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	)	

PETITION TO DENY OF FREE PRESS

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September 16, 2014

EXECUTIVE SUMMARY

In this application before the Federal Communications Commission, AT&T Inc. proposes to acquire DIRECTV, combining the nation's third and fifth largest pay-TV providers, and in the process reducing the number of available pay-TV competitors from four to three for nearly a quarter of American consumers. As we demonstrate in this petition, this transaction is a clear and undisputed violation of the antitrust guidelines. It will concentrate to an extreme degree the pay-TV market in the areas in which AT&T U-verse operates, creating substantial upward pricing pressures. It will enhance AT&T's market power, and create coordinated effects that will harm pay-TV customers of other providers.

We also demonstrate how AT&T and DIRECTV's claimed public interest benefits are non-merger specific and non-cognizable, and how even if they were real, these supposed benefits would not outweigh the adverse competitive impact of this transaction. While we do not doubt that the merged entity would be able to achieve some cost savings for the AT&T U-verse video segment of the combined business, Wall Street analysts feel AT&T is unduly optimistic about the level of these savings. And there is ample reason for this skepticism, given the current secular changes in the video market, the peak of MVPD customer penetration, and the possible tipping point in programming rate increases. But even assuming these cost savings are real, they only become a cognizable benefit when returned to AT&T's customers, not the firm's shareholders. And as we show, all available evidence suggests that the current level of competition in the video market is not sufficient to ensure that volume programming discounts are passed along to consumers. Any cost savings through volume discounts would simply materialize in the form of higher video margins for the merged entity, not lower prices for its customers. Current data from other providers also demonstrates that these volume discounts would not materialize in the form

of lower broadband prices, or lower bundled prices – further discrediting AT&T's notion that this merger "enables" it do to anything other than pay its shareholders higher dividends, while increasing its ability to erode over-the-top competition.

Echoing its promises from its failed takeover of T-Mobile, AT&T appears here again before the Commission making the case that – if permitted to eliminate a competitor in a near $70 billion transaction, only then can it make what amount to small and incremental broadband deployment increases. As we show, these supposed "benefits" are actions AT&T would take in the absence of the merger, and do not come close to offsetting the harms of the transaction.

Finally, we present evidence that the transaction would cause substantial additional competitive harms, including public interest harms that lie outside of the traditional antitrust review. Notably, AT&T could deploy its U-verse service throughout its entire service territory and achieve the scale in video it says it needs, and be able to offer the broadband bundles it says it needs to offer; all for a fraction of the price it is paying for DIRECTV. Thus, Commission approval of this transaction would not only lessen competition in the core MVPD market, it also would incentivize wasteful capital allocation and lead to less broadband deployment than if the Commission were to deny the Application.

These harms collectively are too broad and too substantial to be remedied with conditions, much in the same way that the harms of AT&T's proposed horizontal merger with T-Mobile were too great to overcome. We show that, as was proven to be the case after that failed transaction faded away, AT&T and DIRECTV are likely to innovate, invest and compete in substantially beneficial ways if the Commission does not consent to their merger.

In sum, this transaction does not serve the public interest. The Commission should deny the application in its entirety.

Declaration of Shantel G. Buggs

1. I, Shantel G. Buggs, am a member of Free Press. I am a resident of Austin, TX.

2. I reside at East Oltorf Street, which falls within the Austin, TX designated market area.

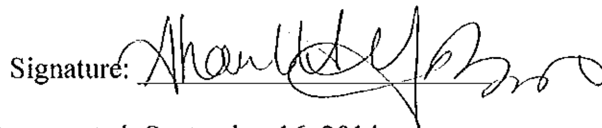
3. I reside within the service area of AT&T U-verse and I am a subscriber to its cable television and Internet access services.

4. I am a regular viewer of the television stations within the Austin, TX designated market area. I regularly use my AT&T U-verse broadband connection to access streaming video content.

5. As a resident of Austin,TX a merger of AT&T and DirecTV would harm me because it would reduce the number of competitors in my area from four to three.

6. This Declaration has been prepared in support of the foregoing Petition to Deny the merger of AT&T and DirecTV.

I declare under penalty of perjury that the foregoing statements are true and correct to the best of my knowledge.

Signature: 

Date executed: September 16, 2014

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I. Introduction

Applicants AT&T Inc. and DIRECTV (collectively, "Applicants") seek Commission approval to reduce the number of available pay-TV competitors from four to three, in dozens of markets and for millions of U.S. consumers. If approved, this proposed transaction would create substantial upward pricing pressure and other consumer harms. In addition, the merger represents a highly inefficient use of capital and comes with a high opportunity cost. AT&T could offer all of the supposed benefits of this transaction to consumers by deploying competitive services, and could do more on that front for *less* money than it is allocating to purchase DIRECTV.

In order to gain the Commission's approval for this transaction that clearly would reduce the number of competitors in the pay-TV market, Applicants must demonstrate that approving the acquisition would serve the public interest and actually enhance competition. They have failed to meet this burden. The merger would seriously harm competition, consumers, and the public interest. It would increase AT&T's market power in the geographic areas in which it offers pay-TV services, and it would lessen the company's incentives to otherwise innovate and compete in the pay-TV and broadband product markets.

Applicants fail to identify any merger-specific benefits, and would have the Commission turn a blind-eye to the obvious merger-specific harms. Indeed, the only supposed benefits of this transaction are outcomes that the market would push AT&T to produce in the absence of the merger. Just as AT&T did not need to acquire T-Mobile to "enable" AT&T to fully deploy 4G LTE services, AT&T does not need to acquire DIRECTV to expand its advanced broadband deployments. Thus, the Commission should deny the application for transfer of licenses and reject this transaction.

II. Statement of Interest

Free Press is a national, nonpartisan organization with more than 850,000 members. We work to reform the media and increase informed public participation in crucial communications policy debates. Free Press has participated in numerous merger proceedings before the Federal Communications Commission.[1] In each, Free Press has advocated for policies that promote competition and serve the public interest.

As such, Free Press constitutes a "party in interest" within the meaning of Section 309(d) of the Communications Act of 1934, as amended, and has standing to participate in this proceeding as demonstrated herein and in the attached declaration. Part of our mission is to promote diversity of viewpoints and content in the media and online, and also to ensure open and affordable broadband choices for telecommunications and Internet access users. Free Press has members that reside in areas served by the Applicants. Grant of the applications therefore would harm Free Press and its members by causing a decrease in diversity of viewpoints, and also in the competitiveness and affordability of broadband offerings available to them.

III. The Proposed Transaction Would Not Serve the Public Interest Because It Would Substantially Reduce Competition in the Multichannel Video Programming Distribution Market, Resulting in Substantial Unilateral Harms and Exacerbating Coordinated Effects.

AT&T's proposed acquisition of DIRECTV would dramatically increase concentration in the pay-TV market in the areas where the companies compete directly. The resulting increase in concentration is well beyond the level that antitrust experts recognize as enhancing market power and the increasing the likelihood of subsequent market power abuses. The transaction would not just harm pay-TV consumers in the specific geographic markets where AT&T video and

[1] For example, Free Press filed petitions to deny and/or extensive comments in *Applications of AT&T, Inc. and Deutsche Telekom AG for Consent to Assign or Transfer Control of Licenses and Authorizations*, WT Docket No. 11-65; *Applications of Comcast Corporation, General*

DIRECTV overlap; it also would reduce Applicants incentives to innovate and invest in more direct competition that would occur in the absence of the acquisition. It would confer outsized gatekeeper market power on the merged entity, threatening the growth of the entire Internet economy and, in turn, harming consumers through loss of access to quality online services.

It is not enough for Applicants to argue that approval of the transfer would improve the bottom line of the combined entity. Applicants bear the burden of demonstrating that the transaction would promote the public interest.[2] In reviewing transfer applications, the Commission determines if the transaction would result in statutory violations;[3] if the transaction would result in Commission rule violations;[4] if the transaction would frustrate the Commission's implementation and/or enforcement of the Communications Act, the Act's objectives, or the objectives of other statutes;[5] and importantly, if the transaction would produce *affirmative* public interest benefits.[6]

Consideration of a transaction's competitive effects is a core concern of the Commission's public interest analysis.[7] This analysis "is informed by, but not limited to,

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[2] *See, e.g.*, *Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.,* CC Docket No. 97- 211, Memorandum Opinion and Order, 13 FCC Rcd 18025, ¶ 10 n.33 (1998).

[3] *Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, for Consent To Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95, and 101 of the Commission's Rules*, CC Docket No. 98-141, Memorandum Opinion and Order, 14 FCC Rcd 14712, ¶ 48 (1999).

