT&T must add a new 10 Gig port in the patch panel and add cross connects to connect that additional capacity to the peer. AT&T must also increase capacity for the fiber facilities that connect the carrier hotel to the peering routers at the Service Node Routing Complex, which can be miles away. Further, AT&T must add capacity to the peering routers and to the core backbone routers to which they are connected. AT&T may also need to perform upgrades for additional core backbone or other routers serving the same metropolitan area, and in AT&T's metro and last mile networks.

**VI. THE CONDITIONS PROPOSED BY COGENT AND NETFLIX WOULD IMPOSE SUBSTANTIAL HARM.**

43. I have reviewed the proposed "merger conditions" described by Cogent and Netflix. I believe these proposed conditions would cause substantial harm to the industry.

**A. Cogent's Proposal For Unlimited Free Upgrades At Peering Links.**

44. Cogent proposes that, if any interconnection point between AT&T and another network with which AT&T peers reaches 70 percent utilization, AT&T must promptly upgrade the ports and cross-connects on a settlement-free basis. This condition would undermine established industry norms and override the contracts and policies under which the entire industry provides peering. As explained above, peering does not mean that interconnection is

given away for free. Rather, peers pay each other on an in-kind basis. If the ratio of traffic becomes lopsided, common industry practice is that the parties would move to a paid arrangement. Cogent's proposal would be a radical departure from these industry norms.

45. Second, this condition would impose enormous costs on AT&T and its customers. Under Cogent's proposal, AT&T would be required to upgrade its links with Cogent constantly to ensure that AT&T can accept *any* amount of traffic being sent by Cogent no matter how imbalanced the traffic. As described above, there are very substantial costs associated with each such upgrade. To the extent AT&T must provide interconnection for free, AT&T ultimately will be forced to recover those costs from its end-user Internet customers, thus forcing many of these customers to pay for services that they will not use. If AT&T were forced to give Cogent interconnection services for free, those costs would have to be recovered from all of AT&T's end-user customers, many of whom do not subscribe to the services these upgrades would support, but would nonetheless be required to subsidize these services.

46. Third, any such automatic augment requirement would cause a daisy chain effect, leading to large unnecessary excess capacity. If any peer could send any amount of traffic to AT&T, regardless of traffic balance and for free, that would risk turning every peer into a CDN with artificially low costs. Such arrangements would encourage Netflix and other large content providers to shift their traffic constantly to the peer offering the lowest price into AT&T's network at any given time, triggering constant demands for augmentation at peering links across the network. As soon as AT&T completed one augmentation, Netflix could shift its traffic to another link or peer, triggering another augmentation at the new locations, leaving the just-augmented links largely unused. The result would be substantial waste and inefficiency.

47. Fourth, the excess capacity would create significant security risks. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** Or AT&T could remove the excess capacity only to have to reinstall it when Cogent wins the traffic back.

48. Fifth, Cogent's proposal would dramatically reduce incentives for content providers to deliver traffic efficiently to AT&T's network. Today, content providers have strong incentives to use effective compression and other technologies to reduce their traffic volumes. If AT&T were forced to pay for all upgrades needed to accept any traffic levels at peering links, there would be little incentive for those delivering content to use links efficiently.

49. Sixth, Cogent's proposal would reduce its own incentives for efficient routing by allowing Cogent to dump traffic into any peering link, no matter how distant from the end user. Cogent could then demand that AT&T carry that traffic all the way to the end user.

**B. Netflix's Proposal For Free Access To AT&T's Network**

50. For many of these same reasons, Netflix's proposal to prohibit AT&T from charging a content provider a fee for interconnection would be contrary to industry norms. Such services have always been provided for a monetary fee, and Netflix's proposal would represent a

radical departure from these industry practices. This condition would also create substantial congestion on AT&T's networks because content providers would have reduced incentives to manage the traffic they send over AT&T's network. And this condition would be extremely costly to AT&T and its customers, including many customers who do not subscribe to Netflix, but would nonetheless be required to subsidize the network upgrades that Netflix would have AT&T provide on its behalf.

**C. Cogent's Proposal To Remain A Peer Regardless Of Whether It Qualifies To Be A Peer Under Industry Standards And Its Contracts With AT&T**

51. Cogent's proposal that it be permitted to retain peering with AT&T for seven years regardless of traffic imbalances also would be a significant departure from industry norms. As discussed, industry standards, and AT&T's contracts and policies, set forth a number of conditions for peering, including roughly equal traffic volumes, a minimum number of interconnection locations, significant network capacity, and various routing guidelines. Cogent's proposal would allow it to obtain access to AT&T's network with no payment regardless whether it meets any of those conditions.

52. In addition, Cogent's proposal would distort the marketplace. Cogent would effectively become a CDN that competes with Akamai and Limelight to deliver content to AT&T's customers. Unlike Akamai and Limelight, which must pay for access to the AT&T IP backbone, Cogent would get such access for free, thus providing it a significant and unwarranted competitive advantage over Akamai and Limelight. Cogent's advantage would also preclude entry by new competitors that would not have "grandfathered" peering status long after they ceased to be peers.

**REDACTED - FOR PUBLIC INSPECTION**

I declare under penalty of perjury that the foregoing is true and correct. Executed on  
October 15, 2014.

A handwritten signature in black ink, appearing to read "Scott Mair", written over a horizontal line.

Scott Mair  
Senior Vice President of Technology Planning and  
Engineering  
AT&T Services, Inc.

*REDACTED - FOR PUBLIC INSPECTION*

**AN ECONOMIC ASSESSMENT OF AT&T'S PROPOSED  
ACQUISITION OF DIRECTV**

**Reply Declaration of Michael L. Katz**

**October 15, 2014**

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**I. INTRODUCTION AND OVERVIEW**

1. AT&T Inc. (“AT&T”) and DIRECTV (“DIRECTV”) have requested the consent of the Federal Communications Commission (“Commission”) to transfer control of licenses and authorizations from DIRECTV to AT&T in conjunction with the merger of the two companies.<sup>1</sup>

2. At the request of counsel for AT&T, I conducted an economic analysis of the likely effects of the proposed transaction on competition and consumer welfare. In an earlier declaration I summarized the findings I reached based on my analysis of the relevant facts and economic theory.<sup>2</sup> My central findings were—and continue to be—as follows. The fundamental economic rationale for the proposed transaction is that it will combine the complementary products and assets of the merging parties. By combining the companies’ complementary products (*e.g.*, combining AT&T’s fixed broadband Internet access services and/or mobile wireless services with DIRECTV’s video services), the proposed merger will cause the firms to internalize what would otherwise be externalities and will create downward pricing pressure on

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<sup>1</sup> Applications of AT&T Inc. and DIRECTV for Consent to Transfer Control of Licenses and Authorizations, Description of Transaction, Public Interest Showing, and Related Demonstrations, June 11, 2014, MB Docket 14-90 (hereinafter, *AT&T/DIRECTV Public Interest Showing*). As part of their application, AT&T and DIRECTV submitted several Declarations that I reference herein: Declaration of John T. Stankey, Group President and Chief Strategy Officer, AT&T Inc., June 10, 2014 (hereinafter, *Stankey Declaration*); Declaration of Rick L. Moore, Senior Vice President of Corporate Development, AT&T Inc., June 10, 2014 (hereinafter, *Moore Declaration*); Declaration Of Lori M. Lee, Senior Executive Vice President – Home Solutions, AT&T, Inc., June 10, 2014 (hereinafter, *Lee Declaration*); Declaration of Patrick T. Doyle, Executive Vice President and Chief Financial Officer, DIRECTV, June 10, 2014 (hereinafter, *Doyle Declaration*); Declaration of Paul Guyardo, Executive Vice President and Chief Revenue and Marketing Officer, DIRECTV US, June 10, 2014 (hereinafter, *Guyardo Declaration*).

<sup>2</sup> Declaration of Dr. Michael L. Katz, “An Economic Assessment of AT&T’s Proposed Acquisition of DIRECTV,” June 11, 2014, attachment to *AT&T/DIRECTV Public Interest Showing* (hereinafter, *Katz Initial Declaration*).

those products. This downward pricing pressure would arise even if, counterfactually, the proposed merger gave rise to no cost-saving efficiencies. Indeed, an initial merger-simulation analysis indicates that the overall effect of the proposed transaction will be to increase consumer surplus, even *before accounting for cost-saving efficiencies*. Additional econometric analyses since conducted by Professors Berry and Haile, which were previously provided to the Commission, reinforce and confirm the finding that the merger would not harm consumers even if—counterfactually—it gave rise to no efficiencies.<sup>3</sup>

3. In fact, by combining the companies' complementary assets (*e.g.*, their respective subscriber bases or AT&T's assets in physical networks and DIRECTV's assets in video content packaging), the proposed merger will allow the combined firm to realize lower marginal costs of providing existing services and to create better new services than could either party operating on its own or through an arm's-length agreement with the other. These lower marginal costs resulting from the realization of asset complementarities will benefit consumers because the combined firm will have economic incentives to offer better and cheaper services. The internalization of product complementarities will reinforce these effects. Moreover, the lower prices and higher quality of the combined firm's services can be expected to create competitive

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<sup>3</sup> See, Steve Berry and Phil Haile, "Quantitative Analysis of an AT&T-DIRECTV Merger," attachment to Letter from Maureen Jeffreys to Marlene H. Dortch, MB docket 14-90, July 17, 2014 (hereinafter, *Berry and Haile Analysis*); Steve Berry and Phil Haile, "Quantitative Analysis of an AT&T-DIRECTV Merger: Updated Results," September 19, 2014, attachment to Letter from Maureen Jeffreys to Marlene H. Dortch, MB docket 14-90, September 23, 2014 (hereinafter, *Berry and Haile Update*); Steve Berry and Phil Haile, "Quantitative Analysis of an AT&T-DirectV Merger: Additional Discussion Of Modeling Choices, Data, and Results," September 22, 2014, attachment to Letter from Maureen Jeffreys to Marlene H. Dortch, MB docket 14-90, September 23, 2014 (hereinafter, *Berry and Haile White Paper*).

pressures for rival service providers—particularly cable companies—to respond by reducing their prices and improving their services, further benefiting consumers.

4. I have been asked by counsel for AT&T to review the economic arguments made in comments and petitions to condition or deny the proposed merger that have been filed in this proceeding in order to determine whether those arguments provide a basis for amending or reversing the conclusions I reached in my earlier declaration.<sup>4</sup> In addition, counsel for AT&T asked me to assess whether opponents' filings identify any likely sources of competitive harm that I have not identified in my earlier declaration.

5. Based on my review of the comments and petitions to condition or deny the proposed merger—as well as my review of the relevant economic literature, application of relevant

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<sup>4</sup> Specifically, I focus on the following filings: Comments of American Cable Association, MB Docket 14-90, September 16, 2014 (hereinafter, *ACA Comments*), including Gary Biglaiser, “The Harms of AT&T-DirectTV Merger, Exhibit A to ACA Comments, September 15, 2014 (hereinafter, *Biglaiser Report*); Comments of Cogent Communications Group, Inc., MB Docket 14-90, September 16, 2014 (hereinafter, *Cogent Comments*); Petition to Condition Consent of Cox Communications, Inc., MB Docket 14-90, September 16, 2014 (hereinafter, *Cox Petition*); Petition to Impose Conditions of DISH Network Corporation, MB Docket 14-90, September 16, 2014 (hereinafter, *DISH Petition*); Petition to Deny of Free Press, MB Docket 14-90, September 16, 2014 (hereinafter, *Free Press Petition*); Petition to Deny of the Greenlining Institute, MB Docket No. 14-90, September 16, 2014 (hereinafter, *Greenlining Petition*); Comments of Netflix, Inc., MB Docket No. 14-90, September 16, 2014 (hereinafter, *Netflix Comments*); Petition to Deny of Public Knowledge and Institute for Local Self-Reliance, MB Docket No. 14-90, September 16, 2014 (hereinafter, *Public Knowledge Petition*); Petition to Deny of Writers Guild of America West, Inc., MB Docket No. 14-90, September 16, 2014 (hereinafter, *WGAW Petition*).

