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 Transfer Control of Licenses and Authorizations	)	
	)	

COMMENTS

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I. INTRODUCTION AND EXECUTIVE SUMMARY

The American Cable Association ("ACA") submits these comments in response to the Public Notice issued by the Commission in the above captioned proceeding requesting comment on applications filed by AT&T, Inc. ("AT&T") and DirecTV (collectively, "the Applicants") seeking consent to transfer control of various Commission licenses.[1] ACA maintains, and will demonstrate, that the transaction will harm consumers and competition in the multichannel video programming distributor ("MVPD") market, and that it is not enough for the Commission to simply adopt the same type of remedial conditions it has adopted in the past to ameliorate harms similar to those presented by this merger because they have proven ineffective for small and medium-sized MVPDs. The Commission cannot approve the applications unless new remedies are crafted that can be used by the smaller MVPDs harmed by the merger.

ACA and its members have a substantial interest in this proceeding. ACA has more than 840 members that, as MVPDs, provide video programming to their subscribers. Of these members, many purchase regional sports programming directly from one of the current DirecTV "must have" regional sports networks ("RSNs") or from Comcast Sportsnet Houston, which DirecTV and AT&T are in the process of acquiring and which, once acquired, will be owned in part by AT&T and in part by DirecTV.[2]

Moreover, all of these MVPDs compete against DirecTV, and some compete against AT&T. While it has been observed that the "vast majority of mergers are either procompetitive and enhance consumer welfare or are competitively benign," this cannot be said of the AT&T-

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[1] *Commission Seeks Comment on Applications of AT&T Inc. and DIRECTV To Transfer Control of FCC Licenses and Other Authorizations*, Public Notice, MB Docket No. 14-90, DA 14-1129 (rel. Aug. 7, 2014) ("Public Notice").

[2] Joe Flint, *DirecTV and AT&T Look to Take Over Houston Sports Channel*, LA TIMES (Aug. 8, 2014), *available at* http://www.latimes.com/entertainment/envelope/cotown/la-et-ct-comcast-houston-directv-att-20140808-story.html.

DirecTV merger.[3] ACA will demonstrate that the proposed transaction, if consummated, will create harms that must be mitigated through conditions that work.

In these comments, which include an economic analysis by Professor Gary Biglaiser, ACA describes how the proposed transaction, if consummated will have significant deleterious competitive effects by enhancing the existing harms of DirecTV's vertical integration with "must have" RSN programming.[4] ACA also provides a critique of the effectiveness of previous Commission remedial conditions, particularly "baseball style" arbitration, to eliminate these harms for smaller and medium-sized MVPDs.[5]

Employing the bargaining model framework used by the Commission in its review of the Comcast-NBCU transaction for analyzing the harms of combining Comcast's distribution assets with NBCU's programming assets, Professor Biglaiser shows that the efficiencies and increased bargaining leverage generated by the combination of AT&T and DirecTV distribution and programming assets will increase the opportunity cost for selling the combined entity's "must have" RSN programming to its rivals.[6] The higher opportunity cost, in turn, will give AT&T an increased incentive to charge greater fees for its RSNs to rival MVPDs, which will raise their costs. These rate increases will be passed down to subscribers in various ways.

ACA will show how previous remedies proposed by the Commission, including "baseball-style" arbitration, are not adequate to alleviate the harms raised by this combination, particularly for small and mid-sized MVPDs. In many cases, due to the widespread use of non-disclosure agreements by programmers, small and medium-sized MVPDs lack the critical

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[3] Christine A. Varney, *Merger Guideline Workshops*, THIRD ANNUAL GEORGETOWN LAW GLOBAL ANTITRUST ENFORCEMENT SYMPOSIUM (Sept. 22, 2009), *available at* http://www.justice.gov/atr/public/speeches/250238.pdf.

[4] *See* Gary Biglaiser, *The Harms of AT&T-DirecTV Merger* (Sept. 15, 2014), attached hereto as Exhibit A ("Biglaiser").

[5] *Id.* at 16-23.

[6] *Id.* at 11-16; Comcast-NBCU Order, ¶ 39.

information to even assess whether AT&T/DirecTV is acting on their incentive to charge higher prices due to their vertical integration. Even when a smaller MVPD believes it is being treated unfairly, in any baseball-style arbitration proceeding, it is disadvantaged by multiple factors. These include a lack of critical information necessary to effectively formulate and make a best and final offer at the outset of the arbitration; the fact that the programmer has access to critical information unknown to the smaller MVPD; the high fixed costs of the process; the threat of retaliation from the vertically integrated programmer in later negotiations; and problems getting the process started in the first place. Unless the Commission adopts robust relief to remedy the vertical harms, the application associated with this merger should not be approved.

Finally, if the application is approved, AT&T has committed to expanding its broadband services to some 15 million customer locations. First, it plans to deploy U-verse broadband service to at least two million additional locations in its existing service territory; and then, it will deploy an LTE-based fixed wireless ("WLL") broadband product to approximately 13 million locations, which are largely underserved. ACA believes the two commitments may have significant value, but only if AT&T is not receiving universal service support to serve the same locations. The Commission should require AT&T to identify the specific census blocks where AT&T plans to deploy broadband service pursuant to its commitment, and determine whether AT&T is already receiving or is eligible to receive universal service support for any of these "commitment" census blocks. In any instances where a "commitment" census block is a block where AT&T receives or could receive universal service support, the Commission should not permit AT&T to access universal service funding.