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *News Corporation and DIRECTV Group, Inc., Transferors, and Liberty Media Corporation Transferee*, MB Docket No. 07-18, Memorandum Opinion and Order, 23 FCC Rcd 3265, ¶¶ 23-24 (2008).

traditional antitrust principles."[8] To find that a merger is in the public interest, it is not enough for the Commission to find that the transaction will not harm competition; the Commission also must "be convinced that [the combination] will *enhance* competition."[9]

This transaction impacts the public interest in multiple product markets, as we discuss in detail below in Part V of this petition. These impacts are ample enough reason for the Commission to reject the Application.[10] However, even if the Commission focuses on the classic antitrust analysis alone, it is clear that Applicants have not met their burden to show that the transaction would enhance competition and produce affirmative public interest benefits. This analysis shows that in the relevant product market – the local market for multichannel video programming distribution – the transaction would dramatically decrease competition, enhance the merged entity's market power, and produce numerous unilateral harms and coordinated effects. The transaction, and its resulting market concentration, raises serious antitrust and public interest concerns. Therefore, the Commission is obligated to reject the Application or designate it for a review hearing.

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[8] *Id.*, ¶ 24; *see also Northeast Utilities Service Co. v. FERC*, 993 F.2d 937, 947-48 (1st Cir. 1993) (public interest standard does not require agencies "to analyze proposed mergers under the same standards that the Department of Justice . . . must apply").

[9] *Applications of NYNEX Corp., Transferor, and Bell Atlantic Corp., Transferee*, Memorandum Opinion and Order, Memorandum Opinion and Order, 12 FCC Rcd 19985, ¶ 2 (1997) (emphasis added).

[10] *Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations*, Description of Transaction, Public Interest Showing, and Related Demonstrations, MB Docket No. 14-90 (filed June 11, 2014) ("Application").

A. The Primary Relevant Product Market Impacted by This Transaction is The Local Multichannel Video Programming Distribution Market.

The Commission's prior reviews of multichannel video programming distributor ("MVPD") mergers focused primarily on public interest and competitive impacts in the pay-TV market, examining the impacts in the separate but related programming distribution and programming acquisition markets.[11] The former is a consumer, retail-facing market, while the latter is an upstream market with which consumers do not directly interact. In this petition, we focus on the retail pay-TV distribution market, as that is the market that this transaction would impact in a demonstrably harmful manner.

The proposed combination of AT&T and DIRECTV is a horizontal merger occurring in an already concentrated multichannel video market. Joining these two companies together would present a textbook violation of the Department of Justice's and Federal Trade Commission's Horizontal Merger Guidelines.[12] The outcome would be what antitrust authorities describe as a "highly concentrated" pay-TV market in 64 separate Designated Market Areas ("DMAs") where nearly all of AT&T's video subscribers reside. (And, as we describe below, the DMA is itself too-large a geographic product market given AT&T's partial footprint in many of

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[11] *See, e.g., Applications for Consent to the Assignment and/or Transfer of Control of Licenses from Adelphia Communications Corporation, Assignor, to Time Warner Cable Inc. and Comcast Corporation, Assignees and Transferees*, Memorandum Opinion and Order, 21 FCC Rcd 8203, ¶ 60 (2006) ("Adelphia/TWC/Comcast Order") ("In analyzing MVPD transactions, the Commission has generally examined two separate but related product markets: (1) the distribution of programming to consumers . . . and (2) the acquisition of programming . . . . The Applicants are significant participants in both of these product markets, and we therefore . . . examine whether the transactions are likely to contravene Commission policy goals by analyzing the potential effects the transactions may have on MVPD competition and on the flow of video programming to consumers.") (internal citations omitted).

[12] U.S. Department of Justice and Federal Trade Commission, "Horizontal Merger Guidelines" (Aug. 19, 2010) (hereinafter, *Merger Guidelines*).

these DMAs.)[13] This level of increase in market concentration comes with a presumption of enhanced market power that encourages firms to "raise price, reduce output, diminish innovation or otherwise harm customers."[14]

We reach this conclusion utilizing the *Merger Guidelines'* preferred quantitative metric, the Herfindahl-Hirschman Index (or "HHI").[15] The HHI is a measure of market concentration that factors in the number of firms in a given industry and their respective market shares, calculating the final index number by squaring and then summing the companies' respective market shares. Under the *Merger Guidelines*, the Department considers markets with an HHI below 1,500 to be "unconcentrated."[16] This is equivalent to a market with roughly seven firms of equal size, and a merger in such a situation would cause few competitive concerns. Conversely, markets with HHIs above 2,500 are considered "highly concentrated."[17] This is equivalent to a market with four equal-sized firms (or one with just a couple of very large firms and a number of much smaller ones). According to the *Merger Guidelines*, mergers that take place in or that result in markets with this level of concentration are concerning, as they usually

[13] These 64 Designated Market Areas include the Hartford, CT DMA, where AT&T is seeking to sell its ILEC properties to Frontier Communications. This application is pending before the Commission, and has yet to be approved by the Connecticut Public Utilities Commission, which recently rejected a proposed settlement between the Connecticut Attorney General and Frontier. *See* Brian Dowling, "Regulators Deny Deal in AT&T-Frontier Sale," *Hartford Courant*, Aug. 28, 2014; *see also AT&T Inc. and Frontier Communications Corporation Application for Consent to Transfer Control of Authority to Provide Global Facilities-Based and Global Resale International Telecommunications Services and to Assign and Transfer of Control of Domestic Common Carrier Transmission Lines, Pursuant to Section 214 of the Communications Act of 1934, as Amended*, WC Docket No. 14-22 (filed Feb. 3, 2014).

[14] *Merger Guidelines* at 2.

[15] *Id*. at 18; see also U.S. Department of Justice, "Herfindahl-Hirschman Index," Merger Enforcement Public Documents.

[16] *Merger Guidelines* at 19.

[17] *Id*.

enhance market power. Consider the AT&T/T-Mobile transaction that DOJ rightly moved to block at the end of August 2011: the post-merger HHI on the national level would have been 3,100, an increase of nearly 700 points from the pre-merger value.[18]

According to the *Merger Guidelines*, "[m]ergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed [ ] likely to enhance market power."[19] These guidelines are not "a rigid screen,"[20] nor the end of the discussion; but the Department (and the Federal Trade Commission) looks skeptically on any deal that concentrates markets to this level and presents the likelihood of problematic market dynamics arising from the transaction under review.

Below we describe the results of an HHI analysis on the instant transaction. We first describe the results of this analysis at the Designated Market Area level. However, because AT&T's pay-TV service area is not widespread across any of these DMAs, the DMA-level analysis understates the competitive impacts of this transaction. Thus, we also present a "franchise-level" HHI analysis that more accurately captures the changes in market concentration at the customer premises where both AT&T and DIRECTV offer MVPD service.

i. The Transaction Violates Department of Justice Merger Guidelines in 64 Designated Market Areas, Containing 99 Percent of AT&T U-verse Pay-TV Subscribers.

In many instances, antitrust authorities will look at the same geographic area that advertisers do — the so-called television Designated Market Area (or "DMA"). There are 210 such media markets in the United States, ranging from very large (the nearly 7.5 million TV

[18] *U.S. v. AT&T Inc.,* Case 1:11-cv-01560, Complaint, ¶ 25 (D.D.C. filed Aug. 31, 2011) (*AT&T/T-Mobile Complaint*).

[19] *Merger Guidelines* at 19.

[20] *Id.*

homes in the New York metro area) to very small (Glendive, Mont., and its 4,260 households). AT&T offers its U-verse pay-TV service in several dozen DMAs. About 99 percent of its television subscribers reside in 64 of the nation's 210 DMAs. And in each and every one of these markets, AT&T's takeover of DirecTV violates the *Merger Guidelines*.

In 61 DMAs, the deal would increase the market's HHI value by more than 200 points and result in a highly concentrated market (meaning a total HHI over 2,500). That indicates this deal is "presumed to be likely to enhance market power," and "likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives."[21]

In the other three DMAs making up AT&T's 64 main U-verse television markets, the deal would result in a post-merger HHI above 2,500 but only increase the HHI by between 100 and 200 points. However, this doesn't mean there's nothing to worry about, as the *Merger Guidelines* say such transactions "potentially raise significant competitive concerns and often warrant scrutiny."[22] Half of the U.S. population resides in these 64 markets, though AT&T currently offers U-verse TV service to only a portion of the homes in these areas, totaling about 25 percent of all U.S. homes.