The comments and petitions to condition or deny submitted in this proceeding contain numerous overlapping opinions and statements. Although I have not tried to rebut every claim made by parties opposed to the transaction, my declaration is intended to cover all of the major categories of opposition based on economic assertions. Any silence with respect to a particular empirical or theoretical claim stated should not be interpreted as agreement with that claim unless I specifically state such an agreement.

economic theory, and analysis of the empirical evidence (including extensive econometric modeling)—I continue to conclude that the proposed transaction will bring about substantial benefits for consumers and does not pose a significant threat of harm to competition or consumers.

6. Public Knowledge put it well when it stated that “[a]s the Supreme Court has explained, antitrust law ‘focuses on tangible economic injury,’ not ‘some abstract conception or speculative measure of harm.’”<sup>5</sup> As I will describe in what follows, opponents to the transaction have offered only unsound abstractions and speculation rather than sound economic analysis based on facts.

7. Briefly, my specific findings are:

- *The internalization of complementarities between satellite television services and fixed and mobile broadband services is the basis of merger efficiencies.* By internalizing the positive externalities that each party’s actions confer on the other, the proposed merger would enhance incentives to competitively price, promote and market complementary products, and provide high-quality customer care, thereby enabling the firm to offer more competitive integrated video and broadband bundles. Free Press’s unsupported speculation that clearly articulated problems associated with synthetic bundles can readily be solved through contracting ignores years of market

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<sup>5</sup> *Public Knowledge Petition* at 7, citing *Blue Shield of Va. v. McCready*, 457 US 465, 475 n.11 (1982).

evidence that past efforts by both parties, with multiple partners, have failed to solve such problems.

- *The programming-cost reductions that commenters agree will occur as a result of the proposed merger constitute a consumer benefit, not a competitive harm.* The American Cable Association, Cox Communications, DISH Network, and Free Press agree that programming costs will fall as a result of the merger. Claims that consumers will not benefit from such reductions in content costs because the merged entity will not pass through marginal cost reductions are unfounded as a matter of fact and basic economics. There also is no sound basis for claims that lower content costs for the merged entity will lead to higher programming costs for other MVPDs or reduced investments by programmers.
- *The proposed transaction would generate increased incentives for AT&T to invest in both fixed wireless and wireline terrestrial network facilities, to the benefit of consumers.* Claims that AT&T would invest in broadband expansion to the same extent without the merger are contrary to the evidence and have no sound basis in economic logic.
- *Claims that the proposed transaction would lead to adverse horizontal pricing effects are based on an incomplete analysis and are contradicted by sophisticated econometric modeling.* Free Press asserts that there would be harm in markets for MVPD services but does so by relying on a simplistic analysis of concentration without regard for the facts that the merging firms' products are complements and that the transaction will produce substantial efficiencies. Although concentration

analysis can be appropriate for a preliminary review (particularly in markets where the merging firms' products are not complements for one another), it cannot substitute for rigorous merger analysis of the type Professors Berry and Haile and I have conducted. No opponent to the transaction has offered a serious critique of our analyses nor has any opponent offered analysis that supports a conclusion different from that of our analyses.

- *Petitioners' claims regarding harm to competition from vertical foreclosure are unfounded.* Opponents posit various types of conduct in which AT&T might engage to protect its pay-television business from online competition (namely, using certain strategies coupled with usage-based pricing to penalize broadband customers for using online video and degrading interconnection with OTT providers). However, none of the hypothesized conduct could be used to harm OVDs without also degrading AT&T's broadband Internet service generally or being a highly visible, targeted strategy that would clearly draw regulatory attention. Such degradation would harm AT&T's broadband Internet access service business and—through effects on the sales of bundles—its video services business. Consequently, the merged company would not have incentives to harm OVD competition. Indeed both companies have recognized that online video services have significant complementarities with the companies' other services and have taken actions to promote those services.

8. The remainder of this declaration explains these findings in greater depth and provides details of the facts and analysis that led me to reach them.

**II. MERGER EFFICIENCIES**

9. As I described in my initial declaration, the proposed transaction will give rise to several types of substantial, cognizable efficiencies that will benefit consumers.<sup>6</sup> Although some commenters have raised objections regarding the cognizability or magnitude of the efficiencies, none of these objections stands up to scrutiny.

**A. CONSUMERS WILL BENEFIT FROM THE AVAILABILITY OF IMPROVED BUNDLES**

10. In my initial declaration, I explained that the proposed transaction would allow the parties to internalize complementarities between their product offerings, which would result in lower prices, higher quality, and increased competitive pressures on rival service providers.<sup>7</sup>

11. As I demonstrated in that declaration, based on a careful review of industry facts, AT&T's high-speed Internet access and mobile wireless services are complements for DIRECTV's video services.<sup>8</sup> I am unaware of any commenters' having challenged the complementarity between AT&T's broadband services and DIRECTV's video services. Indeed, DISH's comments highlight some of the sources of complementarity between broadband Internet access and MVPD services. DISH explains that it "offers [video-on-demand services delivered

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<sup>6</sup> *Katz Initial Declaration*, § VI.

<sup>7</sup> *Katz Initial Declaration*, §§ V.A, V.B, and VI.A.

<sup>8</sup> *Katz Initial Declaration*, § III.B.2. The econometric demand analyses conducted by myself and Professors Berry and Haile (described in Section III, below) also demonstrate the existence of video/broadband complementarity. In particular, as Professors Berry and Haile explained in their recent submission, although the demand model on which we all relied implies some "minimal degree of complementarity" due to its structure, the estimates obtained by fitting the model to the data imply much more complementarity than the minimum. (*Berry-Haile White Paper* at 21.) Thus, the specification of the model is not forcing the results, and the demand estimates reveal significant complementarity between DIRECTV's video service and AT&T's broadband service.

to its set top box via the Internet] to maintain the competitiveness of its [MVPD] service, reduce churn, and discourage ‘cord shaving’ or ‘cord cutting’—consumers reducing their use of MVPD services or leaving them altogether.”<sup>9</sup> DISH also describes its acquisition of wireless spectrum and the importance of offering wireless broadband that would enable DISH to provide “fixed-wireless video, data and voice, and mobile video, data and voice.”<sup>10</sup> DISH further explains that the proposed merger will “enable AT&T to provide, on a nationwide basis, a bundle of mobile, Internet access, and video services” which will be a “direct competitive threat” to DISH’s own bundles.<sup>11</sup>

12. The economic logic underlying the finding that the merger would give rise to efficiencies from the internalization of complementarities is straightforward. As separate companies that market their complementary products on a standalone basis or through a synthetic bundle, each merging party fails to take into account the impact of its actions on the profits of the other party. When their products are complements, the separate firms’ failure to internalize their effects on one another results in their supplying services with lower qualities and higher prices than those that would maximize the firms’ joint profits. Post-merger, these effects would be internalized,

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<sup>9</sup> *DISH Petition* at 15.

<sup>10</sup> *DISH Petition* at 23-24.

<sup>11</sup> *DISH Petition* at 24. Dish claims that, as a result, AT&T would have incentives to “foreclose DISH from entering the wireless business altogether” by, for example, “refusing to enter into data roaming agreements with DISH that it otherwise might have considered pre-merger.” (*DISH Petition* at 24.) DISH acknowledges that there are regulatory safeguards, but claim that such safeguards may be insufficient. (*DISH Petition* at 24.) However, DISH neither provides any evidence that it will lack access to roaming or that existing regulation is insufficient, nor that AT&T would have incentives to refuse to enter into roaming agreements with DISH after the merger.

and the proposed merger would solve a “double marginalization” pricing problem and a broader, “double moral hazard” problem faced by the parties when they are separate companies. The internalization of the positive externalities each party’s actions confer on the other would lead to greater incentives to promote and market their complementary products and to provide high-quality customer care, which will enable the merged firm to offer more competitive integrated video and broadband bundles.

13. Contrary to the evidence, Free Press claims that the benefits of a broadband-video bundle can be obtained without a merger, and that rejection of the proposed merger would create incentives for AT&T and DIRECTV to offer synthetic bundles that are “more attractive to consumers.”<sup>12</sup> This claim ignores the fact that, for years, both companies have tried to overcome the double marginalization and double moral hazard problems through contractual arrangements yet have failed to deliver the benefits consumers expect from integrated bundles. Executives of both companies have amply documented that, despite having spent years working to improve coordination between the two companies, there remain significant obstacles to offering consumers the benefits of one-stop shopping and low bundle prices that a single, integrated firm could offer.<sup>13</sup> For example, the installation of a synthetic bundle purchased from the two parties currently requires that the customer schedule two appointments and that the companies make separate “truck rolls,” typically occurring on different dates.<sup>14</sup> Synthetic-bundle customers who purchase through DIRECTV also receive two separate bills, on separate billing cycles, which

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<sup>12</sup> *Free Press Petition* at 20-22 and 34-35.

<sup>13</sup> *Lee Declaration*, ¶¶ 49, 53-58; *Guyardo Declaration*, ¶¶ 18-38.

<sup>14</sup> *Katz Initial Declaration*, ¶ 104.

may cause confusion in addition to inconvenience.<sup>15</sup> These problems afflict not only the current AT&T-DIRECTV relationship but also the parties' other synthetic bundle partnerships.<sup>16</sup> Similarly, despite the parties' ongoing efforts over several years to improve their joint marketing agreement, they also have not been able to obtain a contractual solution to the double marginalization problem.<sup>17</sup> In summary, Free Press suggests without foundation that the problems of synthetic bundles can readily be solved through contracting, and Free Press chooses to ignore the substantial evidence that past efforts have failed to solve the problems associated with synthetic bundles.

14. Free Press's claims are contradicted not only by facts and experience but also by both the theoretical economic literature<sup>18</sup> and the empirical economic literature.<sup>19</sup> It is widely recognized among economists that contractual mechanisms often fail to induce the parties to behave optimally from the perspective of joint-profit-maximization, leading to services that are priced

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<sup>15</sup> *Guyardo Declaration*, ¶ 33.

<sup>16</sup> *Guyardo Declaration*, ¶¶ 19-20 and 24.

<sup>17</sup> For example, AT&T's integrated bundles **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** (*Katz Initial Declaration*, ¶ 75, and sources cited therein.) This choice maximizes AT&T's individual profits, but solving the double marginalization problem would require a contractual solution that gave AT&T (and DIRECTV) the incentive to maximize their *joint* profit.

<sup>18</sup> See, for example, Oliver Hart and John Moore (1990), "Property Rights and the Nature of the Firm," *Journal of Political Economy*, **98**(6): 1119-1158; Oliver E. Williamson (1975), *Markets and Hierarchies: Analysis and Antitrust Implications*, New York: The Free Press; Armen A. Alchian and Harold Demsetz (1972), "Production, Information Costs, and Economic Organization," *The American Economic Review*, **62**(5): 777-795.

<sup>19</sup> See, for example, Francine Lafontaine and Margaret Slade (2007), "Vertical Integration and Firm Boundaries: The Evidence," *Journal of Economic Literature*, **45**(3): 629-685 at 680.

and offered in ways that are inferior to services that are supplied by vertically integrated firms. The benefits of integration are particularly likely to be strong when relationships between companies are complex and when industries are rapidly evolving in ways that are difficult to predict.<sup>20</sup> The multi-dimensional and changing nature of the services offered by the parties to the proposed merger make the use of contractual arrangements as substitutes for integration particularly difficult.