II. STANDARD OF REVIEW

Under Section 310(d) of the Communications Act,[7] the Commission must determine whether the Applicants have demonstrated that the proposed assignment and transfer of control

[7] 47 U.S.C. § 310(d).

of certain Commission licenses and authorizations held by the Applicants as part of the proposed transaction will serve "the public interest, convenience, and necessity."[8] In making this determination the Commission must first assess whether the proposed transaction complies with the specific provisions of the Act, other applicable statutes, and the Commission's rules. If the proposed transaction would not violate a statute or rule, the Commission next must consider whether it could result in public interest harms by substantially frustrating or impairing the objectives or implementation of the Communications Act or related statutes.[9] The Commission then employs a balancing test weighing any potential public interest harms of the proposed transaction against any potential public interest benefits.[10] The Applicants bear the burden of proving, by a preponderance of the evidence, that the proposed transaction, on balance, will

[8] Section 310(d) of the Act, 47 U.S.C. § 310(d), requires that the Commission consider applications for transfer of Title III licenses under the same standard as if the proposed transferee were applying for licenses directly under Section 308 of the Act, 47 U.S.C. § 308. *See, e.g.*, *Applications of Comcast Corp., General Electric Co. and NBC Universal, Inc. for Consent to Assign Licenses and Transfer Control of Licensees, MB Docket No. 10-56*, Memorandum Opinion and Order, 26 FCC Rcd 4238, ¶ 22 (2011) ("Comcast-NBCU Order"); *Applications for Consent to the Transfer of Control of Licenses, XM Satellite Radio Holdings Inc., Transferor, To Sirius Satellite Radio Inc., Transferee*, MB Docket No. 07-57, Memorandum Opinion and Order, 23 FCC Rcd 12348, ¶ 30 (2008) ("XM-Sirius Order"); *News Corp. and DIRECTV Group, Inc. and Liberty Media Corp. for Authority to Transfer Control*, Memorandum Opinion and Order, 23 FCC Rcd 3265, ¶ 22 (2008) ("Liberty Media-DIRECTV Order"); *Applications for Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation, (and subsidiaries, debtors-in-possession), Assignors, to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation, (and subsidiaries, debtors-in-possession), Assignors and Transferors, to Comcast Corporation (subsidiaries), Assignees and Transferees; Comcast Corporation, Transferor, to Time Warner Inc., Transferee; Time Warner Inc., Transferor, to Comcast Corporation, Transferee*, Memorandum Opinion and Order, 21 FCC Rcd 8203, ¶ 23 (2006) ("Adelphia Order"); *SBC Comm. Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, 20 FCC Rcd 18290, ¶ 16 (2005) ("*SBC-AT&T Order"*); *Verizon Comm., Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, 20 FCC Rcd 18433, ¶ 16 (2005) ("Verizon-MCI Order"); *General Motors Corporation and Hughes Electronics Corporation, Transferors, and The News Corporation Limited, Transferee*, MB Docket No. 03-124, Memorandum Opinion and Order, 19 FCC Rcd 473, ¶ 18 (2004) ("News Corp.-Hughes Order"). *See also SkyTerra Communications, Inc., Transferor and Harbinger Capital Partners Funds, Transferee Applications for Consent to Transfer of Control of SkyTerra Subsidiary,* LLC, Memorandum Opinion and Order and Declaratory Ruling, IB Docket No. 08-184 et al., DA 10-535, ¶ 10 (rel. Mar. 26, 2010).

[9] *See, e.g.*, Comcast-NBCU Order, ¶ 22; XM-Sirius Order, ¶ 30; Liberty Media-DIRECTV Order, ¶ 22; SBC-AT&T Order, ¶ 16; Verizon-MCI Order, ¶ 16.

[10] *See id.*; News Corp.-Hughes Order, ¶ 15.

serve the public interest.[11] If the Commission is unable to find that the proposed transaction serves the public interest for any reason, or if the record presents a substantial and material question of fact, the application must be designated for hearing.[12]

The Commission's public interest evaluation necessarily encompasses the "broad aims of the Communications Act,"[13] which include, among other things, "a deeply rooted preference for preserving and enhancing competition in relevant markets, accelerating private-sector deployment of advanced services, ensuring a diversity of information sources and services to the public, and generally managing spectrum in the public interest."[14] The Commission's public interest analysis may also entail assessing whether the transaction will affect the quality of communications services or will result in the provision of new or additional services to consumers.[15] In conducting this analysis, the Commission may consider technological and market changes as well as trends within the communications industry, including the nature and rate of change.[16]

The Commission's competitive analysis, which forms an important part of the public interest evaluation, is informed by, but not limited to, traditional antitrust principles.[17] The

[11] *See, e.g.*, Comcast-NBCU Order, ¶ 22; XM-Sirius Order, ¶ 30; Liberty Media-DIRECTV Order, ¶ 22; SBC-AT&T Order, ¶ 16; Verizon-MCI Order, ¶ 16; *Application of EchoStar Communications Corporation (a Nevada Corporation), General Motors Corporation, and Hughes Electronics Corporation (Delaware Corporations) (Transferors) and EchoStar Communications Corporation (a Delaware Corporation) (Transferee)*, Hearing Designation Order, 17 FCC Rcd 20559, ¶ 25 (2002) ("EchoStar-DirecTV Order").

[12] 47 U.S.C. § 309(e); *see also* Comcast-NBCU Order, ¶ 22; XM-Sirius Order, ¶ 30; Liberty Media-DIRECTV Order, ¶ 22; Adelphia Order, ¶ 23; SBC-AT&T Order, ¶ 16; Verizon-MCI Order, ¶ 16; EchoStar-DirecTV Order, ¶ 25.

[13] *See, e.g.*, Comcast-NBCU Order, ¶ 23; XM-Sirius Order, ¶ 31; Liberty Media-DIRECTV Order, ¶ 23; News Corp.-Hughes Order, ¶ 16; EchoStar-DIRECTV Order, ¶ 26.

[14] *See* Telecommunications Act of 1996, Pub. L. No. 104-104, § 706, 110 Stat. 56, 153 ("*1996 Act*"), *codified at* 47 U.S.C. § 157; 47 U.S.C. §§ 254, 332(c)(7); *1996 Act*, Preamble; Comcast-NBCU Order, ¶ 23; XM-Sirius Order, ¶ 31; Liberty Media-DIRECTV Order, ¶ 23.

[15] *See, e.g.,* Comcast-NBCU Order, ¶ 23; XM-Sirius Order, ¶ 31; Liberty Media-DIRECTV Order, ¶ 23.