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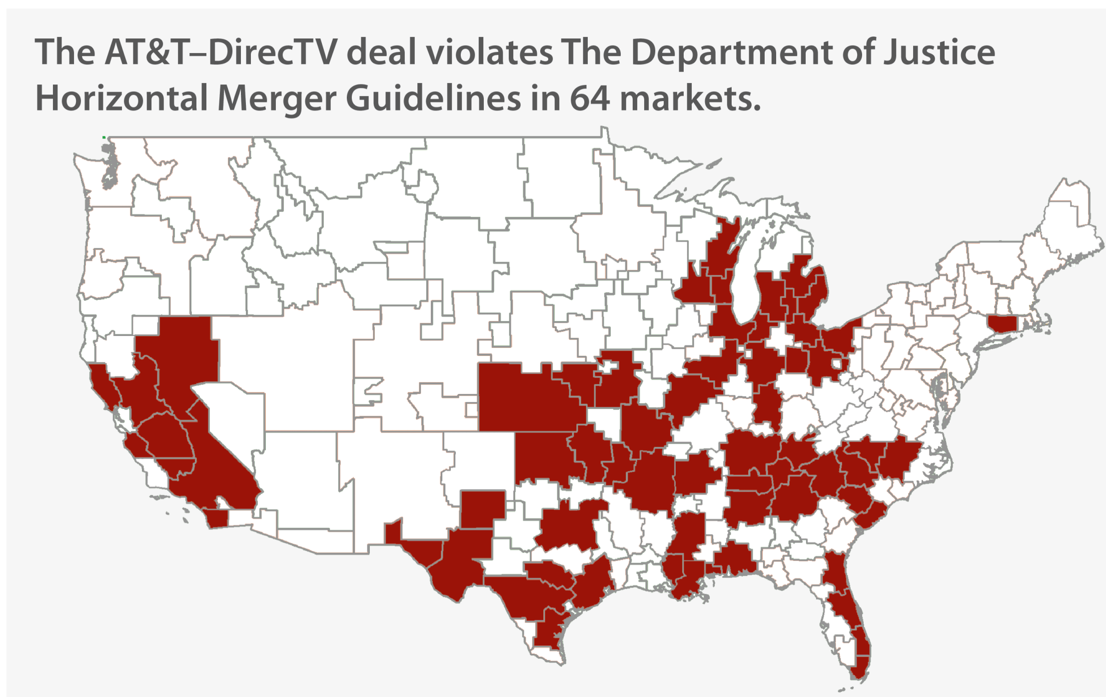
[21] *Merger Guidelines* at 2.

[22] *Id.* at 19.

Figure 1:



Source: Free Press analysis of subscribership data collected by SNL Kagan, as of Mar. 31, 2014

For these 64 DMAs where AT&T offers its own pay-TV service already,[23] the DIRECTV

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[23] Half of all U.S. TV households are located in these 64 DMAs. However, AT&T does not offer its pay-TV service to all the homes in these markets. U-verse TV is currently marketed to 27 million customer locations, or more than 20 percent of the U.S. The AT&T/DIRECTV merger would result in a highly concentrated market with HHI exceeding 2,500 in all 64 DMAs. In 61 of them, the merger-related change in HHI would exceed 200. Free Press analysis of SNL Kagan subscriber estimates indicates DMAs with HHI increase greater than 200 are (rank–name): 2–Los Angeles, CA, 3–Chicago, IL, 5–Dallas-Ft. Worth, TX, 6–San Francisco-Oakland-San Jose, CA, 9–Atlanta, GA, 10–Houston, TX, 11–Detroit, MI, 16–Miami-Ft. Lauderdale, FL, 18–Orlando-Daytona Beach-Melbourne, FL, 19–Cleveland-Akron (Canton), OH, 20–Sacramento-Stockton-Modesto, CA, 21–St. Louis, MO, 24–Raleigh-Durham (Fayetteville), NC, 25–Charlotte, NC, 26–Indianapolis, IN, 28–San Diego, CA, 29–Nashville, TN, 30–Hartford & New Haven, CT, 31–Kansas City, MO, 32–Columbus, OH, 34–Milwaukee, WI, 36–San Antonio, TX, 37–Greenville-Spartanburg, SC-Asheville, NC-Anderson, SC, 38–West Palm Beach-Ft. Pierce, FL, 39–Grand Rapids-Kalamazoo-Battle Creek, MI, 40–Austin, TX, 41–Oklahoma City, OK, 44–Birmingham (Anniston and Tuscaloosa), AL, 46–Greensboro-High Point-Winston Salem, NC, 48–Jacksonville, FL, 49–Louisville, KY, 50–Memphis, TN, 51–New Orleans, LA, 55–Fresno-Visalia, CA, 56–Little Rock-Pine Bluff, AR, 59–Mobile, AL-Pensacola (Ft. Walton Beach), FL, 60–Tulsa, OK, 61–Knoxville, TN, 64–Dayton, OH, 67–Wichita-Hutchinson, KS-Plus, 70–Green Bay-Appleton, WI, 75–Springfield, MO, 76–Toledo, OH, 77–Columbia, SC, 79–Huntsville-Decatur (Florence), AL, 83–Madison, WI, 91–El Paso, TX (Las Cruces, NM), 93–Baton Rouge, LA, 94–Jackson, MS, 95–Charleston, SC, 96–South Bend-

deal would increase the HHI by an average of 450 points and result in an average HHI above 3,300. This is an extraordinary level of market concentration that AT&T cannot simply wish away, particularly with vague promises of non-merger specific benefits that would likely come about even in the absence of this transaction.

ii. The Transaction Violates Department of Justice Merger Guidelines in Every Local Area Where AT&T Offers U-Verse Pay-TV Services. The Transaction Will Reduce the Number of Available Pay-TV Providers in these Areas from Four to Three.

The DMA-level HHI analysis clearly shows that the AT&T-DIRECTV transaction fares poorly under the *Merger Guidelines* tests. Yet, even that likely understates the true competitive harm of this merger. This is because customers can only buy the multichannel video services that are available at their physical locations. In any given DMA, there may be multiple pay-TV providers that don't actually compete directly. For example, in the Dallas market (AT&T's home town) the major cable company is Time Warner Cable; but some areas in that DMA are served instead by Charter or Suddenlink. In general, many people today have access to at most four competitive options for pay-TV: one traditional cable company (like one of the three named just above); two satellite companies (DirecTV and DISH Network); and, for nearly forty percent of the country (*i.e.* approximately 50 million customer premises), the incumbent phone company's pay-TV service (*e.g.*, AT&T U-verse, Verizon FiOS, or CenturyLink Prism TV).

Yet satellite providers offer service everywhere, in every geographic market in the United States, because they are not constrained by the need to run a wire to every house they

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Elkhart, IN, 101–Ft. Smith-Fayetteville-Springdale-Rogers, AR, 107–Reno, NV, 115–Lansing, MI,125–Monterey-Salinas, CA, 127–Bakersfield, CA, 129–Corpus Christi, TX, 134–Topeka, KS, 143–Lubbock, TX, 150–Odessa-Midland, TX, 160–Biloxi-Gulfport, MS. DMAs where post-merger HHI would exceed 2,500 and the change in HHI would be between 100 and 200 are 68–Flint-Saginaw-Bay City, MI, 84–Champaign & Springfield-Decatur, IL, 87–Chattanooga, TN.

serve. AT&T does not offer U-verse pay-TV service everywhere that AT&T offers telephone and Internet service; but U-verse faces video competition from DirecTV everywhere that AT&T offers it, at more than 30 million customer locations.

To account for these factors and to better capture the competitive impact of this transaction, we estimated a value for the change in the HHI at the "franchise-level."[24] This analysis produces a single value that is weighted across the entire U-Verse footprint.[25] (since we do not have subscribership data at the sub-DMA level). When the non-overlapping service areas of cable companies are taken into account and factored out, the deal could increase the HHI by more than 1,000 points, resulting in a post-merger HHI of nearly 4,000.[26]

For multichannel video consumers that live in the U-verse footprint, this proposed reduction in competition is a recipe for terrible service and higher prices. It is also bad for the rest of the country too, as AT&T, with its less than stellar reputation for customer service and innovation, will become a nationwide satellite TV provider.

The Department of Justice rejected AT&T's bid for T-Mobile deal in part because it found a reduction in the number of "providers from four to three, likely will lead to lessened

[24] We use this term simply to denote the local geographies that are smaller than the DMA, but larger than the household level, and are not referring to specific local franchise areas.

[25] Since we do not have subscribership data at the sub-DMA level, we cannot produce separate HHI values for each of the local territories where U-verse is offered. Applicants however likely have access to this data, and the Commission's analysts should be able to replicate this approach using that information.

[26] Our estimates involve weighting DMA subscribership information by the percentage of homes passed by each provider in each respective DMA. This can then be used to estimate the change in HHI at the household level for those that subscribe to MVPD services; or at the housing unit level for all premises where MVPD service is available in areas where U-verse TV is offered, including those not subscribing to any MVPD services. At the MVPD-level, the resulting HHI under this analysis is 3,975, an increase of 1,006 points. At the full housing unit-level, the resulting HHI is 4,260, an increase of 640 points.

competition due to an enhanced risk of anticompetitive coordination."[27] The situation presented by this proposed acquisition is the same: for almost a quarter of the country, this deal would reduce the number of pay-TV competitors from four to three. And the level of market concentration post-merger would be worse in this case than it was in the T-Mobile deal.

B. Applicants Overstate the Level of Pay-TV Competition That Would Remain Following Consummation of This Transaction.

Applicants do not directly address this indisputable increase in market concentration. Instead, in their public interest statement Applicants offer two main defenses. The first revolves around video options that will remain available to subscribers even if the merger takes place. AT&T suggests that for standalone multichannel video customers, the market will retain "sufficient competitive options."[28] The first two subsections of AT&T's argument on this point dwell on the wonders of bundled service, ignoring the impact of increased pay-TV market concentration and the premise that there supposedly would remain "sufficient" alternatives for standalone video customers. But while consumers may purchase services in bundles (or, in the case of some providers, are *forced to*),[29] this does not change the approach to the antitrust analysis, which clearly demonstrates that the relevant product market involved in this transaction is the local market for multichannel video programming delivery services.