15. Free Press acknowledges that the pricing of the synthetic AT&T-DIRECTV bundles “is a prime reason for the apparent lack of viability in these synthetic bundles.”<sup>21</sup> However, Free Press attempts to dismiss the double marginalization problem that is the cause of higher pricing by arguing that the parties control their pricing decisions and therefore could achieve superior pricing for synthetic bundles without the merger.<sup>22</sup> Free Press completely misses the point that the double marginalization problem arises because the parties are unable to come to an agreement that leads to an efficient outcome, not that they literally cannot control their pricing. Stated another way, the fact that the companies have “total control”<sup>23</sup> over pricing does not change the economic reality that each firm has incentives to set its prices at levels that, although

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<sup>20</sup> See, for example, Sanford J. Grossman and Oliver D. Hart (1986), “The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration,” *Journal of Political Economy*, **94**(4): 691–719; Oliver E. Williamson (1971), “The Vertical Integration of Production: Market Failure Considerations,” *The American Economic Review*, **61**(2): 112–23; Philippe Aghion and Richard Holden (2011), “Incomplete Contracts and the Theory of the Firm: What Have We Learned over the Past 25 Years?” *The Journal of Economic Perspectives*, **25**(2): 181-97.

<sup>21</sup> *Free Press Petition* at 21.

<sup>22</sup> *Free Press Petition* at 34.

<sup>23</sup> *Free Press Petition* at 21.

profit-maximizing from the perspective of that firm, are higher than is jointly optimal because neither seller takes into account the effects of its price on the other seller.

16. Free Press also claims that the benefits of an integrated bundle, both with regard to pricing and service quality, can be achieved through some sort of wholesale agreement.<sup>24</sup> Again, Free Press chooses to ignore marketplace facts and economic logic. **[BEGIN AT&T AND DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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<sup>24</sup> *Free Press Petition* at 21 and 35.

<sup>25</sup> *Lee Declaration*, ¶ 59; *Guyardo Declaration*, ¶ 37.

<sup>26</sup> *See, e.g.*, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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<sup>27</sup> *See, e.g.*, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T AND  
DIRECTV HIGHLY CONFIDENTIAL INFORMATION] [BEGIN DIRECTV HIGHLY  
CONFIDENTIAL INFORMATION]**

**[END DIRECTV HIGHLY  
CONFIDENTIAL INFORMATION]** In short, there is no basis for Free Press’s claim that the parties would be able to agree to a wholesale arrangement if the proposed merger were blocked and that such an agreement would overcome the double marginalization and double moral hazard problems.

17. Writers Guild of America, West, Inc. (“Writers Guild West”) attempts to dismiss the consumer benefits of the bundling efficiencies for another, similarly unconvincing reason: Writers Guild West claims that AT&T-DIRECTV bundles, even when offered by the merged entity, will not be competitive because they will contain the “least attractive technologies, combining satellite and DSL, or satellite and [fixed wireless local loop].”<sup>30</sup> Writers Guild West ignores the fact that the fixed wireless local loop (“fixed WLL”) service that AT&T will offer

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<sup>28</sup> *Guyardo Declaration*, ¶ 37.

<sup>29</sup> *Guyardo Declaration*, ¶ 37; **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

<sup>30</sup> *WGAW Petition* at 28. And, in current U-verse markets, Writers Guild West claims that “AT&T already offers [a fully-integrated] bundled service...” (*WGAW Petition* at 28.)

will be competitive with and often superior to the Internet service now available to customers in the largely rural areas where fixed WLL will be deployed (see Section II.C.2 below). Moreover, these bundles will offer consumers the benefits of one-stop shopping and improved customer care. Similarly, integrated bundles of DIRECTV's video service and AT&T's DSL service will meet the needs of many consumers. In fact, DSL is currently used by an estimated [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] percent of broadband subscribers.<sup>31</sup> Lastly, Writers Guild West fails to recognize the benefits that consumers will derive from consuming improved AT&T-DIRECTV bundles based on AT&T's very high speed, wireline broadband Internet access services.<sup>32</sup>

**B. CONSUMERS WILL BENEFIT FROM LOWER PROGRAMMING COSTS**

18. As I explained in my initial declaration, the parties anticipate that AT&T will achieve significant reductions in its content costs as a result of the merger.<sup>33</sup> The American Cable Association, Cox, DISH, and Free Press acknowledge that AT&T's and DIRECTV's programming costs will fall after the merger.<sup>34</sup> These content-cost reductions will be passed on to consumers in the form of lower prices and/or improved quality, and will make further

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<sup>31</sup> Strategy Analytics (SPS), "North American Broadband Forecast 2014," April 2014.

<sup>32</sup> Writers Guild West apparently believes that all MVPD services are identical when it claims that, in current U-verse markets, "AT&T already offers [a fully-integrated] bundled service..." (*WGAW Petition* at 28.)

<sup>33</sup> *Katz Initial Declaration*, § VI.B.1.

<sup>34</sup> See *DISH Petition* at 10 and 11-12; *Free Press Petition* at 24; *Cox Petition* at 13; *ACA Comments* at 17. The American Cable Association's expert, Dr. Gary Biglaiser, states that "the fact is that larger MVPDs pay much lower prices than smaller MVPDs. This conclusion is supported by industry participants and financial analysts who all have found that larger MVPDs generally pay lower content costs per channel, per subscriber." (*Biglaiser Report* at 15.)

deployment of FTTP broadband profitable, further benefiting consumers. This would be a significant consumer benefit because content costs are the biggest component of an MVPD's marginal cost.<sup>35</sup>

19. Although there is general agreement that the merger will allow AT&T to achieve lower content costs, some petitioners claim this cost reduction will not benefit consumers because: (a) the cost savings will not be passed on to consumers; (b) AT&T's savings will cause other programmers to pay higher costs for content; or (c) the proposed transaction will lead to reduced output and lower programming quality due to the exercise of monopsony power. As I now discuss, these claims are not supported by evidence or economic logic.

*1. Content cost savings will be passed on to consumers.*

20. Consider first the argument that the cost savings will not be passed through to consumers in the form of lower prices.<sup>36</sup> Petitioners make several versions of this argument, each of which is fatally flawed.

21. DISH and Free Press claim that the level of competition in the industry is insufficient for pass through of cost savings to occur.<sup>37</sup> The claim that a supplier with market power will not pass through cost reductions in the form of lower quality-adjusted prices lacks any support in economic theory. Content costs, which are contractually structured on a per-subscriber, per-

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<sup>35</sup> AT&T's content costs accounted for [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] of its variable recurring video costs in 2013. (*Lee Declaration*, ¶ 18.)

<sup>36</sup> *DISH Petition* at 12; *Free Press Petition* at 25-28; *Cox Petition* at 6-7; *WGAW Petition* at 14.

<sup>37</sup> *DISH Petition* at 12-13; *Free Press Petition* at 2, 24, and 28.

month basis, are marginal costs. It is a well-established principle taught in freshman economics courses that even a monopolist—which the merged entity manifestly would not be—has incentives to pass through marginal cost decreases to consumers in whole or in part.<sup>38</sup> In fact, economic theory does not generally predict that a firm competing in a concentrated market will likely pass through less of the cost savings than a firm in a more competitive market. Indeed, a perfectly competitive firm facing a highly elastic demand curve will pass through essentially none of its firm-specific cost savings, while a monopolist typically will find it profitable to lower its price in response to a decline in marginal cost, passing through at least some of the cost reduction.<sup>39, 40</sup>

22. Free Press cites statistics indicating that Comcast earns higher operating margins than either Time Warner Cable or Charter and argues that, because Comcast is generally believed to

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<sup>38</sup> See, e.g., Jeremy I. Bulow and Paul Pfleiderer (1983) “A Note on the Effect of Cost Changes on Prices,” *Journal of Political Economy*, **91**(1): 182-85.

<sup>39</sup> See, e.g., Paul L. Yde and Michael G. Vita (1996), “Merger Efficiencies: Reconsidering the ‘Passing-On’ Requirement,” *Antitrust Law Journal*, **64**(3): 735-47, or virtually any microeconomics textbook.

<sup>40</sup> It should be observed that the conclusion that marginal cost savings will be passed through to consumers is based on the same logic that finds upward pricing pressure from a merger. Under that theory, the upward pricing pressure from a merger is equivalent to that associated with an increase in marginal cost, namely, the “cannibalization cost” associated with sales diverted from the merger partner. (See, e.g., Joseph Farrell and Carl Shapiro (2010), “Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition,” *The B.E. Journal of Theoretical Economics*, **10**(1): 1-39.) Hence, any argument that marginal cost changes are not passed-through also logically implies that the upward pricing pressure from the merger will not lead to higher prices.

Attempts to construct a theory under which a firm passes through cost increases but not cost decreases would not salvage a misguided attempt to claim that upward pricing pressures arise but that cost savings are not passed on to consumers—content costs are likely to rise over time with or without the merger. The relevant factor for economic welfare is how the proposed transaction would affect the paths of price and cost changes over time. The merger can be expected to slow the rise in marginal costs and, thus, slow the rise in retail prices.

have the lowest marginal costs, such margins prove that pass through does not occur.<sup>41</sup> This argument is incorrect. First, it ignores any differences among the firms other than scale that may account for differences in operating profit margins. Second, even if the firms were otherwise identical (which they are not), Free Press's argument would establish only that the pass through is less than 100 percent, not that large MVPDs such as Comcast do not pass through any content cost savings. Put another way, the mere fact that two firms have different markups of price over cost does not mean that there is no pass-through of marginal costs.

23. Free Press's claim that past increases in pay-TV prices provide evidence of a lack of pass through is likewise unsound.<sup>42</sup> As Free Press itself notes, programming costs have been strongly rising.<sup>43</sup> The fact that content prices and MVPD rates have gone up at the same time suggests that these costs have been passed through.<sup>44</sup> The Commission itself has concluded that the pass-through of cost savings occurs.<sup>45</sup>

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<sup>41</sup> *Free Press Petition* at 25-26.

<sup>42</sup> *Free Press Petition* at 27.

<sup>43</sup> *Free Press Petition* at 24-25. *See, also*, Robin Flynn, U.S. Multichannel Subscriber Update and Programming Cost Analysis, SNL Kagan, June 2013, available at <http://go.snk.com/rs/snlfinciallc/images/SNL-Kagan-US-Multichannel-Subscriber-Update-Programming-Cost-Analysis.pdf>, site visited October 12, 2014. (“[C]able MSOs’ programming expenses have been rising quickly due to rising retransmission fees, the additional expense of TV Everywhere and multiplatform agreements, escalating costs for cable network programming (again, sports in particular), and additional channel launches.”) Writers Guild notes that basic cable network affiliate fees rose at a compound annual growth rate of 9.1 percent over the period 2008-2013, which does not even consider the even greater increases in the costs of retransmission consent for broadcast networks and sports programming in recent years. (*WGAW Petition* at 11.)

<sup>44</sup> The rising cost of sports programming has been cited as a driver of increased MVPD subscriber costs, and some MVPDs have begun imposing surcharges for access to regional sports networks (RSNs). (Federal Communications Commission, Fifteenth Annual Report, *In the Matter of*

24. An estimate of the likely pass through of costs savings from the proposed merger can be derived from the demand estimation and simulations that I described in my initial declaration and Professors Berry and Haile subsequently enhanced and extended. Specifically, we estimated the demand for video and broadband products, and performed simulations to predict the proposed merger's potential effect on prices. This analysis suggests that for a **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** reduction in video costs, AT&T would pass on **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** of the cost savings to subscribers in the form of lower prices (*i.e.*, AT&T would pass on approximately **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** percent of cost savings in the form of lower prices).<sup>46</sup>

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*Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 12-203, July 22, 2013, ¶ 347.)