[16] *See id.*

[17] *See, e.g.*, Comcast-NBCU Order, ¶ 24; XM-Sirius Order, ¶ 32; Liberty Media-DIRECTV Order, ¶24; Adelphia Order, ¶ 25; News Corp.-Hughes Order, ¶ 17; EchoStar-DIRECTV Order , ¶ 27.

Commission and the Department of Justice ("DOJ") each have independent authority to examine the competitive impacts of proposed communications transactions involving transfers of Commission licenses, but the standards governing the Commission's competitive review differ somewhat from those applied by the DOJ.[18] Like the DOJ, the Commission considers how a transaction will affect competition by defining a relevant market, looking at the market power of incumbent competitors, and analyzing barriers to entry, potential competition and the efficiencies, if any, that may result from the transaction. The DOJ's review, however, focuses on whether a transaction may substantially lessen competition or tend to create a monopoly.[19] Under the Commission's review, the Applicants must show that the transaction affirmatively will serve the public interest; otherwise the application is set for hearing. Whereas the DOJ's review is also limited solely to an examination of the competitive effects of the acquisition, without reference to other public interest considerations,[20] the Commission's competitive analysis under the public interest standard is somewhat broader.

The Commission's analysis recognizes that a proposed transaction may lead to both beneficial and harmful consequences.[21] For instance, combining assets may allow a firm to reduce transaction costs and offer new products, but it may also create market power, create or enhance barriers to entry by potential competitors, and create opportunities to disadvantage rivals in anticompetitive ways.[22] The Commission's public interest authority enables it, where

[18] *See, e.g.*, Comcast-NBCU Order, ¶ 24; XM-Sirius Order, ¶ 32; Liberty Media-DIRECTV Order, ¶ 24; Verizon-MCI Order, ¶ 18; SBC-AT&T Order,¶ 18. *See also Satellite Business Systems*, 62 FCC 2d 997, 1088 (1977), *aff'd sub nom. United States v. FCC*, 652 F.2d 72 (D.C. Cir. 1980) (*en banc*); *Northern 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").

[19] 15 U.S.C. § 18.

[20] *See, e.g.*, XM-Sirius Order, ¶ 32.

[21] *See, e.g.*, Comcast-NBCU Order, ¶ 25; XM-Sirius Order, ¶ 33; Adelphia Order, ¶ 25; SBC-AT&T Order, ¶ 18; Verizon-MCI Order, ¶ 18.

[22] *See*, *e.g.*, XM-Sirius Order, ¶ 33; Liberty Media-DIRECTV Order, ¶ 25; Adelphia Order, ¶ 25.

appropriate, to impose and enforce transaction-related conditions that ensure that the public interest is served by the transaction.[23]

Section 303(r) of the Act authorizes the Commission to prescribe restrictions or conditions not inconsistent with law that may be necessary to carry out the provisions of the Act.[24] Indeed, unlike the role of antitrust enforcement agencies, the Commission's public interest authority enables it to rely upon its extensive regulatory and enforcement experience to impose and enforce conditions to ensure that the transaction will yield overall public interest benefits.[25] Further, the Commission has held that it will impose conditions to confirm specific benefits or remedy specific harms likely to arise from the transaction and that are related to the Commission's responsibilities under the Act and related statutes.[26]

For the reasons explained below, on balance, the proposed transaction threatens significant public interest harms that are not outweighed by the projected public interest benefits of the combination. Accordingly, should the Applicants fail to offer means of addressing these threatened harms, the Commission must consider the imposition of conditions, beyond those imposed in previous transactions, to ensure that the transaction will be, on balance, consistent with the public interest.

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[23] *See*, *e.g.*, Comcast-NBCU Order, ¶ 25; XM-Sirius Order, ¶ 33; Liberty Media-DIRECTV Order, ¶ 26.

[24] 47 U.S.C. § 303(r); *see* also Comcast-NBCU Order, ¶ 25; XM-Sirius Order, ¶ 33; Liberty Media-DIRECTV Order, ¶ 26; *U.S. v. Southwestern Cable Co*., 392 U.S. 157, 178 (1968) (holding that section 303(r) permits the Commission to order a cable company not to carry broadcast signal beyond station's primary market); *United Video, Inc. v. FCC*, 890 F.2d 1173, 1182-83 (D.C. Cir. 1989) (affirming syndicated exclusivity rules adopted pursuant to section 303(r) authority). Similarly, Section 214(c) of the Act authorizes the Commission to attach to the certificate "such terms and conditions as in its judgment the public convenience and necessity may require." 47 U.S.C. § 214(c); *see also* SBC-AT&T Order, ¶ 19; Verizon-MCI Order, ¶ 19.

[25] *See, e.g.*, Comcast-NBCU Order, ¶ 25; XM-Sirius Order, ¶ 33; Liberty Media-DIRECTV Order, ¶ 26; News Corp.-Hughes Order, ¶ 5; *see also Schurz Communications, Inc. v. FCC*, 982 F.2d 1043, 1049 (7th Cir. 1992) (discussing Commission's authority to trade off reduction in competition for increase in diversity in enforcing public interest standard).

[26] *See, e.g.*, Comcast-NBCU Order, ¶ 25; Liberty Media-DIRECTV Order, ¶ 26; SBC-AT&T Order, ¶ 19; Verizon-MCI Order, ¶ 19.

III. THE PROPOSED MERGER THREATENS SERIOUS PUBLIC INTEREST HARMS

A. The Merger Unites Substantial Video Programming and Distribution Assets.

The AT&T-DirecTV deal involves two companies with very significant roles in the downstream video distribution (MVPD) industry. One company, DirecTV, also owns important assets in the upstream video programming industry that provides programming to MVPDs.

AT&T operates as an "IPTV" provider under the U-verse brand. It is the fifth-largest MVPD in the nation,[27] making video services available to between 24.5 million and 33 million TV homes in 142 markets across 22 states.[28] It has 5.7 million video subscribers.[29] AT&T is also a significant player in the broadband distribution market with 11 million broadband subscribers through its U-Verse service and copper plant.[30] AT&T is also one of the two leading national wireless carriers in the United States.