Applicants are largely at a loss to name standalone video alternatives other than the cable and satellite options recited and already captured in the HHI analysis discussed above. Applicants cite video competition from nascent entrants such as Google Fiber – while noting that

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[27] *AT&T/T-Mobile Complaint* ¶ 36.

[28] Application at 68.

[29] Many of AT&T's current "Internet-only" offerings actually require purchase of voice service and/or TV service in some cases, or voice in others. *See* http://www.attsavings.com/offer-terms.html. In the past, the Commission has required AT&T and other providers to offer standalone broadband services through merger conditions.

Google has only "entered one AT&T U-verse DMA (Kansas City, Kansas/Missouri), and has stated that it will enter a second (Austin, Texas) this year."[30] They also assert that AT&T faces "additional competition in a substantial portion of [its] footprint from other competitors that offer video and broadband bundles," suggesting that such overbuilders "are present in approximately half of the U-verse DMAs" but failing to provide data on just how substantial the number of homes passed and served by such alternatives may be.[31] This is likely because the level of overbuilding nationwide is incredibly low, and it is also low in the U-Verse footprint.[32]

Finally, as a last alternative for video consumers, AT&T cites over-the-top (or "OTT") video distributors. This argument conveniently ignore the fact that OTT video alternatives can only be accessed over a wired or wireless broadband connection available from a shrinking number of facilities-based broadband providers, such as AT&T. The future viability of OTT competition is in doubt, and will be largely determined by how the Commission acts in this proceeding as well as the proposed merger of Comcast and Time Warner Cable. AT&T is one of four ISPs (Comcast, AT&T, Verizon and Time Warner Cable, the top four ISPs by number of subscribers) that purposefully let their broadband customers experience poor performance when accessing OTT services in order to extract terminating access fees.[33]

Thus, the mere presence of OTT options offers no mitigation of the concerns about AT&T's enhanced power in the MVPD market. This is so despite AT&T's commitment to abide

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[30] *Application*, Declaration of Lori M. Lee, ¶ 31.

[31] *Id.*, Declaration of Lori M. Lee, ¶ 38.

[32] For example, according to our analysis of SNL Kagan data, the two largest cable overbuilders, RCN and Wide Open West, combined pass approximately 3 percent of the housing units passed by Multiple System Operators. These two companies account for approximately 1 percent of total U.S. MVPD subscribers.

[33] *See* "Netflix agrees to pay AT&T to ensure smooth video downloads," *Reuters*, July 20, 2014.

by the FCC's Open Internet rules, recently struck down by the D.C. Circuit Court of Appeals, for a mere three years after closing this transaction.[34] The 2010 rules were full of loopholes, including a lack of protections against discrimination on mobile wireless platforms and against ISPs' ability to effectuate the same discriminatory outcomes through terminating access fees.

To that end, the FCC currently proposes to adopt successor Open Internet rules that could permit "substantial room for individualized bargaining and discrimination in terms."[35] Enter AT&T, promising in a declaration attached to this Application from its Chief Strategy Officer that the combined company could "partner more effectively with content providers to follow consumer demand for OTT video."[36] If AT&T truly were committed to providing open pathways rather than special deals for third-party OTT video, it is not clear why that commitment would depend on capturing a "nationwide base of video customers"[37] from DIRECTV.

However, even if the future for OTT video was bright, with unfettered access to common carrier broadband, this would only impact the analysis of this transaction if OTT video providers were found by the Commission to be in the *MVPD* market. If they were, then under *Merger Guideline's* "hypothetical monopolist test," these OTT services would provide a substitute for MVPD offerings that would keep the merged firm from profitably implementing a small but significant and non-transitory increase in price ("SSNIP").[38] That is not what we actually see in the market today.

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[34] *Application* at 51.

[35] *Verizon v. FCC*, 740 F.3d 623, 652 (D.C. Cir. 2014).

[36] *Application*, Declaration of John T. Stankey, ¶ 9.

[37] *Id.*

[38] The Department of Justice and Federal Trade Commission note that the "SSNIP" test "is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger." *See Merger Guidelines* at 9.

When analyzed through this lens, and when looking at actual and likely future facilities-based pay-TV competition, it is clear that MVPD and OTT are in separate product markets. The availability of OTT video may incentivize cord-cutting behavior by a growing number of consumers who no longer wish to pay for *both* a pay-TV and a home broadband subscription. But that number is still small compared to the number of pay-TV subscribers. And most importantly, these are a subset of consumers who are *exiting* the MVPD market and entering the OTT market, not moving to an alternative provider within the MVPD market. The MVPD market as a whole is still growing in subscribers and profits, despite routine price increase and the growth in the OTT market. That is why the cord-cutting phenomenon cannot completely alleviate concerns about the increased concentration in the pay-TV market that would result from combining the second and fifth largest multichannel video providers, with the market-by-market concentration outcomes and enhanced market power illustrated above.

C. AT&T's "Integrated Bundle" Product Market Definition Does Not Alleviate Concerns.

Presumably because the classic antitrust analysis is so unfavorable, Applicants spend a large portion of their public interest statement on trying to define away the competition problem altogether. Applicants want the Commission to find that AT&T and DIRECTV do not truly compete today for video customers, because DIRECTV offers a standalone video product while AT&T focuses on bundling video with broadband and voice services.[39] One of Applicant's hired expert refers to concerns about video market concentration as "naïve,"[40] dismissing them as AT&T once attempted to brush aside similar concerns by claiming that T-Mobile was not a particularly close competitor either. Given AT&T's history in filing self-serving public interest

[39] *See, e.g., Application* at 1.

[40] *Id.*, Declaration of Michael L. Katz at 7.

statements that are untethered from the facts, it is imperative that the Commission look upon the company's claims and assertions with deep skepticism.

The question of how bundles impact competition is one that the hypothetical monopolist test can answer. To date, whenever the Commission and Department have faced this issue, they have always found the product market to be the MVPD market, which includes wired and satellite pay-TV services. However, it is true that bundles impact the overall analysis of consumer welfare. That is why the Commission must carefully examine precisely why AT&T's and DIRECTV's so-called "synthetic" bundles are not yet as viable as "natural" bundles, as Applicants claim, and consider whether or not these synthetic bundles would become more viable if the Application were rejected.[41] Indeed, as we discuss below in Part VI, in the absence of Commission approval of this transaction, each Applicant would have greater incentive to make these synthetic bundles more attractive to consumers.

In dismissing synthetic bundles, AT&T suggests that a viable bundle must be assembled and integrated for the customer by a single-source provider, which must own all of the facilities used to offer the bundled products, but that can only be configured in the manner in which the AT&T and DIRECTV bundle is *currently* assembled. But this is not the only way such offerings can come together; it is merely the way this particular synthetic bundle is formed, based on the market realities for both companies that existed *prior* to the filing of the instant Application.

The Commission must determine why exactly these combined products, offered to subscribers without the need for combining the two companies outright, have not worked "to make significant inroads against the integrated bundle offerings of entrenched cable

[41] *Application* at 3.

companies."[42] We suggest that a large part of the reason may be AT&T's unwillingness to wholesale a competitive broadband product to DIRECTV at a reasonable and competitive price. Were AT&T to do so, or if the FCC had policies in place promoting such resale opportunities, then the "synthetic" bundles that the Application critiques might do just as well as the "natural" bundles to be achieved only from the consolidation and concentration that this merger promises.

DIRECTV's Chief Revenue and Marketing Offer notes in his declaration that "AT&T prices [its own] broadband and voice components substantially lower when paired with U-verse video versus paired with DIRECTV. For example, the current introductory price for 6 Mbps broadband when paired with U-verse video is $14.95 versus $34.95 when paired with DIRECTV."[43] He concludes that the total price to consumers of an integrated AT&T bundle is substantially less than the price of signing up with DIRECTV for a "synthetic" bundle.[44]

This price differential, over which Applicants have total control , is a prime reason for the apparent lack of viability in these synthetic bundles. This unexplained and economically unjustified markup of 133 percent explains why the joint marketing endeavors are not making those "significant inroads" against the integrated bundle offerings of entrenched cable companies. The higher price alone (and not the apparent differences in the installation process) might be enough to keep away a substantial number of consumers who would otherwise subscribe to DIRECTV's synthetic broadband/TV service package.

The only attempt to explain such high prices for synthetic bundles comes from AT&T's economic expert again. He opines, "economic theory also indicates that 'because the merger will internalize complementarities, the merged company can be expected to offer a bundle superior to

[42] *Id*.

[43] *Application*, Declaration of Paul Guyardo, ¶ 29.

[44] *Id*.

those that they offer through their existing joint marketing arrangement.'"[45] The Commission should consider precisely what this means: As soon as AT&T can control the whole service bundle, and capture *all* of the revenues from customers of the combined company, it may no longer impose such a ridiculously large markup on the broadband it bundles with DIRECTV. Thus, this deal may be good for AT&T's bottom line, but it's certainly not good for customers who'll see fewer video choices when they could have gotten the same benefits from better competition, and better competition policies.