<sup>45</sup> “The negative coefficient for the vertically integrated variable suggests that vertically integrated operators pass some of their cost savings to their subscribers.” (Federal Communications Commission, *Report on Cable Industry Prices*, MM Docket No. 92-266, January 16, 2009 at 86.)

<sup>46</sup> In particular, Professors Berry and Haile used their three-nest model to predict the post-merger change in the price of the AT&T video and broadband bundle assuming that AT&T's video costs decline by **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** after the merger. They also estimated the post-merger change in the price of the AT&T video and broadband bundle assuming that AT&T's video costs would not change after the merger. The difference between these two post-merger prices provides an estimate of the reduction in price—about **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** — due to the **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** reduction in AT&T video costs. (*Berry and Haile Update* at 102 and 111.)

25. Lastly, DISH inadvertently provides support for the conclusion that programming cost savings will be passed on to consumers in the form of lower prices and/or higher quality products. In particular, DISH asserts that the proposed transaction will allow AT&T to achieve “unfairly favorable prices for programming.”<sup>47</sup> DISH’s concern regarding lower programming costs should be taken as evidence that DISH expects significant pass through to occur because DISH will be competitively harmed by the merged company’s paying lower licensing fees for content *only* if those lower fees lead the merged company to offer more attractive services to its customers. DISH’s assertion also provides a clear example of the distinction between harm to a competitor (which is what DISH is claiming) and harm to competition (the valid concern of public policy). Rather than harming competition, the reduction in programming costs due to the proposed merger will strengthen competition.

26. A final important point in considering the extent to which cost savings are passed through to consumers is to recognize that even a small change in costs can lead to a large change in consumer welfare when the cost change (or other merger efficiency) tips the balance in favor of a supplier’s undertaking a discrete investment that generates a large amount of consumer surplus. In principle, the consumer surplus generated by these new services made possible by the investment can exceed the merger-specific reduction in the costs of offering these services. In fact, as discussed in Section II.C below, the lower programming costs will trigger a large increase in network investment, which will give rise to a large decrease in the quality-adjusted prices faced by millions of consumers.

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<sup>47</sup> *DISH Petition* at 2.

2. *There is no sound basis for predicting that other MVPDs will pay higher programming prices as a result of the merger.*

27. Some petitioners claim that the merging parties' ability to obtain lower programming prices as result of the merger will harm competition and consumers by leading to an increase in the programming costs of smaller MVPDs.<sup>48</sup> DISH asserts smaller MVPDs will pay more because: (a) after large programmers have already secured national carriage through AT&T/DIRECTV, these programmers will be less constrained in their negotiations with smaller MVPDs, and (b) programmers are under pressure to attain certain financial growth targets and will have to replace a dollar lost to AT&T/DIRECTV with a dollar gained from smaller MVPDs.<sup>49</sup> DISH is thus arguing that: (a) if programmers are on *firmer* commercial footing as a result of their negotiations with the post-merger AT&T, then programmers will raise prices to smaller MVPDs, and (b) if programmers are on *weaker* commercial footing as a result of their negotiations with the post-merger AT&T, then programmers will raise prices to smaller MVPDs. Not only are these two arguments in conflict with each other, but each argument is unfounded and incorrect on its own.

28. DISH provides no basis at all for its first claim.<sup>50</sup> Moreover, this claim has nothing to do with the proposed merger. In the absence of the merger, DISH's argument would apply to any

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<sup>48</sup> *DISH Petition*, § III.A; *ACA Comments* at 19, citing *Biglaiser Report* at 15-16; *Cox Petition* at 14; *WGAW Petition* at 14.

<sup>49</sup> *DISH Petition* at 13.

<sup>50</sup> To the extent that DISH is arguing that smaller MVPDs will be harmed because they no longer would be pivotal (*i.e.*, essential to the programmer's decision whether to be in business at all), DISH is making an argument directly counter to the economics literature. See Alexander Raskovich (2003), "Pivotal Buyers and Bargaining Position," *The Journal of Industrial Economics*, 51(4): 405-26.

situation in which a programmer had already reached carriage agreements with AT&T and DIRECTV as separate companies, and the large programmers to which DISH refers all have such carriage agreements already.

29. DISH's sole argument in support of its second claim, that "[a] dollar less from AT&T means that the foregone dollar must be gotten from someone else—a smaller distributor," has no basis in economics.<sup>51</sup> Economically rational content providers will negotiate with other MVPDs based on the specific circumstances, including the value of the content to the MVPD, the incremental advertising revenues that the content provider and MVPD can obtain from distribution of the content, and the content provider's opportunity cost of licensing to the MVPD. There is no basis in the economics of bargaining to conclude that a better deal for AT&T should result in a worse deal for other MVPDs.<sup>52</sup> Instead, DISH simply asserts that programmers would fail to maximize their profits in the absence of the merger and instead behave in an economically irrational manner.

3. *There is no sound basis for predicting that content cost reductions would lead to monopsonistic quantity reductions or reduced investments in programming.*

30. Lastly, while admitting that the proposed merger would lead to lower content costs, some petitioners claim that the reduction in content costs would be anticompetitive because it would

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<sup>51</sup> *DISH Petition* at 13.

<sup>52</sup> In fact, the economic theory of bargaining indicates that, if the merged entity obtained lower programming rates, then other MVPDs also would be able to negotiate *lower* rates, all else equal. In particular, if AT&T has negotiated lower programming rates, then a programmer's opportunity cost of licensing to a competing MVPD, which would divert customers away from AT&T, will be lower. Presumably, DISH's concern with increased competitive pressure from AT&T outweighs the perceived benefits of such a price decrease.

result from the creation and exercise of monopsony power by the merged entity.<sup>53</sup> Writers Guild West also claims that the reduction in programming rates that will be obtained by the merged entity will harm “content creators and consumers as investment, innovation and choice in programming will be reduced.”<sup>54</sup> These claims rest on a misunderstanding of economic theory and are not supported by evidence.

31. As I explained in my initial declaration, the standard monopsony model does not apply to the bargaining context in which content providers sell programming to MVPDs.<sup>55</sup> Neither DISH nor Writers Guild West contradicts this analysis or presents a framework in which monopsony theory is applicable. The fact that monopsony is the wrong model matters because the predictions of a monopsony model are very different from those of bilateral bargaining. The key reason for the difference in the predicted efficiency of monopsony and bilateral bargaining frameworks stems from the incentives of the buyers. When the parties are engaged in bilateral (or multilateral) negotiations, buyers and sellers have incentives to maximize the size of the available surplus and then divide it between themselves.<sup>56</sup> In contrast, in the monopsony framework, the buyer is able to exercise market power only by reducing the quantity purchased below the efficient level, which leads to more favorable pricing on the inframarginal units.

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<sup>53</sup> *WGAW Petition* at 9-14; *DISH Petition* at 10-14.

<sup>54</sup> *WGAW Petition* at 13-14.

<sup>55</sup> *Katz Initial Declaration*, ¶ 111.

<sup>56</sup> Of course, this is not to say that the bargaining parties fully achieve joint profit maximization. As result of asymmetric information and bargaining frictions, they generally do not. Nevertheless, the nature of the departures from the joint-profit-maximizing outcome is very different from that of the monopsony model. Indeed, the distortions that arise when bargaining over price more closely resemble monopoly distortions, which are reduced if the buyer’s bargaining position is strengthened.

32. Writers Guild West provides no empirical basis for its prediction of harm to program creation. In fact, although the cost savings the combined firm will achieve will be very significant from the perspective of the combined firm, they will not be of a magnitude that would be expected to affect the quality or variety of programming that the content industry would be able to offer. Cable networks generate approximately **[BEGIN CONFIDENTIAL INFORMATION]** **[END CONFIDENTIAL INFORMATION]** percent of their revenues from programming licensing fees, and the remainder from advertising and other sources.<sup>57</sup> AT&T estimates that it will achieve content cost reductions of roughly 20 percent within **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** as a result of the merger.<sup>58</sup> Given AT&T's share of MVPD subscribers **[BEGIN CONFIDENTIAL INFORMATION]** **[END CONFIDENTIAL INFORMATION]** that reduction would amount to about **[BEGIN CONFIDENTIAL INFORMATION]** **[END CONFIDENTIAL INFORMATION]** percent of content providers' revenues. Even accounting for growth of AT&T video subscribers, and for content-cost reductions that may be achieved beyond the rates currently paid by DIRECTV, the reduction in programmer revenues still will be too small to

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<sup>57</sup> "Cable Network Revenue Mix, 1992-2012," SNL Kagan Media Trends Report 2013 at 89.

<sup>58</sup> *Moore Declaration*, ¶ 18.

<sup>59</sup> "AT&T – Verizon Video Subscriber Growth," SNL Kagan; "U.S. Multichannel Video Market Share Trends," SNL Kagan.

materially affect “investment, innovation and choice in programming” for the content industry as a whole.<sup>60</sup>

33. Moreover, as discussed above and in my initial declaration, the proposed merger is likely to increase the monetization opportunities of content providers because a larger video service provider can offer a content owner greater distribution, which enhances the value that it can offer advertisers.<sup>61</sup> Bargaining theory predicts that some of this incremental benefit will be appropriated by the content providers. The combined entity also will increase value for content owners by offering distribution through multiple integrated platforms—wireline Internet access, wireline and DBS video, and mobile wireless.<sup>62</sup> The expansion of broadband networks made possible by the merger will further lead to expanded demand for content. Thus, rather than decrease, the merger may in fact increase the revenues received by content providers which, according to Writers Guild West, would lead to increased “investment, innovation, and choice in programming.”

**C. CONSUMERS WILL BENEFIT FROM INCREASED INVESTMENT INCENTIVES**

34. As I explained in my initial declaration, the proposed transaction would generate increased incentives for AT&T to invest in both fixed wireless and wireline terrestrial network

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<sup>60</sup> *WGAW Petition* at 14. For example, if AT&T’s content costs declined by 25 percent and DIRECTV’s content costs declined by five percent, that would amount to a reduction of about **[BEGIN CONFIDENTIAL INFORMATION]** **[END CONFIDENTIAL INFORMATION]** percent of content providers’ revenues. (“AT&T – Verizon Video Subscriber Growth,” SNL Kagan; “U.S. Multichannel Video Market Share Trends,” SNL Kagan; “DBS Sub Growth,” SNL Kagan.)

<sup>61</sup> *Katz Initial Declaration*, ¶ 112.

<sup>62</sup> *Katz Initial Declaration*, ¶ 112.

facilities.<sup>63</sup> These increased incentives arise from both the combination of complementary products and the combination of complementary assets. A detailed analysis of AT&T's ordinary course of business investment model (appropriately modified to account for potential adverse effects of the merger on investment incentives) demonstrates that the proposed merger would lead to substantial increases in the economic incentives to deploy fiber to the premises ("FTTP"). AT&T also will have increased incentives to build fixed WLL (primarily in rural areas).<sup>64</sup> This incremental fixed WLL investment will create a new broadband Internet access option for many consumers who have no such—or only very limited—options at present. Similarly, incremental FTTP investment will provide superior options to consumers and will place greater competitive pressures on rival broadband providers.