DirecTV is the second-largest MVPD with approximately 20 million video subscribers in the United States. Through direct broadcast satellite (DBS) distribution, it makes video programming available to 116 million TV homes in all 50 states. DirecTV competes against all other MVPDs, and also owns a number of important programming assets. On the national side, it has interests in the Game Show Network, the MLB Network, and the NHL Network, among others.

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[27] Leichtman Research Group, *Major Multi-Channel Video Providers Lost about 105,000 Subscribers in 2013* (Mar. 14, 2014), *available at* http://www.leichtmanresearch.com/press/031414release.pdf; *see also* Testimony of Michael K. Powell, President and CEO, National Cable & Telecommunications Association, *Hearing on Reauthorization of the Satellite Television Extension and Localism Act*, Subcommittee on Communications, Technology and the Internet, Committee on Commerce, Science and Transportation, UNITED STATES SENATE, Washington, D.C., at 5 (Apr. 1, 2014), *available at* https://www.ncta.com/sites/prod/files/NCTA_Powell-Testimony-STELA-April2014_0.pdf.

[28] *Applications of AT&T 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, at 10-11 (filed June 11, 2014) ("Public Interest Statement").

[29] *Id.* at 13.

[30] *Id.*

Regionally, DirecTV owns or manages three RSNs: Root Sports Pittsburgh, Root Sports Rocky Mountain, and Root Sports Northwest. These RSNs broadcast professional sports such as the Seattle Mariners, Utah Jazz, Pittsburgh Pirates and Penguins, Colorado Rockies, and college sports like Pac-12, Big East, Big Sky, and Big 12 Conferences – just to name a few.

Large MVPDs carry the DirecTV RSNs, including DirecTV. All of these large MVPDs compete with DirecTV as well. The following large cable and satellite TV providers carry each of the three RSNs currently owned or managed by DirecTV:

Root Sports Pittsburgh:	Comcast, DISH, DirecTV, Suddenlink, Time Warner Cable, and Verizon.
Root Sports Rocky Mountain:	Charter, Comcast, DirecTV, DISH, Suddenlink, and Time Warner Cable:
Root Sports Northwest:	Charter, Comcast, Cox, DirecTV, DISH, Suddenlink, and Time Warner Cable.

Small and medium-sized MVPDs also carry DirecTV's RSNs. All of these MVPDs also compete with DirecTV. ACA is aware of 42 of its members who purchase Root Sports Pittsburgh, 35 members who purchase Root Sports Rocky Mountain, and 44 members who purchase Root Sports Northwest. For all of the Root Sports RSNs, ACA members negotiate directly with DirecTV rather than relying on a buying group, such as the National Cable Television Cooperative ("NCTC"), as they do for the majority of their national cable programming.

AT&T and DirecTV are also in the process of purchasing Comcast SportsNet Houston, which broadcasts the professional games of the Houston Rockets, Astros, and Dynamo.[31] Once effectuated, AT&T and DirecTV will own 40 and 60 percent of the Houston RSN,

[31] Tom Hals, *DirecTV, AT&T Could Own Houston Sports Network Under Bankruptcy Plan,* REUTERS (Aug. 7, 2014) *available at* http://www.reuters.com/article/2014/08/07/us-houstonregionalsportsnetwork-bankrupt-idUSKBN0G71VR20140807.

respectively.[32] Comcast carries its own RSN, and ACA is aware of five of its members who directly purchase Comcast SportsNet Houston. These five members also compete head-to-head with DirecTV. For the Comcast SportsNet Houston RSN, each ACA member negotiates directly with Comcast, and expects to negotiate directly with AT&T-DirecTV as owners of the RSN once their acquisition of the network is completed.

According to its Public Interest Statement, in the proposed merger, AT&T will acquire all of DirecTV's equity, which includes its 20 million video subscribers and its RSNs.[33] DirecTV will merge with a wholly owned subsidiary of AT&T that post-transaction, will retain the name "DirecTV", as a subsidiary of AT&T.[34] With approval of the deal, the new AT&T will have approximately 26 million subscribers. Thus, the proposed transaction involves both a vertical combination of AT&T and DirecTV programming assets, and a horizontal integration of the companies' distribution assets.

AT&T and DirecTV stress that their merger is one of "complements" and claim that the proposed transaction "will serve the public interest, [and] result in no harms to competition."[35] This unduly narrow view of the potential harms posed by the transaction should be given little credence. The primary complements that are joining together to form what will be the second largest MVPD with a nationwide footprint are those of the distribution and programming assets of AT&T and DirecTV. The harms of this form of vertical integration are well-recognized by the Commission. As demonstrated below, these harms are as present in this merger as they were in the transactions that gave rise to DirecTV's ownership of its RSNs. ACA members who

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[32] Joe Flint, *DirecTV and AT&T Look to Take Over Houston Sports Channel*, LA TIMES (Aug. 8, 2014) *available at* http://www.latimes.com/entertainment/envelope/cotown/la-et-ct-comcast-houston-directv-att-20140808-story.html.

[33] Public Interest Statement at 16.

[34] *Id.*

[35] *Id.*at 18.

purchase RSNs from the new AT&T will be directly and adversely affected by the merger in the form of higher affiliation fees, which will be passed on in various ways to consumers.

B. The Commission has Routinely Found that an MVPD Owning "Must Have" Programming has an Incentive and Ability to Raise its Rivals' Programming Costs.