These outcomes could be avoided were the FCC to promote resale by limiting how a facilities-based provider can frustrate the development of such arrangements. Resale markets naturally exist in competitive markets, and they "confer[ ] important public benefits in less competitive markets, including encouraging competitive pricing; discouraging unjust, unreasonable, and unreasonably discriminatory practices; reducing the need for regulatory intervention and concomitant market distortions; promoting innovation; improving carrier management and marketing; generating increased research and development; and positively affecting the growth of the market."[46]

The Commission's public interest analysis must consider what market forces would produce in the absence of the merger. As we discuss in Part VI, the incentives that Applicants, and particularly AT&T, had before the proposed transaction are substantially different from what they would be in the absence of the transaction going forward. If AT&T cannot simply acquire DIRECTV's 20 million U.S. pay-TV subscribers in order to offer pay-TV services in the non-U-

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[45] *Application* at 32 n.90 (quoting Declaration of Michael L. Katz, ¶ 62).

[46] *Personal Communications Industry Association's Broadband Personal Communications Services Alliance's Petition for Forbearance For Broadband Personal Communications Services*, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 13 FCC Rcd 16857, ¶ 32 (1998).

verse areas of its service territory, then market forces will lead AT&T to achieve growth through other means. If the Commission rejects AT&T's latest takeover effort, the company will achieve growth through additional deployment of U-verse as well as through the offering of synthetic bundles that are actually attractive to end-users.[47]

IV. Applicants' Claimed Public Interest Benefits Are Non-Merger Specific, Non-Cognizable, and Would Not Outweigh the Adverse Competitive Impact of This Transaction.

Applicants essentially offer no merger specific benefits. There are no promises to lower prices. The best Applicants can do is the suggestion that the transaction will "enable" AT&T to expand its deployment of U-verse, as well as the company's "ability" to offer fixed LTE services. Not only are these promises non-merger specific, there is no reason whatsoever for the Commission to believe that AT&T would not do both of these things in absence of the merger.

As discussed above, the benefits of bundles suggested by Applicants could be replicated without removing a competitor from the market, and rejection of the transaction would increase the incentives of both AT&T and DIRECTV to make these bundles a more attractive product to consumers. Thus, Applicant's claims about the integrated bundle benefits – even if those outcomes were real – also are not merger-specific benefits that can be said to offset the likely harms from additional concentration in the MVPD market, because any benefits could be obtained without removing a competitor from the market.

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[47] Because resale is a function of competitive markets, and is important in uncompetitive markets, it is clear that approval of the Application will have public interest harms beyond the specific harms in the MVPD market in the areas where U-Verse service is offered. This is because the resulting lessening of competition in the MVPD markets will in turn lessen other broadband provider's market incentives to offer resold services on reasonable terms to other pay-TV providers, particularly those that may seek to enter the market with a non-facilities, virtual MVPD service.

Applicants suggest that the transaction will bring two other supposed benefits: reduced programming acquisition costs for AT&T's video content, and increased broadband deployment both inside and outside of AT&T's wireline footprint. We address each of these below.

A. Claimed Program Cost Savings Are Uncertain, Overstated, and Will Accrue to Shareholders, not Customers.

According to AT&T, its willingness to outlay $67 billion for a standalone satellite TV provider makes financial sense because the acquisition would deliver the combined firm $1.6 billion in cost savings. It attributes the bulk of such savings to reduced video programing acquisition costs, owing to the benefit of increased scale in negotiations with pay-TV channel owners.[48] However, cost-savings alone are not enough to justify a horizontal merger, particularly one that takes place in a highly concentrated market that lacks the level of competition needed to ensure these savings are returned to consumers.

Furthermore, it may be the case that Applicants are overstating the level of these cost savings. Some analysts estimate these at just $400 million a year, one-quarter the estimate AT&T provides.[49] Savings at that lower level wouldn't come close to justifying and offsetting the harms of the deal, even if they were returned 100 percent to consumers.[50] Even at a higher level than AT&T's public prediction of $1.6 billion, the deal still may not make financial sense for AT&T.[51] And while volume discounts for multichannel video providers undoubtedly are real, recent research from SNL Kagan suggests that rising costs for sports programming, for broadcast

[48] *Application*, Declaration of Rick L. Moore, ¶¶ 9-10.

[49] *See, e.g.*, Stephen Gandel, "AT&T's bid for DirecTV doesn't add up," *Fortune*, May 20, 2014; Peter Kafka and Amy Schatz, "AT&T Could Probably Buy DirecTV. But Why?" *Re/Code*, May 1, 2014.

[50] *See* Kafka and Schatz, *supra* note 49 (quoting analyst Craig Moffett).

[51] *See* Jeffrey Goldfarb, "AT&T Will Struggle to Justify a Deal for DirecTV," *NY Times Dealbook*, May 14, 2014.

retransmission consent, and for the digital rights that bundled providers now seek to obtain, all may be eroding the benefits of such scale in the pay-TV distributor business.[52]

The pay-TV markets are at a tipping point, where there is no longer any expected future growth in MVPD penetration.[53] This trend has implications for the analysis Applicants offer, including implications that the Applicants do not appear to have considered. Indeed, this inherent uncertainty about the benefits of negotiating scale and how that impacts retail prices is likely why AT&T has made no consumer-level pricing promises in its Application, and why Comcast avoided making similar promises in its application to acquire Time Warner Cable. The market data suggests that continued rate increases are unsustainable, and so the rate of increase may decline even in the absence of this and other MVPD mergers.

However, there is ample existing evidence that any cost-savings AT&T or any other MVPD may enjoy because of scale simply accrue to the particular company's profit margins, and are not reflected whatsoever in the prices charged for these services. For example, Comcast already enjoys the benefits of scale and volume discounts more so than any other distributor, yet there's no evidence its programming packages are priced significantly lower than other MSOs. In fact, these discounts appear to do nothing more than give Comcast higher margins on video than

[52] *See* Tony Lenoir, "MSOs log seasonal surge in programming costs in Q1," SNL Kagan: Multichannel Trends, June 11, 2014 (reporting that the programming costs of Comcast, the nation's largest multichannel video distributor by number of subscribers, had risen more than the costs incurred by smaller cable operators).

[53] AT&T in its public interest statement tells the Commission that it expects pay-TV penetration to continue its decline (Application, Declaration of Lori M. Lee at 21), which includes a redacted value for this estimate, but an unredacted assessment of a projected "decline"). Thus, from the public interest analysis perspective, the company's claimed merger benefits will be in immediate decline; furthermore, this decline also suggests that the programming price hikes the company attributes to the poor state of its pay-TV product will reverse if present trends continue. Thus, for the purposes of the Commission's analysis, the benefits of the alternative, non-merger scenario are magnified, as every dollar AT&T would have invested in DIRECTV would reap declining benefits, but increasing benefits if put to their next highest-value use: increased fiber deployment and more favorable synthetic bundles.

its peers. According to SNL Kagan, as of the end of 2012, Comcast's operating margin for its pay-TV service was 30.2 percent, compared to 20.8 percent for Time Warner Cable and 16 percent for Charter.[54] If Comcast is not currently passing along these savings, there's no reason to believe AT&T would do so either as it gains more scale and dominance in the bundled pay-TV/Internet market – particularly when the pathway to achieving scale is the removal of a competitor from the market.[55]

Yet the key question for the Commission is not whether the deal makes financial sense for AT&T but whether there are merger-specific benefits that would arise because of the deal, and that would enhance competition, but that would not come about in absence of the transaction.[56] The answer to this key question is clear: AT&T makes no commitment to pass any

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[54] *See* "Cable MSO Margin Analysis by Product," *SNL Kagan*, Mar. 26, 2013.

[55] Indeed, based on AT&T's estimates for EBITDA uplift, it appears that the company expects the synergies to accrue to earnings, not benefit customers. Based on data from DIRECTV's 2013 10-K filing, its programming costs are 44 percent of its video revenues. In AT&T's public interest statement, it reports programming costs account for 60 percent of U-verse video revenues (Lee Declaration at 8). AT&T also states, "this transaction will reduce AT&T's expected per-subscriber content costs as a standalone company by at least 20%" (Moore Declaration at 8). Based on these values, and the publicly reported values for DIRECTV's programming costs, video revenues and EBITDA, we can estimate the values for AT&T's video revenues and programming costs, on a total and per subscriber basis, and can compare this with the value AT&T estimates for EBITDA lift (a value only disclosed in its highly confidential filing). This analysis indicates that AT&T is over-estimating the programming costs savings (a conclusion Wall Street analysts also reached); it also suggests AT&T will boost earnings with the expected synergies from the transaction, but not return any of the value to customers in any form (*i.e.* changes in prices or reinvestments in other segments). These of course are necessarily imprecise estimates based on publicly reported information, though the highly confidential data disclosed in the public interest statement does not contain the information necessary to estimate the value of the synergies that AT&T expects to accrue to shareholders versus users. The Commission can and should ask Applicants to provide a more detailed accounting of the distribution of cost-savings.