1. *There is no sound basis for claims that AT&T's proposed investments in broadband expansion would take place without the merger.*

35. Free Press claims that investments in fiber were already planned pre-merger<sup>65</sup> and that "there is no reason whatsoever ... to believe that AT&T would not [expand its deployment of U-verse and offer fixed WLL] in the absence of the merger."<sup>66</sup> Similarly, Writers Guild West claims that wired broadband expansion would happen "regardless of whether the merger is

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<sup>63</sup> *Katz Initial Declaration*, § VI.C.

<sup>64</sup> Fixed WLL will allow the provision of voice and broadband Internet access but will not provide enough capacity to offer a service that is a good substitute for DIRECTV's video service. Hence, there would be no possibility of significant cannibalization of DIRECTV's video profits over the anticipated life of this investment, and the effect of the acquisition on AT&T's incentives to invest in fixed WLL will be unambiguously positive.

<sup>65</sup> *Free Press Petition* at 29-30.

<sup>66</sup> *Free Press Petition* at 23.

approved.”<sup>67</sup> These claims ignore the facts. The expansion by AT&T would be *over and above* what would be economically justified without the merger, as I demonstrated in my initial declaration using the models that AT&T uses in its ordinary course of business, adjusted to reflect factors that are economically relevant to assessing the impact of the merger.<sup>68</sup> Claims by Free Press and Writers Guild West that AT&T would undertake the same expansion but-for the merger are not based on any reasonable analysis, and are simply unfounded.

36. Free Press asserts that the nature of forward-looking statements about capital spending that AT&T has made “suggests this alleged expansion is something the firm already is planning to do.”<sup>69</sup> Free Press cites an AT&T 2014 Second Quarter filing stating that it “expect[s] 2014” capital investments to be “proportionately consistent to 2013.”<sup>70</sup> However, the incremental capital investments to expand FTTP deployment would begin in **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** so that comparison is inapposite. Moreover, changes in capital investments from year to year are affected by many factors. Contrary to the speculation of Free Press, the prediction that the proposed merger will result in greater investment in broadband facilities is supported by sound economic modeling.<sup>71</sup>

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<sup>67</sup> *WGAW Petition* at 25.

<sup>68</sup> *Katz Initial Declaration*, § VI.C.

<sup>69</sup> *Free Press Petition* at 30.

<sup>70</sup> *Free Press Petition* at 30, citing AT&T 2Q 2014 SEC Filing at 35: “We expect 2014 to be our peak investment year for Project VIP and anticipate our Wireless and Wireline segments’ spend to be proportionally consistent to 2013.”

<sup>71</sup> *Stankey Declaration*, ¶ 44.

37. Free Press and Writers Guild West claim that AT&T’s expansion of FTTP to an incremental two million customer locations is not actual expansion of a fiber network, but just an “upgrade” of its already planned expansion of fiber-to-the-node (FTTN).<sup>72</sup> Free Press asserts that.<sup>73</sup>

AT&T never suggests that the total U-verse coverage will increase by 2 million, only that its FTTP deployment will. Total planned U-verse coverage still appears to be what was stated in the November 2012 “Project VIP” announcement – 33 million customer locations. This suggests that the “commitment” here is simply an incremental FTTP upgrade to AT&T’s existing FTTN plans....

These claims are incorrect and misleading.

38. AT&T determined that, absent the merger, it would be profitable to deploy FTTP to a total of approximately [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] customer locations.<sup>74</sup>

AT&T determined that the merger would “justify deploying GigaPower to at least 2 million additional customer locations” above and beyond this number.<sup>75</sup> Of these 2 million incremental

locations, only [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] will be “upgrades” to locations that currently have FTTN.<sup>76</sup>

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<sup>72</sup> *Free Press Petition* at 30; *WGAW Petition* at 26.

<sup>73</sup> *Free Press Petition* at 30.

<sup>74</sup> *Stankey Declaration*, ¶ 43.

<sup>75</sup> *Stankey Declaration*, ¶ 44.

<sup>76</sup> AT&T Response to FCC Request No. 61.f.

39. Second, the number of customer locations to which AT&T planned on deploying FTTN in 2012 is irrelevant. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** Thus, the appropriate comparison is the number of customer locations to which AT&T will deploy FTTP after the merger versus the number of FTTP customer locations it would deploy but-for the merger. As discussed in my initial declaration, AT&T's ordinary course of business model shows that on top of the **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** customer locations for FTTP deployment that would be profitable without the merger, the transaction will make profitable millions of incremental customer locations.<sup>78</sup>

40. Moreover, although Free Press and Writers Guild West dismiss the significance of the “upgrade” from FTTN to FTTP, it is well recognized that FTTP offers considerable performance improvements over FTTN. AT&T's broadband Internet access service provided over its FTTN network “can offer peak download speeds of only 45 Mbps in the majority of the U-verse video

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<sup>77</sup> **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**  
**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** in order to offer very high-speed broadband services that can compete with the offerings of cable and other providers, such as Google Fiber. (*See, e.g., Lee Declaration*, ¶¶ 24, 31-35.)

<sup>78</sup> *Katz Initial Declaration*, § VI.C.1.

footprint and much less in many areas.”<sup>79</sup> In contrast, AT&T’s FTTP broadband product, known as GigaPower, will be able to deliver speeds up to 1,000 Mbps.<sup>80</sup>

2. *Claims that fixed WLL expansion will not provide consumer benefits are factually incorrect and economically flawed.*

41. Several petitioners attempt to dismiss the competitive significance of fixed WLL expansion. First, Free Press claims that such deployment is not actual expansion, and will not yield consumer benefits, because mobile wireless broadband service is currently available for most consumers. In particular, Free Press asserts that “AT&T *already offers* fixed LTE service nationwide. Anyone can sign up. Thus, AT&T’s broadband solution for rural America is the same expensive, capped, fixed 4G wireless services that it currently offers in areas where it refuses to upgrade its wired networks.”<sup>81</sup> Again, Free Press is wrong on the facts. The currently-available service to which Free Press appears to refer to is AT&T’s “Wireless Home Phone and Internet,” which is different in important respects from the planned fixed WLL service.

42. The most important consumer benefit is that fixed WLL is expected to deliver faster speeds at **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**  
**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** of Wireless Home Phone and Internet.<sup>82</sup> One reason is that AT&T’s “Wireless Home Phone and Internet” service utilizes an indoor portable device (similar to a modem) which contains an antenna to receive and transmit

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<sup>79</sup> *Lee Declaration*, ¶ 24.

<sup>80</sup> *Lee Declaration*, ¶ 8.

<sup>81</sup> *Free Press Petition* at 31 (emphasis in original).

<sup>82</sup> *See, e.g., Stankey Declaration*, ¶ 49; Project Star: FWLL Expansion Question, May 23, 2014 at 8, ATT-FCC-02122591 at ATT-FCC-02122598.

wireless signal.<sup>83</sup> In contrast, fixed WLL will utilize an outdoor antenna which will be much more powerful than the indoor device that is currently offered.<sup>84</sup> Fixed WLL also will utilize 20 MHz of dedicated spectrum that will not be used for mobile devices.<sup>85</sup> In contrast, the “Wireless Home Phone and Internet” service shares spectrum with AT&T’s LTE mobile services.<sup>86</sup> The outdoor antenna and dedicated spectrum are important reasons why fixed WLL will be able to achieve faster speeds than current wireless broadband products.<sup>87</sup>

43. Writers Guild West and Public Knowledge attempt to dismiss the competitive significance of fixed WLL expansion for another reason—that it allegedly will not be competitive with cable offerings. These claims also are factually incorrect and economically flawed.

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<sup>83</sup> Project Star: FWLL Expansion Question, May 23, 2014 at 8, ATT-FCC-02122591 at ATT-FCC-02122598.

<sup>84</sup> See, e.g., Project Star: FWLL Expansion Question, May 23, 2014 at 8, ATT-FCC-02122591 at ATT-FCC-02122598; *Stankey Declaration*, ¶ 48. (Fixed WLL services “will incorporate advanced technologies, including professionally installed customer premises equipment, that significantly enhance spectral efficiency and signal quality.”) The fixed WLL antenna is mounted on the exterior of the customer’s home and is capable of a **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** [END AT&T HIGHLY CONFIDENTIAL INFORMATION] signal strength increase compared to an indoor device such as the “Wireless Home Phone and Internet” product. (Project Star: FWLL Expansion Question, May 23, 2014 at 18, ATT-FCC-02122591 at ATT-FCC-02122608.)

<sup>85</sup> *Stankey Declaration*, ¶ 48.

<sup>86</sup> AT&T, Fixed Wireless Local Loop Executive Summary, June 30, 2014 at 3, ATT-FCC-02208746 at ATT-FCC-02208749.

<sup>87</sup> AT&T, Fixed Wireless Local Loop Executive Summary, June 30, 2014 at 2-3, ATT-FCC-02208746 at ATT-FCC-02208748-49.

44. Writers Guild West claims that “a majority of these new WLL locations will be in places where consumers have another fixed Internet choice,”<sup>88</sup> and that fixed WLL “may not be competitive with fixed broadband offerings” available from rivals.<sup>89</sup> Writers Guild West concludes that “it seems questionable that such a service is a quantifiable benefit for consumers.”<sup>90</sup> Contrary to this claim, the new fixed WLL service will be a dramatic improvement for customers that currently do not have access to any high-speed fixed broadband. As acknowledged by Writers Guild West, 20 percent of planned fixed WLL locations are currently not served by *any* wireline broadband provider, which amounts to 2.6 million customer locations.<sup>91</sup> Even for those customers who currently have such a choice, the addition of a new competitor will bring important benefits, including the availability of a lower-priced and/or faster-speed broadband service. For instance, fixed WLL is expected to deliver speeds comparable to those of wireline broadband services available in rural areas, where the majority of the fixed WLL expansion enabled by the merger will occur.<sup>92</sup> The availability of an additional broadband service also will exert important competitive pressure on rival broadband providers,

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<sup>88</sup> *WGAW Petition* at 26.

<sup>89</sup> *WGAW Petition* at 25-26.

<sup>90</sup> *WGAW Petition* at 26.

<sup>91</sup> *WGAW Petition* at 26; *Stankey Declaration*, ¶ 55.

<sup>92</sup> *Stankey Declaration*, ¶ 49. Similarly, fixed WLL is expected to deliver faster speed at **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]** the cost of satellite broadband services available in rural areas. (Project Star: FWLL Expansion Question, May 23, 2014 at 8, ATT-FCC-02122591 at ATT-FCC-02122598.)

which can lead to lower prices and greater investments in infrastructure that would allow for higher broadband speeds.<sup>93</sup>

45. Public Knowledge claims that bundles of fixed WLL and DIRECTV video will be inadequate unless it is “fully substitutable for cable” and that this will be so only if it “matches the prices and capabilities of cable.”<sup>94</sup> This claim demonstrates a fundamental misunderstanding of competition, consumer preferences, and the workings of the market economy. When consumers have heterogeneous tastes, a supplier’s product offerings do not have to match exactly the price and quality of rivals’ products to benefit consumers. Moreover, as noted above, fixed WLL is expected to deliver speeds comparable to those of wireline broadband services available in rural areas.

3. *Free Press’s claim of “Wasteful Capital Allocation” evinces a fundamental misunderstanding of real and financial capital.*

46. Free Press compares the purchase price of DIRECTV with the cost of expanding broadband facilities, and suggests that, rather than spend \$68 billion on purchasing DIRECTV,

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<sup>93</sup> AT&T has determined that fixed WLL has an **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** share opportunity relative to satellite broadband and cable broadband, respectively. (Project Star: FWLL Expansion Question, May 23, 2014 at 8, ATT-FCC-02122591 at ATT-FCC-02122598.)