The Commission has long recognized that vertical integration between MVPDs and programmers can result in competitive and consumer.[36] Beginning with its analysis of the merger of News Corp. and DirecTV, and continuing through its analysis of the Comcast-Time Warner Cable-Adelphia and Liberty Media-DirecTV transactions, the Commission has consistently recognized that transactions uniting video programming and video distribution assets give the vertically integrated MVPD an incentive and ability to extract higher prices from rival MVPDs than the programmer would seek absent the vertical integration.[37]

Most recently, the Commission came to a similar conclusion in the *Comcast-NBCU Order*, observing that the combination of Comcast distribution and programming assets and NBCU programming assets gave Comcast an incentive and ability to charge competing MVPDs higher prices for its programming. There, the Commission was concerned both that Comcast would withhold programming from other distributors and that it would raise the prices for such programming, finding, with respect to the latter form of harm that:

> Comcast-NBCU will negotiate more aggressively relative to the pre-transaction NBCU when selling NBCU content to Comcast's video distribution rivals. Unlike the pre-transaction NBCU, the integrated firm will take into account the possibility that any harm from failure or delay in reaching agreement would be offset to some extent by a benefit to Comcast, as reaching a higher price would raise the costs of Comcast's rivals. As a result, the transaction will improve Comcast-NBCU's bargaining position, leading to an increase in programming costs for Comcast's video distribution rivals.[38]

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[36] News Corp.-Hughes Order, ¶ 71.

[37] News Corp.-Hughes Order, ¶¶ 4, 80, 159; Adelphia Order, ¶¶ 115-121; Liberty Media-DirecTV Order, ¶ 65.

[38] Comcast-NBCU Order, ¶ 37.

In analyzing the competitive vertical harms of the combination of Comcast and NBCU, the Commission relied on a bargaining model framework.[39] This framework computes the opportunity cost that an MVPD incurs by selling affiliated programming to a rival MVPD, and takes account of the probability that a given consumer will leave the rival provider if the programming is withheld and will go to the vertically integrated MVPD to regain access to it. In such cases, the vertically integrated MVPD will profit from the gain of a subscriber at the expense of the rival MVPD. As Professor Biglaiser explains, following the Nash Bargaining Solution, "each dollar increase in the opportunity cost would result in a 50-cent increase in the cost of programming. That is, the vertically integrated MVPD would capture one half the gains from the increase in opportunity cost when negotiating with a rival MVPD."[40] A higher opportunity cost for providing programming to a rival therefore gives an incentive to the vertically integrated MVPD to raise its price for that programming.

C. DirecTV Already has a Strong Existing Incentive and Ability to Charge Higher Programming Prices to its Rivals for its RSNs.

DirecTV is already a vertically integrated MVPD. As Professor Biglaiser demonstrates, using the same bargaining framework the Commission adopted in the *Comcast-NBCU Order*, DirecTV has an existing incentive and ability to charge rivals higher prices for its RSN programming.[41] The existing harm of DirecTV's vertical integration is significant:

> First, the programming assets affiliated with DirecTV are regional sports networks that are considered "must have" programming. This means that consumers are more likely to leave a rival if the programming is unavailable compared to other programming. Second, DirecTV's profit's per subscriber is among the best in the business. I have reviewed data from respected Wall Street analyst, Craig Moffett, MoffettNathanson Research, that showed the estimated video gross profit dollars per subscriber for DirecTV is $55, which is significantly higher than the average video gross profits of other vertically integrated operators, like Comcast, which according to Moffett are estimated to be about $37 per subscriber. Third, DirecTV has a nationwide footprint, which

[39] Comcast-NBCU Order, ¶ 46 & Appendix B, Technical Appendix, Section I.B.

[40] Biglaiser at 8.

[41] *Id.* at 8; Comcast-NBCU Order, Appendix B.

> means it competes in these markets for all households in the markets of its regional sports networks with all other MVPDs in these markets. This means that all MVPDs in the market are potentially harmed by DirecTV's vertical integration.[42]

For these reasons, Professor Biglaiser concludes that "competition and consumers are already significantly harmed by the existing vertical integration of DirecTV and the three RSNs."[43]

For more than a decade, DirecTV's RSNs were subject to conditions that only recently expired under the terms of the Commission's *Liberty Media-DirecTV Order*. The competitive harm identified by the Commission, similar to that which underlay the program access rules, was that, "post-transaction, Liberty Media and John Malone would have the incentive to unduly influence the decisions of attributable programming networks to improve DirecTV's competitive position.[44] To alleviate the harms arising from DirecTV's increased incentive and ability, post transaction, to temporarily foreclose access by its competitors to its RSNs, the Commission extended application of the arbitration remedy to Liberty Media and DirecTV that it had previously imposed on News Corp when it acquired DirecTV.[45] The only reason the conditions no longer apply to DirecTV is because they have expired by their terms. Significantly, when the conditions expired earlier this year, the Commission performed no formal evaluation of whether or not DirecTV still had the same incentives and abilities to charge higher prices for its programming to rivals as it had when they were first imposed. However, it is clear that DirecTV has the same incentives and abilities now as when the programming first became affiliated with

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[42] Biglaiser at 8-9.

[43] *Id.*at 9.

[44] Liberty Media-DirecTV Order, ¶ 79.

[45] Liberty Media-DIRECTV Order, ¶ 88. In addition, the Commission imposed a condition requiring Liberty Media and DirecTV to continue to comply with the restrictions embodied in the program access rules in the event the RSNs are no longer subject to the rules. Liberty Media's programming was at the time subject to the program access rules due to John Malone's common interests in Liberty Media and cable operator LCPR, a condition which the Commission understood could change at any time. *Id.* at n. 264.

DirecTV. AT&T, by acquiring DirecTV, will inherit the same incentives and abilities to raise rivals' costs.

D. The Proposed AT&T-DirecTV Merger Will Increase the Vertical Harms of DirecTV's Ownership of Must-Have Programming Assets.

In his economic analysis, Professor Biglaiser outlines how he determines the incremental harm of the AT&T-DirecTV transaction. He notes that not all of the inputs used in the bargaining model for calculating the merged entity's opportunity cost in selling its programming to rivals change a result of the merger.[46] Professor Biglaiser then explains that the key input for determining whether the AT&T-DirecTV merger will result in increased vertical harm is whether the merged entity's profits per video subscriber will be larger as a result of the deal. As Professor Biglaiser explains, in the Root Sports RSN regions where, "the merged entity's RSN programming [is offered, but] where AT&T U-verse is not available, the incremental harm will be based on the increase in DirecTV's video profits per subscriber."[47] The same will apply to the region where AT&T/DIRECTV will own and operate its Houston RSN. "[W]here AT&T U-verse is available, the incremental harm will be based on the increase in the profitability of a subscriber that can choose to subscribe to either AT&T or DirecTV."[48]

Professor Biglaiser further explicates how the opportunity cost increases in two ways. "One is due to the alleged efficiencies of the merger. The other is from the increased bargaining power in buying programming when AT&T and DirecTV bargain as one entity."[49] He concludes that "[t]he higher opportunity costs for selling its programming to rivals will result in AT&T charging higher rates for this programming than DirecTV charged before the deal."[50]

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[46] Biglaiser at 9-10.