[56] *See Merger Guidelines*, § 10 ("The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market.").

cost savings along to its subscribers, nor should it be expected to do that in a more concentrated and commensurately less competitive pay-TV market. The Application is replete with references to the "downward pressure" on price about which AT&T's predictions and econometric analyses speculate. Yet, AT&T can't quite bring itself to claim that all of this downward pressure will result in real price savings for consumers. The most definitive claim AT&T seems willing to put on paper appears on a single page in the Application, referencing one hired economic expert's opinion that "market forces will ensure that the company uses these reduced marginal costs to enhance consumer welfare, whether through reduced prices, improved offerings, new services and capabilities, or a combination of these."[57]

The absence of anything remotely concrete in this speculation about what market forces may "ensure" is telling. Even AT&T, which has a long track record of speculating about positive outcomes from its further consolidations, cannot be bothered to promise any tangible consumer benefits in the MVPD market that would see substantially lessened competition as a result of this transaction. Applicants' claim that the combined company would face continued competition in the pay-TV and broadband markets, and thus "have incentives to pass through some" savings, is belied by almost two straight decades of pay-TV price increases across the industry[58] – even in markets served by the largest pay-TV providers with, in theory, the largest volume discounts on their programming costs.[59]

If volume discounts enjoyed by the largest MSOs in *the current market* are simply accruing to shareholders in the form of higher margins, with no discernable difference in the

[57] *Application* at 33-34 & n.97 (citing Declaration of Michael L. Katz, ¶ 118).

[58] *See* S. Derek Turner, Combatting the Cable Cabal: How to Fix America's Broken Video Market, at 10 (May 2013).

[59] *See* Multichannel Pricing Reports, and Bundled Pricing Reports, SNL Kagan (various editions).

prices charged for these services between large and small companies, then it is clear that the *existing* level of competition in the MVPD market is not sufficient to incentivize distributors to pass through savings. There is no reason to believe this transaction, which reduces the number of available providers in these markets from four to three, will come with any incentives for AT&T to pass through anything to consumers other than higher prices and worse customer service.

B. AT&T's Broadband Promises Represent Deployments that The Company Will Undertake in the Absence of The Transaction.

As explained in detail in Part V below, actual network investment would be a much better use of the billions that AT&T proposes to spend on this merger. Yet never shy about trotting out the same deployment promises in more than one deal or announcement, AT&T claims that this pay-TV merger would "enable" it to invest in broadband. In fact, the company insists the transaction at issue here is what will "allow" it "to expand and enhance its deployment of both wireline and fixed wireless broadband to at least 15 million customer locations across 48 states, with most of the locations in underserved rural areas."[60]

The takeaway from the Commission's review of AT&T's attempted takeover of T-Mobile is this: AT&T has no problem blatantly misleading the Commission, the media, policymakers and the public about what it would and would not do in the absence of merger approvals or other decisions granting its policy wishes. This, along with all the subsequent investment, innovation and competition by both AT&T and T-Mobile after that deal fell apart, are the lessons that should weigh heavily in the Commission's review of the instant Application.

The Commission should greet with deep skepticism anything AT&T says about what a merger approval will "enable" or "allow" the company to do. In this transaction, the candy the company is dangling before the Commission is a familiar treat: broadband buildout promises.

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[60] *Application* at 1-2.

This should be familiar to the Commission, with the company having repeatedly made such promises. As described below, AT&T has apparently failed to fulfill similar promises after prior Commission approvals. And as we now see, AT&T did not "need" T-Mobile in order to "enable" it to fully deploy LTE. Indeed, just as we and many other opponents of that deal argued, market realities were the only thing AT&T would "need" in order to "enable" deployment, with market forces pushing it to not skimp on that buildout. Even without fulfilling its supposed need for T-Mobile to fully deploy LTE by 2018, AT&T has already reached a coverage level of 300 million persons as of September 2014.[61]

So, when AT&T dangles the promise of broadband deployment to 15 million customer locations, the Commission should do everything within its power to first determine what AT&T's existing plans were prior to striking a deal with DIRECTV, and then it should conduct an analysis of what AT&T would do if this new transaction fails to close too. This will of course involve examination of AT&T's internal communications. But based on existing publicly available data, it is clear that while expanding to 15 million customer locations sounds impressive, it isn't – especially not once all of the nuances of this commitment are unpacked, and certainly not once this promise is compared to AT&T's eerily similar claims from the past.

AT&T is not planning to extend U-verse advanced DSL technology or more advanced wireline capabilities to all of those homes. To reach 15 million locations, AT&T says it will "provide [fiber-based] wireline broadband service to 2 million more customer locations" but

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[61] AT&T said it needed Commission approval for its takeover of T-Mobile in order to "enable" it to cover 97 percent of the U.S. with LTE by 2018. However, AT&T is currently running commercials claiming its network serves 99 percent of Americans, just as the company promised it would do less than a year after the Commission rejected its T-Mobile bid. *See* "AT&T to Invest $14 Billion to Significantly Expand Wireless and Wireline Broadband Networks, Support Future IP Data Growth and New Services," AT&T Press Release, Nov. 7, 2012.

"fixed wireless local loop ('WLL') technology" for the remaining "13 million largely rural customer locations" in that total.[62] First, regarding the 2 million more fiber claim, in all of its communications to investors, AT&T indicates that the company does not expect any increase in capital spending matching what such a commitment would entail. That suggests this alleged expansion is something the firm already is planning to do.[63] Indeed, 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, making the overall marginal capital outlay relatively minor compared to the company's normal and routine investment. And other statements from AT&T suggest that the total initial capital outlay for this endeavor, which we estimate to be on the order of *substantially less than* an incremental 1 billion dollars,[64] is something the company would undertake in the absence of the merger because that is the direction that the *market* is pushing AT&T towards.[65]

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[62] Application at 5.

[63] Indeed, in its Second Quarter filing from this year, AT&T reports that it "expect[s] 2014 to be our peak investment year for Project VIP and anticipate our Wireless and Wireline segments' spend to be proportionally consistent to 2013."

[64] Given AT&T's current deployment of "Gigapower" targeted at multiple dwelling units, and given that this "commitment" is apparently incremental over planned U-verse deployments, we expect the per customer-passed cost for these 2 million customers is likely less than what Google incurred in the Kansas City market, which was between $500 and $675 per customer passed. FTTN deployments already involve shortening the local loop by extending fiber from the Central Office to remote terminals (the "node" in FTTN). Thus the incremental cost of deploying fiber to the home vs. fiber to the node in high-density office and multiple dwelling units (those AT&T appears to be targeting with Gigapower) is likely substantially less than $500-$675 per unit passed.

[65] *See, e.g.*, *C*omments of John J. Stephens, Chief Financial Officer & Senior Executive VP, AT&T, Inc., J.P. Morgan Global Technology, Media and Telecom Conference, May 21, 2014 ("So the market I can talk about right now is Austin, where we went in and were able to do what

But while AT&T would likely make this incremental investment in fiber absent the transaction, its fixed wireless commitment is even less relevant to the review. This is because AT&T *already offers* fixed LTE service nationwide.[66] Anyone can sign up.[67] 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. This "commitment" doesn't even come close to offering real broadband at future-proofed speeds to these 13 million homes, and it *is currently available*.[68]

I'll call an efficient build, a targeted build, a success-based build, with some of the, for us, new streamlined permitting right-of-way easement processes. All we've seen is great adoption by our customers of high-speed products, high satisfaction, some of the best NPS scores, Net Promoter Scores we've seen, a real acceptance and desire and appreciation for the product. After that experience, and remember, we've done this just in the course of an eight to ten-month cycle. After seeing that, we decided that we would take a look at other markets and, quite frankly, because we had plans to put more U-verse out there, decided to accelerate, so to speak, the announcement of our willingness to do GigaPower so we could redirect the U-verse dollars to GigaPower and be efficient in that way, if you will just jump from the historical technology or assets we have to GigaPower as a post in one step as opposed to doing it in two, first going into U-verse and then going to GigaPower. *So quite frankly, the process we're going through now is about efficient capital deployment and making those changes once*.") (emphasis added).

[66] *See, e.g.*, Jeff Baumgartner, "AT&T's Fixed Wireless Service Goes Nationwide," *Multichannel News*, May 23, 2014.

[67] *See* AT&T Wireless Home & Internet information page, at http://goo.gl/KBW8Ab.

[68] The nature of this fixed wireless deployment is as clear as mud when described in the public interest statement. It is possible AT&T envisions an augmented fixed LTE offering. However, even if this were the case, the company is likely to make such an offering in the absence of the acquisition of DIRECTV, given the AT&T's WCS spectrum holdings and its prior moves to make this spectrum usable for this exact type of service. *See, e.g.*, Joan Engebretson, "Stankey: AT&T Fixed Wireless Broadband Will Use Fallow Spectrum," *Telecompetitor*, Aug. 13, 2014. ("Stankey declined to provide details about where the new wireless broadband offering would be made available. But he said the company estimates that about 10 to 12 million U.S. households could be targeted for the fixed wireless offering. *That doesn't quite match the 15 million households that the company talked about serving with fixed wireless broadband when it announced the plan to purchase DirecTV*, so perhaps the company has another fixed broadband wireless offering up its sleeve that would be based on different parameters.") (emphasis added).