<sup>94</sup> *Public Knowledge Petition* at 17. Public Knowledge further states that “If AT&T’s fixed wireless service has lower data caps, lower real-world throughput, higher latency, or materially differs from the quality of service available through cable broadband in any material way, then it can at most be considered a partial substitute or complement to cable, not a substitute.” (*Public Knowledge Petition* at 17.)

AT&T could deploy FTTP to between 35.4 and 92.5 million homes.<sup>95</sup> Writers Guild West makes the same argument, referencing testimony by Free Press.<sup>96</sup> To put it bluntly, these claims make no economic sense. Free Press and Writers Guild West misunderstand both the economics of asset transfers and the nature of efficiencies.

47. Although the proposed transaction creates positive incentives for AT&T to deploy FTTP to additional customer locations, the *purchase price* of DIRECTV bears no relation to the incentives it creates for FTTP deployment. The purchase price of DIRECTV includes the value of all of DIRECTV's assets, including satellites, network facilities, personnel, content agreements, customer relationships and revenues, *etc.*, and the discounted expected future cash flows from using those assets. Even ignoring enhanced incentives to invest in FTTP and other efficiencies from the merger, AT&T will receive substantial value from the purchase of DIRECTV. Free Press and Writers Guild West argue that the purchase price of DIRECTV ought to be redirected towards expanding FTTP to between 35.4 and 92.5 million homes. But doing so would be economically irrational because it would mean that AT&T would forgo future profits from DIRECTV's businesses as well as synergies from the acquisition, and instead deploy FTTP to tens of millions of locations where such deployment could not be justified economically.<sup>97</sup>

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<sup>95</sup> *Free Press Petition* at 38-40. Free Press similarly claims that AT&T could deploy FTTP to 15 million customer locations with only the cash portion cost of the deal. (*Free Press Petition* at 39.)

<sup>96</sup> *WGAW Petition* at 15.

<sup>97</sup> As noted, AT&T analysis determined that, without the merger, it would be profitable to deploy FTTP to [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] customer locations; the merger justifies deployment to at least 2 million more locations. (*Stankey Declaration*, ¶¶ 43-44.)

48. The claims by Free Press and Writers Guild West also misconstrue the nature of efficiencies, which accrue not just to the merging parties. The value to AT&T of the incremental investments in FTTP is the discounted expected cash flow from such investments, minus the upfront capital costs. The benefits to consumers, however, include the availability of broadband alternatives that they may prefer and the competitive pressure that AT&T's expansion would exert on rivals, which can lead to lower prices and improved services. These consumer benefits may be much greater than the amount of the incremental investments by AT&T. For instance, as noted above, even small changes in costs may tip the balance in favor of a supplier making sizable investments that generate significant consumer welfare. Thus, Free Press's comparison of the purchase price of DIRECTV with the incremental investments in FTTP from the merger is simply inapposite.

### **III. HORIZONTAL COMPETITIVE EFFECTS ANALYSIS**

49. Free Press claims that the proposed merger would give rise to substantial, adverse unilateral and coordinated competitive effects.<sup>98, 99</sup> It bases this claim on a concentration analysis

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<sup>98</sup> *Free Press Petition*, § III.A.

<sup>99</sup> Free Press also asserts that the proposed merger would harm potential competition. (*Free Press Petition* at 6-7.) However, Free Press provides no evidence or analysis to support its claim. The merger simulation demonstrates that consumers would benefit from the merger even in areas where both firms already are incumbents. Hence, even if the firms would have expanded in the absence of the merger, it would be still better for them to operate as a single firm in those areas. And, as described in detail in the investment section above, there will be greater geographic expansion as a result of the merger, not less. Similarly, the combination of DIRECTV and AT&T assets will lead to new entry into products involving video and mobile wireless.

and the assertion that the proposed merger would “violate” certain thresholds for concentration and the change in concentration defined in the Horizontal Merger Guidelines.<sup>100</sup>

50. Free Press states that “[t]hese guidelines are not ‘a rigid screen,’ nor the end of the discussion....”.<sup>101</sup> In this regard, Free Press is correct. The *Merger Guidelines* state<sup>102</sup>

The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration.

and<sup>103</sup>

The Agencies evaluate market shares and concentration in conjunction with other reasonably available and reliable evidence for the ultimate purpose of determining whether a merger may substantially lessen competition.

51. Despite acknowledging the proper role of the thresholds, the *Free Press Petition* treats the thresholds as the end of the story. Specifically, Free Press incorrectly asserts that exceeding certain thresholds constitutes a “violation” of the *Guidelines*. Free Press does nothing to address the substantial evidence submitted in the record regarding the lack of anticompetitive effects. Free Press’s simplistic approach to competitive effects is particularly troubling in the present instance because the merger involves both substitute and complementary products.

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<sup>100</sup> *Free Press Petition*, §§ III.A. (i) and (ii), referring to U.S. Department of Justice and Federal Trade Commission (2010), “Horizontal Merger Guidelines” (hereinafter, *Merger Guidelines*).

<sup>101</sup> *Free Press Petition* at 11, internal footnote citing the *Merger Guidelines* omitted.

<sup>102</sup> *Merger Guidelines* at 19.

<sup>103</sup> *Merger Guidelines* at 15.

52. In my initial declaration, I explained that, because the proposed transaction gives rise both to downward pricing pressure (due to the internalization of complementarities) and to upward pricing pressure (due to the internalization of diversion among substitutes), economic theory alone cannot predict the proposed transaction's overall effect on prices or consumer welfare.<sup>104</sup> Neither can a simple concentration analysis, in part because a merger that leads to improved internalization of complementarities, and thus to lower prices, also increases concentration. The interpretation of concentration measures is also more complex in markets for differentiated products. In a situation such as the present one in which products are complements and are differentiated, merger simulation techniques are particularly useful to balance the various effects and reach a bottom-line conclusion on pricing and consumer welfare effects. For this reason, I presented the results of an initial econometric analysis and associated merger simulation.<sup>105</sup>

53. My simulation analysis showed that, even without accounting for *any* cost or quality efficiencies, the proposed transaction would not reduce consumer welfare, a striking result when compared to more standard horizontal mergers in which economic theory predicts that, absent efficiencies, there will be at least some reduction in consumer welfare due to the reduction in competition. In particular, following well-established economic literature, I presented the results of a nested logit econometric demand analysis and an associated merger simulation. I defined 15 products (each product was a combination of the choice of a video provider and a broadband

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<sup>104</sup> *Katz Initial Declaration*, ¶¶ 3, 82, and 84.

<sup>105</sup> For a more complete discussion of the simulation analysis, see *Katz Initial Declaration*, ¶¶ 85-92 and Appendix I.

provider, with “none” being an option in each case) and grouped them into four nests, reflecting the most basic distinction between products—whether a product is video only, broadband only, a combination of video and broadband (whether from one provider or multiple providers), or the no-purchase option, also known as choosing the “outside good.” My econometric demand model predicted DMA<sup>®106</sup>-level product shares as a function of product prices, as well as product characteristics including firm identities, maximum number of channels and broadband speeds offered by the various providers, and other product characteristics. Following the standard approach in the literature, I treated price as endogenous, relying on the rich variation across local markets in the set of providers offering service and the coverage and other characteristics of those providers within each local market, to form a valid set of instruments from which to identify both substitution patterns across products and price effects.

54. Building on my econometric demand model, I simulated the merger’s effects using a standard Bertrand-Nash model. In particular, I compared pre-merger equilibrium prices to the predicted post-merger equilibrium, in which the combined AT&T/DIRECTV jointly sets prices for its various standalone video and broadband offerings, as well as for the AT&T video/AT&T Internet bundle (where available), and the DIRECTV video/AT&T Internet bundle.

55. Results from my analysis were entirely consistent with economic theory *and* showed that in combination, the merger would not harm consumer welfare, even without accounting for any efficiencies. In particular, the model predicted that, post-transaction, prices for the DIRECTV video/AT&T Internet bundle would fall significantly, while prices for products involving just

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<sup>106</sup> DMA<sup>®</sup> is a registered trademark of The Nielsen Company. Used under license.

one of the combined firm's offerings would rise. The combined effect of these changes would be to put more competitive pressure on cable companies, as seen through lower prices for both the cable video/cable Internet bundle and the cable companies' standalone video and Internet offerings. And consistent with these pro-competitive effects on cable companies' pricing, the bottom-line effect of the proposed transaction would be to increase consumer welfare, even before accounting for efficiencies. It follows that the consumer gains are even larger once the merger's cost savings and other efficiencies are incorporated into the analysis.

56. Subsequently, Professors Steve Berry and Phil Haile, widely recognized as leaders in the field of econometric demand analysis (including applications to merger simulation), have conducted their own, refined version of my analysis.<sup>107</sup> Their analysis is in many ways quite similar to mine, building on the same foundation but refining and extending particular aspects of the approach. They too reach the conclusion that *the proposed transaction will not harm consumer welfare even without accounting for the efficiencies from the transaction*. They also find that taking into account the content cost savings due to the merger (but ignoring other merger efficiencies), the proposed-transaction is clearly consumer welfare enhancing. Specifically, they find: (a) no evidence of significant harm to consumers even absent any cost savings, and (b) strong evidence of consumer benefits taking into account content-cost savings efficiencies, but ignoring other merger-specific benefits such as improved bundle characteristics.

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<sup>107</sup> *Berry and Haile Analysis* and *Berry and Haile Update* for more details on the points made in this and the subsequent paragraphs in this section.

57. The following are the main ways in which Professors Berry and Haile refined and extended my analysis:<sup>108</sup>

- First, Professors Berry and Haile considered a more flexible model. Specifically, my analysis used a model in which there was a single, common “nesting parameter.” In some of their runs, Professors Berry and Haile estimate a version of the econometric demand model that allows for three “nesting parameters,” one for each of the video-only, Internet-only, and bundle nests. The nesting parameter controls the “tightness” of within-nest substitution—the higher the parameter, the more consumers substitute among the products in a nest and the less they substitute across nests. By allowing separate nesting parameters, Professors Berry and Haile’s model allows the tightness of substitution to vary across the nests if the data indicate that this tightness does, in fact, vary.
- Second, Professors Berry and Haile conduct their analysis at a finer geographic level than did I in my initial analysis. For tractability, my model relied on a single choice set for all DMAs<sup>®</sup>. In contrast, Professors Berry and Haile account for the fact that consumers living in different ZIP codes may have access to different subsets of products. For example, consumers in some ZIP codes may have access to AT&T Internet access services but not video, while others may have access to both or neither. Professors Berry and Haile explicitly account for this choice set variation in

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<sup>108</sup> More detailed descriptions of their analysis are provided in *Berry and Haile Analysis* and *Berry and Haile Update*.

constructing DMA<sup>®</sup>-level shares from their model—computing DMA<sup>®</sup>-level shares as a weighted average of shares across ZIP codes with different choice sets.