[47] *Id.* at 10

[48] *Id.* at 9-10.

[49] *Id.* at 6.

[50] *Id.*

Accordingly, the existing vertical harm of DirecTV owning the Root Sports RSNs will grow larger because the merged entity will have even greater opportunity costs when selling its programming to rivals. In this way, the current deal makes the existing vertical harms "even worse."[51]

1. The Efficiencies Resulting from the Merger Will Lead to Increased Costs for Rivals and Consumers.

As discussed, using the bargaining framework employed by the Commission in its analysis of the harms of the Comcast-NBCU transaction, if the merged entities' profits per video subscriber is higher under common control than as separate entities in the markets where its programming is made available, then the opportunity cost that the merged firm incurs by selling its programming to rival MVPDs will rise as well. As Professor Biglaiser shows the merger will increase the merged entities' video subscriber profits from new business savings and sales opportunities AT&T realizes through greater efficiencies.

In their public interest statement, the parties list a number of efficiencies that will result from this transaction. AT&T points to the ability to integrate AT&T and DIRECTV's billing, and combine each company's expertise and technological capabilities which should include eliminating redundancies in the employee base, particularly among DirecTV's executives and middle managers lowering the cost for AT&T to offer DIRECTV services.[52] The merged entity will also save costs and increase benefits from increasing each of the separate company's access to additional marketing and sales channels.[53]

The merger will also allow the merged entity to combine services that will reduce costs and also attract new customers. For example, the company could bundle the services of

[51] *Id.*at 9.

[52] Public Interest Statement at 29-32, 37-39, Declaration of Michael L. Katz, ¶¶ 104-5 ("Katz Declaration"); Biglaiser at 12.

[53] Biglaiser at 11-12.

DirecTV with AT&T wireless services, and find new ways to integrate the services to save costs and increase sales.[54] A DirecTV set-top box with a built in AT&T LTE network connection would permit DirecTV to better interact with their customers and offer better services.[55] By bundling services together, customers will also appreciate the additional convenience and cost savings in one-stop-shop installations. Reducing installation visitation will save customers money, and will reduce the company's marginal cost of adding subscribers.

The bundling of services will create the most efficiencies in the markets where AT&T offers voice and broadband Internet services, such as in the Comcast SportsNet Houston market. For instance, the merged entity can create significant savings from combined installation.[56] By bundling their services – which they stress consumers are likely to favor – the combined AT&T-DirecTV will increase its profits on the separate components of their services.[57] Even though AT&T might not currently provide broadband and telephone service in the markets of DIRECTV's regional sports networks, the company has committed to deploying fixed wireless broadband services in areas outside of its current AT&T footprint. To the extent that greater deployment of fixed wireless broadband services is made possible by the merger, and such services are offered in the markets of DirecTV's regional sports networks, the company can better retain customers and potentially increase the profitability of its DirecTV service.

Professor Biglaiser also observes:

> The efficiencies from the merger need not only occur in the markets of the RSNs to increase the profitability per subscriber in those markets. Given that DirecTV is generally considered a fixed cost business, to the extent the AT&T-DirecTV merger results in DirecTV having more subscribers than it would have absent the merger, these additional subscribers will lower the overall cost of doing business across the country, and increase the profitability per subscriber for all

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[54] DirecTV's video service presently requires a phone line or broadband connection to download content to the customer's set top box. *See id.*at 12.

[55] *Id.* at 12-13.

[56] *Id.* at 13.

[57] *Id.*

subscribers.[58]

Continuing, Professor Biglaiser explains that if even only some of these efficiencies come to pass, AT&T will be able to lower its costs of doing business around the country. Consequently, that will raise the opportunity cost of supplying programming to rival MVPDs, and will likely lead to increased prices for consumers.[59]

2. AT&T's Increased Bargaining Power Will Harm MVPD Competitors and their Subscribers.

The new AT&T will have approximately 26 million subscribers. This is an enormous increase from its current 6 million subscriber base. Post-transaction, AT&T's substantial market size will allow the company to demand even lower programming prices from content providers, a fact attested to by AT&T in the Public Interest Statement.[60] In fact, the merged entity with 26 million subscribers will be able to command better prices than DIRECTV can commend with only 20 million. Professor Biglaiser explains that AT&T's ability to obtain lower prices for programming from other content providers will reduce its overall business expenses, and thus increase its profitability per video subscriber. As the merged company profits more per subscriber, its opportunity cost for selling its own vertically integrated programming will increase, as will its incentive to charge higher programming fees to rival MVPDs.[61] These higher programming fees will inevitably be borne by subscribers.[62]

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[58] *Id.*

[59] *Id.* at 13-14.

[60] *See*, *e.g.*, Public Interest Statement at 35-36 (describing how "rapidly increasing content costs have a disproportionate effect on providers with smaller subscriber bases, including AT&T" and how the transaction will create a combined entity with a much larger subscriber base than AT&T has now, permitting AT&T to reduce its per-subscriber programming costs over a period of years "by at least 20 percent").

[61] Biglaiser at 14.

[62] *Id.* at 14-15.