AT&T's current suggestion that it must first buy out a competitor before it can afford to improve its broadband coverage, in a plainly horizontal merger that results in a highly concentrated market, should sound familiar to the Commission. That's the same play the company ran in the T-Mobile takeover bid. In 2011, while trying to persuade regulators of the benefits from its attempted buyout of T-Mobile, AT&T continually recited the preposterous claim that it could not afford to deploy LTE to 97 percent of the country (by 2018) without first spending some $39 billion on its rival. Just how preposterous that claim was only became apparent to the public, however, when AT&T's attorneys failed to redact the additional cost that AT&T claimed it could not afford without first acquiring T-Mobile: $3.8 billion.[69] Then as now, it is hard to accept the claim that AT&T can only justify spending on broadband deployment if the government first approves an anticompetitive merger. This is especially hard to believe given the price tag of the current transaction ($68 billion) versus the likely cost of this fiber deployment (less than a billion dollars) and the actual wireless LTE commitment ($0).

But AT&T's track record doesn't just involve promises made but not needed; it also involves promises made and not kept. Before 2011, AT&T successfully closed a different merger while promising to deliver broadband to 100 percent of the housing units located within its wireline territory. In 2006, AT&T's commitments for its BellSouth acquisition detailed plans to serve 85 percent of AT&T's wireline footprint with wired broadband offerings, and the remaining 15 percent with satellite and wireless technologies.[70] AT&T today suggests the same kind of comprehensive coverage is possible with newer fiber and 4G technologies only if it is allowed to merge once more. Yet its track record on fulfilling such promises is spotty at best,

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[69] *See, e.g.*, Karl Bode, "Leaked AT&T Letter Demolishes Case For T-Mobile Merger," *DSL Reports*, Aug. 12, 2011.

[70] See Letter from Robert W. Quinn, Jr., AT&T, to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 06-74, ¶ 1 (filed Dec. 28. 2006).

with residents in its wireline service territory suggesting they were still waiting for AT&T to meet BellSouth merger commitments some six years after those promises were made.[71]

V. The Transaction Would Cause Substantial Competitive and Public Interest Harms Beyond Those Cognizable Under a Traditional Antitrust Inquiry.

A. The Application Fails the Public Interest Test, as It Will Harm Future Competition in The Over-The-Top Video Market, Which Will In Turn Lessen Competition in the MVPD Market.

In testimony before the Congress earlier this year, AT&T's CEO claimed that the company loses money on its U-verse TV service.[72] In Applicants' public interest statement, AT&T seems to attribute this to the fact that 60 percent of its U-verse TV revenues go to programming[73] (compared to 44 percent for DIRECTV).[74] Even if this claim about U-verse TV as a money loser is true and not an accounting trick, it does not matter for the purposes of this review.[75] The public interest analysis does not turn on whether the acquisition will enhance

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[71] See Gerry Smith, "Many Rural AT&T Customers Still Lack High-Speed Internet Despite Merger Promise," *Huff Post Tech*, Nov. 18, 2012.

[72] See Statement of Randall Stephenson, Chairman, CEO, and President, AT&T Inc., Hearing: The Proposed Merger of AT&T and DIRECTV, United States House of Representatives, Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial and Antitrust Law (June 24, 2014). ("Today, 60 cents of every video dollar we earn goes straight to programmers, before we spend a penny to market our service, install a set top box, send a bill, or answer a customer's call. As a result, our video product is, on its own, unprofitable.").

[73] Declaration of Lori M. Lee, ¶ 18.

[74] According to DIRECTV's year-end 2013 SEC 10-K filing, the company's programming expenses totaled $13.991 billion, on $31.754 billion in revenues.

[75] AT&T states that 97 percent of U-verse video subscribers are bundled subscribers, and as indicated on its website, these bundles are priced as a whole. Whenever a firm sells a bundle of products using the same infrastructure, that share all service, general and administrative costs, and which are priced at a single price, the firm has some ability to allocate joint and common costs and revenues across the various services in the bundle, and this can even be done in an arbitrary manner. AT&T has not provided any detailed explanation on the costs for all of these services and how the firm allocates them across the services in the bundle. It is interesting that Verizon has not made similar claims about the profitability of its FiOS TV service, which has approximately the same number of subscribers as AT&T's U-verse video service, and is offered on a network that was more costly to construct on a per home passed basis.

AT&T's profitability, but on how the merger will impact the public interest, and how in the absence of the merger the market will develop. AT&T is still a new player in the pay-TV market; the penetration of U-verse TV is growing at a time when its MSO competitors are losing share and its satellite competitors are treading water. This growth in U-verse TV penetration is accelerating and will continue to accelerate as AT&T offers more competitive U-verse Internet speeds. Therefore, it is not unreasonable for the company to experience lean years as it builds *and grows* its business (lean for video, perhaps, though U-verse overall is certainly profitable because broadband is a high margin/low competition service). There is no doubt that AT&T wants and needs to grow its business. The question for the Commission is whether or not the route AT&T has chosen to do that – the removal of a competitor – is in the public interest. As we discuss below, it clearly is not, as AT&T could achieve the same level of growth, for less cost, in a manner that enhances competition.

As discussed above, AT&T bemoans the poor viability of synthetic bundles, but this is of course something that it has the power to change. We assume AT&T and its video partners each contribute to the terms of these agreements. If the discounts for the synthetic bundles (as compared to the standalone prices for each service) are not as high as they need to be to make the bundles more attractive to consumers, AT&T and its partners could change this. If bundles are as important to both the pay-TV and video provider as AT&T suggests they are, then there's no reason this shouldn't happen. Given the secular changes in the pay-TV market, the rise in over-the-top viewing, and the consumer view of broadband as the essential service in the bundle, it is highly likely that even in the absence of the merger both AT&T and DIRECTV would move to increase the attractiveness of these bundles, since this would benefit both parties. Many of the supposed problems Applicants describe about the synthetic bundles are not unsolvable problems.

For example, there are numerous ways to overcome the installation and billing issues. AT&T could make U-verse Internet and Voice available to DIRECTV on a wholesale basis at reasonable prices, and AT&T could become a DIRECTV reseller with a U-verse branded satellite service. There are perhaps business incentives that explain why these problems have not yet been solved. But if the merger were rejected, the parties would have increased incentive to find mutually beneficial solutions.

AT&T fully admits that its strategic goal of increasing bundle sales is something it *pursues today* via "synthetic" bundles with DIRECTV's services. Thus, the bulk of the claimed merger-specific benefits are in fact, non-merger specific, since AT&T is currently offering, or would offer, the same bundles today that it would offer in the merged case. We reiterate this rebuttal to Applicants' arguments about the failure of synthetic bundles here, as AT&T's public interest case centers around the further expansion of bundled product offerings, including apparently its own over-the-top bundled TV/Wireless offering. AT&T states it "views the growth of OTT services as an important opportunity for AT&T's broadband and mobile services."[76]

Thus, if its claim about the poor performance of U-verse video is to be believed, it follows that in the absence of the merger AT&T would execute its overall bundled product strategy through investment in OTT offerings, something it absolutely does not need to acquire DIRECTV in order to implement. In the absence of the merger, DIRECTV too would likely get serious about entering the OTT market (as Dish Networks is preparing to do at the end of this year). Having both AT&T and DIRECTV enter the OTT market as competitors could help boost the prospects of non-facilities-based video delivery services, and make it more difficult for other MSOs such as a vertically integrated Comcast, to act in a coordinated fashion to harm OTT. But

[76] Declaration of Lori M. Lee, ¶ 22.

with the purchase of DIRECTV, AT&T would have less incentive to fully embrace OTT as anything more than an add-on to its existing services, and more incentive to participate in any coordinated effects to harm OTT that would arise from the Comcast-Time Warner Cable transaction.

The loss of DIRECTV as a standalone, non-broadband company would have substantial impacts on video competition beyond the markets involved in this transaction. As mentioned above, Dish Networks is preparing to launch a lower-priced OTT offering this year. Verizon[77] and AT&T[78] have publicly reported acquisitions that indicate these companies are interested in and already planning future OTT offerings. It is therefore a reasonable assumption that AT&T would continue this strategy in the absence of approval of the instant transaction, particularly considering the fact that its closest wireless competitor is doing the same. It is also a reasonable assumption that DIRECTV would in the absence of the merger explore and offer its own OTT offerings, perhaps offering lower-priced virtual MVPD services like Dish is reportedly preparing to offer.[79]

Having multiple firms investing in OTT increases the market *and political* demand for open broadband pathways and faster broadband services. Removing one of the largest firms from this pool, and combining that firm with a wired provider, would reduce future competition in the OTT market nationwide, and reduce AT&T's own incentives to preserve an open pathway on other wired platforms in addition to its own. Contrary to Applicants' claims that the transaction

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[77] *See* Ryan Knutson, "Verizon Eyes Digital Video Service by Mid-2015," *Wall Street Journal*, Sept. 14, 2014.

[78] "The Chernin Group and AT&T Create New Venture to Acquire, Invest In and Launch Online Video Businesses," AT&T Press Release, Apr. 22, 2014.