- Third, Professors Berry and Haile update and extend the data used in my analysis. They add data from Cable Data Corporation on the number of subscribers to “wired” video providers (cable and telco MVPDs) by DMA<sup>®</sup>, thus providing additional information from which to pin down actual product shares. They also add data from a Nielsen survey of broadband subscribership, thus refining the estimates of broadband shares. In addition to these new data sources, they also refine some of the data sources I used, including the incorporation of data from additional web scraping to collect more information on prices of products sold by firms other than the merging parties, as well as some refinements to the data provided by the merging parties.
- Fourth, Professors Berry and Haile define a somewhat more granular set of products than I did. In particular, rather than define a single “telco” provider in each DMA<sup>®</sup>, they allow for the possibility that both AT&T and another telco provider are available, and they also explicitly include “other” Internet access providers, such as satellite or mobile broadband.<sup>109</sup> Their more granular product definition yields six

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<sup>109</sup> In my analysis, because I included a single “telco” provider in each DMA<sup>®</sup>, I only included DMAs<sup>®</sup> in which AT&T was the largest telco provider in my merger simulations. In contrast, because Professors Berry and Haile separately account for both AT&T and other telco providers in their analysis, they are able to include in their merger simulation all DMAs<sup>®</sup> with any AT&T presence.

video and five Internet options (including “none” in each case), for a total of 28 products.<sup>110</sup>

- Next, although Professors Berry and Haile and I use very similar sets of product characteristics in modeling consumer utility functions (the characteristics that determine shares), Professors Berry and Haile use a slightly different specification. First, because they explicitly model choice sets at the ZIP code level, they do not need to include the DMA<sup>®</sup>-level coverage variables that I used as proxies for variations in product availability across DMAs<sup>®</sup>. Second, they include a more-complete set of product-level fixed effects, with a separate fixed effect for each product (which also means that they cannot include a separate “true bundle” dummy variable, as it is subsumed in these fixed effects). Third, they include some DMA<sup>®</sup>-level demographic variables to allow for variation in consumer preferences across different types of consumers, thus permitting variation in substitution patterns across DMAs<sup>®</sup> based on demographic differences.
- Finally, relative to my analysis, Professors Berry and Haile use a refined set of instruments to deal with the endogeneity of price and to identify the nesting parameters. Specifically, in addition to the instruments I used—based on the distribution of Internet service speeds and number of video channels across providers in a DMA<sup>®</sup>—Professors Berry and Haile add instruments based on the characteristics

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<sup>110</sup> There are 28 products rather than 30 because a consumer would not be expected to buy video from AT&T and purchase Internet access from another telco provider, or vice versa, thus eliminating two products from the relevant choice set.

of *other* products in the DMA<sup>®</sup>. For example, one instrument is the DMA's<sup>®</sup> latitude—which affects the quality of DBS service in the DMA<sup>®</sup>—applied to all products that *do not* contain DBS video. By using a rich set of such instruments, Professors Berry and Haile gain even more information about the pattern of substitution across products. For example, their analysis can answer questions such as: when DBS is a poor alternative at high latitudes, where do customers go as an alternative?

58. In summary, Professors Berry and Haile refine and extend the standard framework that I applied in my initial analysis. The additional work that they have conducted confirms my finding that: (a) even without accounting for its efficiencies, the proposed transaction will not harm consumer welfare, and (b) the proposed transaction will clearly enhance consumer welfare once those efficiencies are taken into consideration.

59. Opponents of the transaction offer neither a critique of these econometric and simulation analyses nor any econometric or simulation analyses of their own. Instead, as described above, Free Press makes an argument based purely on an examination of concentration measures without consideration of any other factors in the market and without acknowledging the complementary nature of the product offerings of AT&T and DIRECTV. Although concentration analysis can be appropriate for a preliminary review, it cannot substitute for rigorous merger analysis, such as Professors Berry, Haile, and I have conducted.

**IV. VERTICAL FORECLOSURE**

60. Several parties claim that the proposed transaction would harm online video competition because it would increase AT&T's incentive to harm OVD providers by impeding their access to AT&T's broadband Internet access service customers. For these claims to be valid, AT&T would have to have *both*: (a) the ability to weaken OVD competition, and (b) the incentive to do so (*i.e.*, the costs of any such strategy must not be greater than the benefits). As I will now discuss, the evidence clearly demonstrates that the merged company would not have the ability and incentive to profitably harm OVD competition.

**A. AT&T LACKS THE ABILITY TO DEGRADE ITS BROADBAND CUSTOMERS' ACCESS TO OVDS WITHOUT BROADLY DEGRADING ITS BROADBAND SERVICES.**

61. I begin by considering whether the merged company would have the ability to harm competition from OVDS. Opponents posit various types of conduct (namely, degrading interconnection with OTT providers and using usage-based pricing to penalize broadband customers for using online video) in which AT&T might engage to protect its pay-television business from online competition. As I will now discuss, none of the hypothesized conduct could be used to successfully target OVDS for harm without also degrading AT&T's broadband Internet service generally.

62. Before doing so, it should be noted that the merger would give rise to no increase in the parties' ability to pursue a partial or complete foreclosure strategy against OVD providers. This conclusion is an immediate consequence of the fact that DIRECTV has no broadband Internet

access facilities and that AT&T and DIRECTV do not control “must have” content that OVD providers require to be successful.<sup>111</sup>

*1. Peering and Interconnection*

63. First, consider allegations that AT&T would be able to harm OVD competition by degrading OVDs’ connections to AT&T broadband Internet access customers. As Mr. Scott Mair explains, OVDs and other edge providers have a wide range of Internet backbone options to gain access to AT&T’s broadband Internet access network.<sup>112</sup> Coupled with AT&T’s three-year commitment to the 2010 Open Internet Rules, which prevent unreasonable discrimination among edge provider traffic over the “last mile,”<sup>113</sup> this wide range of options implies that strategic degradation or blocking would have to occur at interconnection points between AT&T’s network and the edge provider or any third party on which the edge provider relies for backbone service or content delivery network (CDN) service.

64. Because edge providers have a wide range of transit or CDN options, AT&T would have to degrade its interconnection with multiple transit providers and CDNs in order to degrade

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<sup>111</sup> Although some petitioners may claim that the NFL Sunday Ticket is must-have programming, it manifestly is not, as major MVPDs and OVDs are prospering without it. Moreover, DIRECTV does not own or control this programming, which is the property of the NFL, and it is the NFL, not DIRECTV, that determines the terms on which it will be licensed to MVPDs and others.

<sup>112</sup> Declaration of Scott Mair, October 15, 2014, Attachment to Joint Opposition AT&T Inc. and DIRECTV to Petitions to Deny and Condition and Reply to Comments, MB Docket No. 14-90, (hereinafter, *Mair Declaration*), ¶¶ 4 and 10.

<sup>113</sup> *AT&T/DIRECTV Public Interest Showing* at 8, 51; Federal Communications Commission, Report and Order, Preserving the Open Internet Broadband Industry Practices, GN Docket No. 09-191 (rel. December 23, 2010) (hereinafter, *Open Internet Order*), ¶¶ 63-66 and 68.

interconnection with a specific edge provider, or class of edge providers.<sup>114</sup> Otherwise, the edge provider could easily make an “end run” around the specific point of degraded interconnection. Moreover, because transit providers and CDNs generally deliver the content of many different edge providers, including those that do not compete with AT&T and DIRECTV’s video services (and may even be complementary to them), the degradation strategy would harm the quality of AT&T’s broadband services broadly.<sup>115</sup> As I discuss below, any such strategy would cause serious harm to AT&T’s broadband business and risk substantial losses of profitable broadband and bundle customers.

65. Although Netflix has raised concerns that, as an OVD, it would be harmed by the merged entity,<sup>116</sup> AT&T and Netflix have a long-term contract that **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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<sup>114</sup> *Mair Declaration*, ¶ 24.

<sup>115</sup> *Mair Declaration*, ¶¶ 5 and 24.

<sup>116</sup> *Netflix Comments* at 3, 14, 28.

<sup>117</sup> AT&T-Netflix Master IP Interconnection Agreement, May 8, 2014, Appendix A and **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** Schedule 1, ATT-FCC-00903794 at ATT-FCC-00903804-14.

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66. Subscriber data further suggest that AT&T will lack the ability to foreclose or significantly weaken OVDs. Specifically, in April 2014, AT&T provided broadband service to only [BEGIN AT&T AND DIRECTV HIGHLY CONFIDENTIAL INFORMATION] [END AT&T AND DIRECTV HIGHLY CONFIDENTIAL INFORMATION] percent of U.S. households with high-speed/broadband Internet service.<sup>119</sup>

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<sup>118</sup> Specifically, [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] (*Mair Declaration*, ¶ 26.) For the year ending June 2014, Netflix’s U.S. domestic streaming segment had more than 36 million customers and earned approximately \$3 billion in annual revenues while spending approximately \$2 billion in annual “cost of revenues” (including content licenses and content delivery expenses) and approximately \$276 million in annual marketing expenses. (Netflix Inc., Consolidated Segment Information as of June 30, 2014, *available at* <http://ir.netflix.com/financials.cfm?CategoryID=282>, *site visited* October 14, 2014.) These numbers imply that the cost of interconnection with AT&T amounts to only [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] of Netflix’s “cost of revenues” and to a cost per Netflix user connected to AT&T broadband service of [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION] a month. (This assumes that the share of Netflix customers relying on the AT&T broadband network is the same as AT&T’s national broadband market share of [BEGIN AT&T AND DIRECTV HIGHLY CONFIDENTIAL INFORMATION] [END AT&T AND DIRECTV HIGHLY CONFIDENTIAL INFORMATION] percent (see ¶ 66, below).) Moreover, Netflix has a market capitalization of over \$27 billion, and investors clearly do not see a danger of its being driven out of business. (Netflix, Inc. Stock Summary, Yahoo! Finance, *available at* <http://finance.yahoo.com/q?s=NFLX>, *site visited* September 29, 2014.)

<sup>119</sup> This share was estimated from the data described in *Berry-Haile White Paper*, which was used to estimate DMA<sup>®</sup>-level shares of each product. The data included a consumer survey conducted by Applied Marketing Solutions, subscriber counts calculated using AT&T and DIRECTV internal data, data from the U.S. Census Bureau’s Current Population Survey, and data from a Nielsen

2. *Usage-based retail pricing*

67. DISH, Netflix, Writers Guild West, and Public Knowledge claim that AT&T would—or could—first impose caps on consumers’ use of broadband or implement usage-based pricing and then harm competition by discriminating in favor of its own OVD services.<sup>120</sup> Two points are important in response.

68. First, it is critical to recognize that usage-based pricing can benefit end users, edge providers, and Internet access service providers alike. Usage-based pricing can do so because it is a rational and efficient response to congestion and the need to allocate capacity among alternative uses. It can also be an efficient mechanism for recovering common network costs by having the users who derive the greatest benefit from the network make the greatest contribution toward those costs.

69. Second, after completing the proposed transaction, AT&T would not have the ability to use usage-based pricing to frustrate OVD streaming by its broadband customers without degrading its broadband service generally or engaging in highly visible discrimination against OVD traffic. Suppose that AT&T attempted to set inefficiently high usage-based prices and then discriminate in favor of its own OVD services. Unless it imposed usage-based prices that were explicitly targeted at OVD streaming, this pricing would discourage the consumption of other

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survey of video subscribers. High-speed/broadband Internet service was defined as “High-speed/broadband (*e.g.*, cable, fiber optic, DSL, satellite) Internet service from a cable or telephone company (such as Comcast, Time Warner, Verizon FiOS, or AT&T U-verse) or a satellite TV provider (such as DirecTV or DISH).” The national share was calculated as the weighted average across DMAs<sup>®</sup>, using the number of households in each DMA<sup>®</sup> as weights.

<sup>120</sup> *DISH Petition* at 26-27; *Netflix Comments* at 25 and 27-28; *WGAW Petition* at 20; *Public Knowledge Petition* at 8.

content over AT&T's broadband Internet access service that did not compete with—or was even complementary to—AT&T's services, and this inefficient pricing would make AT&T's broadband service generally less attractive to customers.

70. Such discrimination would be highly unlikely. AT&T has explicitly agreed to abide by the Commission's 2010 Open Internet Rules, which would empower the Commission to act against any conduct that violates the rule against unreasonable discrimination for three years after the consummation of this transaction.<sup>121</sup> And even after that, any attempt to single out OVD traffic would be highly visible and invite regulatory scrutiny to ensure that it was not an attempt at anticompetitive foreclosure. Hence, AT&T would lack the ability to engage successfully in a usage-based pricing strategy that harmed competition by targeting OVDs.