Professor Biglaiser and the Applicants' economic expert, Professor Michael Katz, both confirm that in the video industry programmers traditionally give larger distributors better prices by offering volume discounts based on the number of subscribers an MVPD serves.[63] Professor Katz specifically identifies two broad mechanisms through which a merger enables the parties to secure lower content fees: (i) the benefits of increased exposure and greater advertising revenue received from selling to a larger MVPD, and (ii) to the extent the disagreement point is more than proportionally worse for a content owner bargaining with a larger buyer, the resulting license fees will be lower.[64] The simple fact is that in the MVPD market today, "larger MVPDs pay much lower prices than smaller MVPDs."[65]

After the merger, the combined AT&T-DirecTV will have approximately 26 million video subscribers, giving it close to 30 percent of MVPD subscribers across the country. AT&T repeatedly notes in the Public Interest Statement that the "challenging economics of AT&T's MVPD service" for content acquisition are a result of its lack of scale (only serving about 6 million subscribers) is a key driver of the merger that give it close to 26 million subscribers and hence, bigger volume discounts from programmers.[66] The 30 percent market share threshold is the share the Commission once demarcated as the maximum MVPD market share, out of concern that undue concentration in the distribution market would adversely impact the ability of

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[63] *Id.* at 14; *see also* Public Interest Statement, Katz Declaration, ¶ 114. "In his testimony, Professor Katz agrees the merged entity will likely receive better programming rates due to its size than either the old AT&T or the old DirecTV…I agree with Professor Katz that despite the theoretical possibility, there's no evidence in the MVPD market today that buyers with more bargaining power pay *higher* programming prices for programming than those that are smaller. Instead, the fact is that larger MVPDs pay much lower prices than smaller MVPDs." *See* Biglaiser at 14-15.

[64] Biglaiser at 14, *citing* Katz Declaration, ¶¶ 112-113.

[65] *Id.* at 15, *citing* Katz Declaration, ¶ 114; Tasneem Chipty and Christopher Snyder, *The Role of Firm Size in Bilateral Bargaining: A Study of the Cable Television Industry*, REVIEW OF ECONOMICS AND STATISTICS (1999).

[66] *See*, *e.g.*, Public Interest Statement at 3, 21, 25.

programmers to fairly obtain and be compensated for carriage.[67] By growing to 26 million video subscribers, AT&T-DirecTV will have more video subscribers than Comcast has today and could demand at least as good prices as Comcast currently receives who is widely believed to receive the best programming prices among all MVPDs.

In addition to increasing their video profits per subscriber as a result of obtaining lower programming fees due to their increased subscriber volume, the combination of AT&T and DIRECTV's subscribers creates other harms. Operators of small cable systems explain that in their experience when larger MVPDs demand lower programming prices, they are saddled with the differential increase in their programming rates.[68] Accordingly small cable operators believe that after the merger, when programmers do not receive what they expect from AT&T-DirecTV, they will make it up by charging higher prices to those smaller providers who lack the bargaining leverage to resist.[69]

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[67] *In the Matter of Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal Ownership Limits,* Third Report and Order, 14 FCC Rcd 19098 (1999) *reversed and remanded by Time Warner Entertainment Co., LP. v. FCC, et al.*, 240 F.3d 1126 (D.C. Cir. 2001). The FCC issued a Further Notice of Proposed Rulemaking in 2001 and a Second Further Notice in 2005, soliciting evidence on industry changes affecting the implementation of horizontal and vertical limits. *See The Commission's Cable Horizontal and Vertical Ownership Limits*, Second Further Notice of Proposed Rulemaking, 20 FCC Rcd 9374 (2005); *In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992; Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996; The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules; Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests; Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry; Reexamination of the Commission's Cross-Interest Policy*, Further Notice of Proposed Rulemaking, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, (rel. Sept. 21, 2001). The Commission reasoned that this cap would reduce the possibility that if any one MVPD refused to buy an entity's video programming, there would remain enough MVPDs in the market to which a programmer could sell its content and still be able to cover its costs. This rulemaking to reinstate a cable horizontal ownership limit remains pending.

[68] Biglaiser at 15.

[69] *Id.* at 16; *Applications of Comcast Corp., Time Warner Cable, Inc., Charter Communications, Inc. and SpinCo*, MB Docket No. 14-57, Comments of the American Cable Association, Exhibit B, Declaration of Rich Fickle, ¶ 7 (filed Aug. 26, 2014) ("Fickle Declaration"). It is telling that an MVPD with 6 million subscribers finds the marketplace "challenging." For ACA members, who have a median subscriber count of 1060, the environment can be overwhelming, even when they are purchasing most of their cable programming through the NCTC. *See Protecting and Promoting the Open Internet, Framework for Broadband Internet Service*, GN Docket Nos. 14-28, 10-127, Comments of the American Cable

Professor Biglaiser explains this assertion from an economic perspective:

> [W]hen publicly held programming firms address market analysts they often promise to achieve a given rate of return in order to convince the analysts to recommend to their clients that they buy the programmer's stock. . . If the programmer does not meet Wall Street's expectations, it could lead to a drop in the programmer's stock. It is much more difficult for a programmer to try negotiate a substantial price increase from a large MVPD than a smaller MVPD, because the large MVPD is seen as being a "must have" program distributor, whereas a programmer would not be hurt as much if a smaller MVPD did not carry its programs. Accordingly, if the programmer must give the new AT&T a lower price in return for carriage of its programming, then it will be inclined to turn to other buyers, particularly those with less bargaining leverage – the smaller MVPDs.[70]

In short, the largest operators will have gotten larger relative to the collective ACA's membership, which will undoubtedly result in a corresponding competitive harm to its members.

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The efficiencies of the merger arising from cost savings and business opportunities, including the lower programming prices the combined entity will be able to command, will increase its opportunity costs in selling the RSNs to rival MVPDs, and that, in turn, will increase AT&T-DirecTV's incentive and ability to charge higher prices to its rivals. The higher prices that rival MVPDs will pay will cascade down to consumers, who will absorb these costs, either in whole or in part, through higher subscription television prices. This public interest harm is not outweighed by any corresponding public interest benefit alleged by the applicants, and must be remedied by the Commission through conditions if the application is to be approved.

Association, Exhibit B, Research and Analysis by Cartesian, *Connecting Hometown America, How the Small Operators of ACA are Having a Big Impact*, at 3 (filed July 17, 2014).