[79] *See* Todd Spangler, "Dish on Track to Launch Internet-TV Service by End of 2014, Ergen Says," *Variety*, Aug. 6, 2014.

will enhance their OTT efforts, the merger would reduce the combined firm's incentives to make OTT a viable *alternative* to traditional MVPD services.

History shows that in markets with heterogeneous competitors, these firms will engage in both direct competition and indirect competition. The latter often provides the source of the most innovation and new product development, which in turns increases competition in the core product market.[80] Thus, contrary to AT&T's assertions, DIRECTV plays an important competitive role beyond its MVPD offerings, and its removal from the market would harm consumers and the public interest. Viewed through this lens, it is clear this transaction would have a "rebound" harm in the MVPD market, including the MVPD markets not currently served by U-verse; not only would there be one less MVPD competitor in a quarter of the country, but the resulting harms to the development of over-the-top competition would rebound back into the broader MVPD market, exacerbating the core harms of this acquisition.

B. The Application Fails the Public Interest Test, as AT&T Could Achieve the Same Level of Growth For a Lower Cost by Expanding Its Existing Service Territory.

The Commission's public interest merger standard goes beyond mere antitrust concerns. This is in part because Congress recognized the importance of communications networks to our economy and democracy, and was cognizant of the realities of insurmountable barriers to entry

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[80] *See, e.g.*, Statement of Daniel L. Brenner, Senior Vice President, Law and Regulatory Policy, National Cable & Telecommunications Association, FCC Open Commission Meeting, at 3-4 (Feb. 10, 2006) ("Evidence of a highly competitive marketplace can be found not only in the choices available to consumers, but also [in] how cable operators and their competitors have reacted. When DBS began to offer consumers an alternative with more channels, more pay-per-view movies, and digital audio and video, cable operators embarked on a $100 billion, nationwide upgrade of their facilities. With additional capacity and digital capability, cable operators began to offer new tiers of digital programming, along with video-on-demand and digital video recording capability. Cable expanded its video services to offer high definition television programming. Cable also increased the quality and diversity of its programming and pioneered commercial high-speed Internet service.").

in many of these markets. Lowering barriers to entry is in the public interest. It is a central theme of the Communications Act, as amended by the 1996 Telecom Act, and it is the purpose of Section 706 of that 1996 Act. The Commission should give careful consideration to how this transaction would impact entry barriers. The U.S. communications industry currently faces a capital environment that favors mergers and acquisitions (M&A). M&A however is just a means to an end that shareholders ultimately demand: growth.

For the purposes of promoting the public interest, competition and diversity (the Commission's core goals under the Act), the Commission's review of this transaction must be centered around this question: What actions would AT&T take if it could not grow its TV business through the elimination of a direct competitor?

To help the Commission answer this question, we first look to what AT&T is most trying to accomplish with this merger – the ability to add a video service to its IPDSLAM/Voice bundles in the 24 million customer locations at which it does not currently plan to extend U-verse. To do this, AT&T is spending a whopping $68.4 billion to acquire DIRECTV. This total transaction value includes $14.3 billion in cash, $34.9 billion in stock, and the taking on of DIRECTV's net $19.2 billion in debt ($22.2 billion debt, less $3 billion in cash).

This is of course a staggering amount of money. AT&T may choose to deflect this argument by claiming that the stock portion of this deal doesn't represent "real" money. Stock certainly has value, but even excluding the stock portion of the purchase price, AT&T is handing over $14.3 billion in cold hard cash, and taking on an additional $19.2 billion in debt. Cash and debt are very much "real" money, and capital that could be put to other uses. For example, one of AT&T's claimed public interest benefits from this transaction is the deployment of Gigapower services to 2 million U-verse locations, and offering wireless broadband to 13 million customer

locations (even though, as noted above, these are already served by AT&T's fixed wireless service).

Yet for just the cash portion of this deal alone, excluding stock and debt, AT&T could wire those 15 million customer locations with gigabit broadband. Indeed, in its public interest statement AT&T repeatedly cites the successes of Google Fiber. Instead of making the same full fiber investments that Google is making though, AT&T proposes to spend *more* money on DIRECTV than it would take to duplicate Google Fiber's success. This is of course because of the company's desire not to spook short-term investors into harming the company's stock price, as any substantial increase in capital spending would. But the Commission's public interest standard operates apart from the standard of short-term stock market investors. Rejecting this merger would incentivize AT&T to invest in new deployments if it wants to grow.

What is the opportunity cost of this transaction? That is, what could AT&T do if it built its way to growth instead of buying it? The answer is, far more than it is proposing to accomplish with this transaction, and without the concomitant reduction in competition. To illustrate this, we compare the price AT&T is paying for DIRECTV with what these resources could be used for instead, based on the publicly reported costs for Google's fiber deployments. Bernstein Research estimates that in Kansas City, Missouri, Google's build cost $500 per home passed, and in Kansas City, Kansas, $674 per home passed. Bernstein estimated an additional $794 per home connected (for homes taking TV and Internet) or an additional $464 per home connected to just Internet access service.[81] Based on this data, below in Figure 2 we model how far AT&T's $68.4 billon would get it were the company to build gigabit fiber instead of buying DIRECTV. We show four scenarios: 1) Google Fiber's cost in Kansas City, Mo.; 2) Google Fiber's cost in

[81] *See* Ingrid Lunden, "Analyst: Google Will Spend $84M Building Out KC's Fiber Network To 149K Homes; $11B If It Went Nationwide," *TechCrunch*, Apr. 8, 2013.

Kansas City, Kan.; 3) Double Google Fiber's average passing cost in the Kansas City metro area; and 4) Triple Google Fiber's average passing cost in the Kansas City metro area. For each scenario, we assume a 30 percent take rate (though Google's take rate in Kansas City is reportedly far higher).[82]

Figure 2: What AT&T's $68.4 Could Build

Cost per Home Passed	Cost per Home Connected	Homes Passed	Homes Connected (Assume 30% of those Passed)	Total Cost	Notes
$500	$800	92,500,000	27,750,000	$68.4B	Google Fiber's Cost in Kansas City, MO
$674	$800	74,800,000	22,440,000	$68.4B	Google Fiber's Cost in Kansas City, KS
$1,128	$800	50,000,000	15,000,000	$68.4B	Double Google Fiber's Kansas City Metro Area Average Cost
$1,692	$800	35,400,000	10,620,000	$68.4B	Triple Google Fiber's Kansas City Metro Area Average Cost

Source: Free Press Research, based on estimates provided by Bernstein Research

This analysis shows that even at triple the cost Google Fiber incurred in Kansas City, but for the same price that AT&T is paying for DIRECTV, AT&T could cover 35.4 million homes with gigabit fiber. Put another way, and given its lower per-home cost, AT&T could extend U-verse to the remaining 24 million homes in its footprint for far less than it is spending on this transaction.[83]

There's no way to characterize AT&T's spending here as anything other than a shortsighted, inefficient waste. This waste is a sign of market failure. It is a market failure the Commission has the power to correct, simply by sending the right and efficient investment signals to the market. The Commission can do this by rejecting this Application, for a deal that is clearly not in the public interest.

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[82] See Phillip Dampier, "Uh Oh Time Warner Cable & AT&T: Google Fiber Winning 75% of Customers in Kansas City," Stop the Cap!, May 6, 2014 (citing Bernstein Research analysis of Google's performance in Kansas City).

[83] These are of course imprecise estimates. AT&T likely has conducted its own internal analysis as to the cost of deploying U-verse and/or Gigapower to the remaining 24 million customer locations. The Commission should solicit this analysis from AT&T.

VI. Conclusion

The merger would stifle competition and innovation in the MVPD market by reducing the number of competitors from four to three in the AT&T U-verse territories, which cover nearly a quarter of the U.S. It would lead to significant consumer harms in other product markets and geographic markets as well, and would not serve the public interest. For the reasons described herein, the Commission must deny the transaction and grant all other relief as may be just and proper.

Respectfully submitted,

______/s/______________

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Declaration of Shantel G. Buggs

1. I, Shantel G. Buggs, am a member of Free Press. I am a resident of Austin, TX.

2. I reside at East Oltorf Street, which falls within the Austin, TX designated market area.

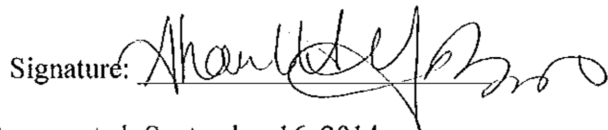
3. I reside within the service area of AT&T U-verse and I am a subscriber to its cable television and Internet access services.

4. I am a regular viewer of the television stations within the Austin, TX designated market area. I regularly use my AT&T U-verse broadband connection to access streaming video content.

5. As a resident of Austin,TX a merger of AT&T and DirecTV would harm me because it would reduce the number of competitors in my area from four to three.

6. This Declaration has been prepared in support of the foregoing Petition to Deny the merger of AT&T and DirecTV.

I declare under penalty of perjury that the foregoing statements are true and correct to the best of my knowledge.

Signature: 

Date executed: September 16, 2014

CERTIFICATE OF SERVICE

I, Lauren M. Wilson, Policy Counsel for Free Press, certify that on September 16, 2014, the foregoing Petition to Deny was served by electronic mail, on the following:

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