71. As discussed in the next subsection, an OVD-foreclosure strategy based on broad degradation of AT&T's broadband Internet access service would alienate a significant number of profitable broadband customers and would likely cause some of these customers to switch their broadband provider and, in some cases, their MVPD as well.

**B. THE MERGED COMPANY WOULD NOT HAVE INCENTIVES TO HARM OVD COMPETITION**

72. Perhaps the most fundamental point relevant to the merged company's alleged incentives to harm OVD competition is that an economically rational firm has incentives to promote the sales of complements, not harm them.<sup>122</sup> This point is critical because OVD services clearly are

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<sup>121</sup> *AT&T/DIRECTV Public Interest Showing* at 8, 51; *Open Internet Order*, ¶ 68.

<sup>122</sup> It should also be recognized that, even if a service is a substitute for one or more services offered by the merging parties, AT&T would have incentives to reach a deal to carry the service if doing

complementary to AT&T's broadband services. Online video is a major driver of broadband demand, and desire to consume online video leads consumers to purchase more broadband service, including higher speed tiers.<sup>123</sup> Intentionally degrading the quality of OVD services delivered over AT&T's Internet access facilities would thus harm AT&T's broadband business. In addition, as Public Knowledge concedes, "most online video services are today" "only complementary to pay TV."<sup>124</sup> Hence, today, the primary effect of degrading OVD services would be to harm the merged entity through effects on both its broadband Internet access and MVPD businesses.

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so increases the joint profits of AT&T and the service provider (*e.g.*, if it is a lower-cost or higher-quality service or is especially attractive to a particular group of potential customers).

<sup>123</sup> In 2012, online video traffic accounted for approximately **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** percent of global IP traffic and **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** percent of AT&T wireline Internet traffic. (*See*, AT&T Video Strategy: The Evolution of OTT Video Entertainment, January 24, 2014 at 3, ATT-FCC-00374720; AT&T Video Strategy Update, February 2013 at 2, ATT-FCC-00546629 at ATT-FCC-00546630) Moreover, in comments submitted for this proceeding, Netflix recognizes that online video consumption drives broadband demand: "In response to OVD innovation, users increasingly demand more Internet-delivered video that they have paid high-speed broadband providers to access. In turn, broadband providers can attract new subscribers and sell existing customers more robust Internet speeds." (*Netflix Comments* at iii) *See*, also, John Engebretson, "FCC Sees Big Jump in Broadband Connections Above 6 Mbps," telecompetitor.com, January 2, 2014, *available at* <http://www.telecompetitor.com/fcc-sees-big-jump-in-broadband-connections-above-6-mbps/>, *site visited* October 8, 2014. ("The rise in higher-speed connections is likely the result of increased use of video streaming – and it's good news for broadband service providers, who increasingly are relying on customer speed upgrades for revenue growth.")

<sup>124</sup> *Public Knowledge Petition* at 9. This fact is supported by third-party studies. For example, a study based on comScore data found that, although 71 percent of consumers indicate "Missed episode on TV" as a reason to watch video online, only 7 percent of consumers indicate "Don't subscribe to cable/don't have a TV" as a reason for doing so. (*Ad Age Insights*, "The Economics of Online Video 2011," adage.com, February 15, 2011 at 15, *available at* <http://adage.com/images/bin/ppt/AdAgeInsights-OnlineVideo2011.pps>, *site visited* October 15, 2014.)

73. Both AT&T and DIRECTV have recognized these complementarities and, as a result, are both pursuing strategies to support third-party video services offered over the Internet (“OTT services”). AT&T has recently been negotiating partnerships with several of these providers to enhance its broadband and/or U-verse TV offerings.<sup>125</sup> For example, AT&T is currently offering a promotional package in four US cities in conjunction with Amazon Prime. Described by industry media as “a cord-cutter bundle,” the \$39 monthly offer includes broadband, U-Basic TV, HBO, a one-year membership to Amazon Prime, and an Amazon Fire set-top-box.<sup>126</sup>

**[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

**[END DIRECTV HIGHLY CONFIDENTIAL**

**INFORMATION]** DIRECTV does not offer broadband Internet access services; its actions were motivated by the complementarity between DIRECTV’s MVPD services and OTT services, **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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<sup>125</sup> AT&T, OTT TV Service Options, November 12, 2013 at 26, ATT-FCC-02734254 at ATT-FCC-02734279.

<sup>126</sup> Daniel Cooper, “AT&T tempts cord-cutters with \$40-a-month broadband with HBO and Amazon Prime,” *engadget.com*, September 23, 2014, *available at* <http://www.engadget.com/2014/09/23/att-cord-cutter-hbo-go-amazon-prime/>, *site visited* October 2, 2014.

<sup>127</sup> **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

**[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** (DIRECTV, General Market OTT Assessment, April 7, 2014 at 8-9, DTVFCC-04050917-18; DIRECTV, OTT Strategy Market Context and Product Development Planning, July 21, 2014 at 13-15, DTVFCC-00173685-87.)

**[END DIRECTV HIGHLY**

**CONFIDENTIAL INFORMATION]** These initiatives demonstrate that, contrary to the speculation of commenters, AT&T and DIRECTV recognize that they have incentives to work with third-party OVD providers, both to promote broadband sales and in order to retain pay-TV customers.

74. Experience demonstrates that, if AT&T were to change its strategy and instead degrade the quality of its customers' access to popular online services, it would risk losing broadband customers. For example, when AT&T customers experienced congestion affecting Netflix streaming, AT&T's customers lowered their evaluation of AT&T's service, and the company feared that this degraded customer experience would lead to reduced customer satisfaction and substantial financial losses.<sup>129</sup> Other sources support the view that degrading its customers' online video experience would hurt a broadband provider's sales. For example, Comcast has presented evidence that 79 to 89 percent of all Internet users would be likely to switch their Internet service provider if their current provider took any of the following actions: "prevent access to favorite websites;" "slow down Internet speeds for your favorite websites;" or "slow down Internet speeds for Netflix."<sup>130</sup>

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<sup>128</sup> DIRECTV, General Market OTT Assessment, April 7, 2014 at 8-15, DTVFCC-04050917-24.

<sup>129</sup> AT&T, Impact of OTT on NPS, April 2014, ATT-FCC-01904641 at ATT-FCC-01904641-54.

<sup>130</sup> See, Reply Declaration of Mark A. Israel, Economic Analysis of the Effect of the Comcast-TWC Transaction on Broadband: Reply to Commenters, Appendix I; attached as Exhibit 1 to Comcast Corporation and Time Warner Cable, Opposition to Petitions to Deny and Response to Comments, September 22, 2014. See also, "Broadband decisions: What drives consumers to

75. Moreover, if AT&T were to alienate subscribers because of issues with the quality of its broadband service, it would likely lose not only the profits associated with broadband itself, but also the profits associated with the other components, such as video and voice, of the double-play or triple-play bundles purchased by a majority of its broadband Internet access subscribers. In February 2014, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** percent of AT&T U-verse broadband customers bought broadband service as part of a bundle.

76. In addition, although AT&T would bear the full costs of its foreclosure strategy in terms of harm to its broadband Internet access and MVPD businesses, AT&T would almost certainly be unable to capture the full benefits of any foreclosure strategy. To the extent that degrading OTT performance makes customers more reluctant to discontinue or reduce their consumption of pay-TV, that will benefit other MVPDs, including cable operators and DISH, as well as AT&T. Moreover, if AT&T targeted a specific OTT provider for discrimination, customers could turn to many other OTT providers rather than turning back to AT&T and DIRECTV in their roles as providers of traditional MVPD services. In fact, in its comments Netflix recognizes that OVDs are closer substitutes for one another than for MVPD services.<sup>131</sup> A related factor that makes it unlikely that a degradation strategy would be sensible is that AT&T would receive no benefits outside of AT&T's broadband footprint—degradation in transmission is local and, for reasons

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switch – or stick with – their broadband Internet provider,” FCC Working Paper, December 2010, showing that quality of service is a major factor driving switching among broadband providers.

<sup>131</sup> *Netflix Comments* at 18-19.

discussed in the previous subsection, it is implausible that AT&T would drive out of business or significantly weaken any meaningful competitor on a national basis.<sup>132</sup>

77. These considerations indicate that any benefit to the post-merger firm's video business from degrading access to OVDs would very likely be outweighed by the harms to the firm's Internet access business and—through the effects on bundle purchases—its video business. It is useful to consider the economic forces in more detail. Under the foreclosure theory, the post-merger AT&T would degrade its broadband Internet access service in order to discourage consumers from purchasing its broadband Internet access service on a standalone basis and using that access to reach third-party OVDs. Economic theory clearly predicts that reducing the quality of AT&T's broadband Internet access service would reduce the total sales (*i.e.*, both sales in bundles and sales on a standalone basis) of that service. Degrading its broadband Internet access service could be profitable for AT&T only if it encouraged consumers to purchase more video services from the company. However, one would expect that the most likely response to a decrease in the quality of AT&T's broadband Internet access service by consumers who were purchasing that service on a standalone basis in order to reach OVDs would be to seek an alternative access provider through which to reach their desired OVDs. In other words, there would be few gains. Moreover, there would be collateral damage to AT&T's sales of video

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<sup>132</sup> Indeed, the effect could run in the opposite direction. Degrading interconnection quality would lower the OVD's quality only for those households consuming AT&T's broadband services. An OVD might respond by increasing the quality of its services along other dimensions as compensation. To the extent that these quality improvements are done on a nationwide basis, attempts to degrade the OVD's service regionally could result in a higher quality service in the rest of the nation. Hence, the hypothesized degradation would result in the OVD's being a *stronger* rival to DIRECTV or any other national service offered by the merged company.

services to consumers for whom broadband Internet access and video services are complements. In sum, economic theory indicates that the hypothesized foreclosure strategy would reduce broadband sales and have ambiguous effects on video sales. The prospect of the certain loss of profitable broadband sales coupled with uncertain effects on video sales clearly does not create strong incentives to pursue a foreclosure strategy.

78. Econometric modeling provides additional insights. Specifically, I used Professors Berry and Haile's econometric model of demand to predict the net effect of the different economic forces that would act on video sales if AT&T were to degrade its broadband Internet access services. Starting from the predicted post-merger prices, I used an increase in the price of AT&T broadband (both when sold in bundles and on a standalone basis) to represent a quality decrease.<sup>133</sup> The model predicts that, in response to a decrease in the quality of its broadband Internet access services, AT&T's sales of *video* services would *fall*, reflecting the importance of complementarities. As expected, the model also predicts that broadband sales would fall. Such a strategy clearly would be unprofitable. In summary, the evidence indicates that the merged firm would not have incentives to foreclose OVD competition.

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<sup>133</sup> As a starting point, I used the post-merger equilibrium price vector generated by the simulation model that itself was based on the three-nesting-parameter version of the Berry-Haile demand model. I then added to this price vector a constant amount (either \$5 or \$10 per month) to every product that contains AT&T broadband Internet access service as one of its components. This adjusted price vector was then used as an input to the estimated demand system to predict sales shares. Lastly, these shares were compared to the pre-price-increase shares.

**V. CONCLUSION**

79. For the reasons described above, the comments and petitions to deny or modify the proposed transaction that I have reviewed (along with the relevant economic literature, economic theory, and empirical evidence) do not change the conclusions described in my initial declaration, including my overall conclusion that the proposed transaction will generate substantial consumer benefits and does not pose a significant threat of harm to competition.

I declare, under penalty of perjury, that the foregoing is true and correct.



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Michael L. Katz  
October 15, 2014