[70] Biglaiser at 16.

IV. THE ARBITRATION REMEDY THE COMMISSION HAS USED TO AMELIORATE COMPETITIVE HARMS FROM OTHER TRANSACTIONS IS INADEQUATE TO PROTECT SMALLER MVPDs FROM THE HARMS OF THIS TRANSACTION

A. The Commission Created an Arbitration Remedy in Recognition of the Fact that its Rules Are Otherwise Insufficient to Protect Against Certain Merger-Specific Harms.

The Commission has long recognized that its program access rules, even in combination with voluntary commitments by merging parties, are inadequate to ameliorate the harms of transactions between programming suppliers and distributors.[71] In the *Liberty Media-DirecTV Order*, the Commission conditioned its approval of the companies' license transfer on DirecTV's ongoing compliance with the "final offer" or "baseball style" arbitration carriage dispute process.[72] In its most recent iteration in *Comcast-NBCU*, the Commission once again imposed remedial conditions that employed a "baseball-style" arbitration process for programming disputes with Comcast, including those involving retransmission consent, with modifications to attempt to make the remedy usable by smaller MVPDs.

In baseball-style arbitration, an aggrieved MVPD can initiate the process. Both the MVPD and the programmer are required to submit "final offers" at the outset to the arbitrator that each side believes reflects the fair market value of the programming at issue.[73] The

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[71] *See*, *e.g.*, News Corp.-Hughes Order, ¶¶ 84-87, 169 (finding that a strategy of uniform price increases for video programming would not necessarily violate the program access rules and agreeing "with commenters that both the program access rules and the Applicants' proposed program access commitment are insufficient to protect against harms arising from News Corp.'s enhanced incentive and ability to use its market power in the market for regional sports programming to the detriment of consumers."); Comcast-NBCU Order, ¶ 49 (finding program access rules insufficient to remedy the potential harm of Comcast's increased incentive and ability to uniformly raise its rivals' fees).

[72] Liberty Media-DirecTV Order, ¶ 88, 95-99; Appendix B, Conditions, Section IV, Additional Conditions Concerning Access to Regional Sports Networks (extending arbitration condition imposed in the 2004 News Corp-Hughes Order).

[73] The aggrieved MVPD is required to submit its final offer no later than the end of the 15th business day following its formal filing. Comcast is required to file its final offer within two business days of being notified that a formal demand for arbitration has been filed. *See* Comcast-NBCU Order, Appendix A, ¶¶ 7, 10.

arbitrator then chooses the final offer that most closely approximates the fair market value of the programming at issue. To determine fair market value, the arbitrator may consider any relevant evidence, including current or previous contracts between MVPDs and broadcast stations, national networks, or RSNs. Each party is also required to submit all other evidence that it intends to rely on in the arbitration.

Recognizing that small and mid-sized MVPDs could be at a particular risk, the Commission instituted one-way fee shifting in an attempt to make the arbitration remedy work for smaller MVPDs. Under the one-way fee shifting provisions, if an MVPD with 600,000 or fewer subscribers is the prevailing party in the arbitration, it is entitled to recover its legal fees and the costs of arbitration. Additionally, if the small MVPD loses, it is not required to reimburse Comcast's corresponding fees and costs.

Although ACA is deeply appreciative of the Commission's attempt to make the arbitration remedy useable for smaller MVPDs, the result can at best be described as an incomplete success. Unfortunately, in practice the *Comcast-NBCU* remedial conditions did not create a feasible remedy for smaller MVPDs, leaving them unprotected from the recognized harms posed by the merger. These MVPDs will be at an even greater risk if the proposed transaction that will vastly expand AT&T's distribution footprint and programming heft is consummated.

The experience of ACA members before and after the Comcast-NBCU transaction has demonstrated the inadequacies of the Commission's baseball-style arbitration condition to address the harm from that transaction. In particular, the baseball-style arbitration provisions adopted in the Comcast-NBCU transaction are of no utility to smaller MVPDs because of the uncertainty and information imbalance in the arbitration process and the high fixed costs of arbitration, among other factors. Indeed, even when acting collectively through their buying group, the National Cable and Television Cooperative ("NCTC"), smaller MVPDs were not adequately protected by the arbitral process.

B. Uncertainties in Preparing a Final Offer in Advance of Discovery Put Smaller MVPDS at Particular Risk in Initiating the Arbitration Process.

A number of uncertainties in knowing when above-market rates are being charged, and preparing a final offer in accordance with the baseball-style arbitration process put small MVPDs at a competitive disadvantage when faced with an impasse in negotiations. These uncertainties amplify the likelihood that a vertically integrated programmer can act on its incentive to charge its smaller rivals higher prices, and increase a small MVPD's hesitation to enter into the arbitration process.

First, small MVPDs lack the critical information necessary to know when a programmer integrated with an MVPD rival is acting on its incentive to charge it higher prices. Because of the widespread use of non-disclosure agreements, smaller MVPDs only have access to the prices and terms of their own agreements. As a result, they do not have precise information to easily identify when they are being treated fairly or not. The remedies adopted in previous mergers to address the expected vertical harms of mergers depend on the purchaser of the programming knowing or even sensing that they are being treated unfairly. Only if the buyer of the programming knows that he or she is being treated in an anticompetitive way, will the harms expected from the vertical integration be possibly mitigated. As is the case with smaller MVPDs, they often do not have the data and information to precisely know, and therefore vertically integrated programmers have enormous leeway to act on their incentives against the most vulnerable without impunity.

Even in instances, where a vertically integrated programmer is acting so egregiously that a smaller MVPD believes that they are being treated unfairly, these small MVPDs lack the critical information on the factors that an arbitrator would likely use to make its determination on a fair rate, leaving the MVPD unable to accurately and confidently estimate a fair rate at the start of the arbitration process. If a smaller MVPD does not believe it can accurately estimate a fair market value for the programming at issue, it will believe its chance of prevailing in arbitration is low, and will not consider arbitration to be a viable option even if the operator thinks it is being treated unfairly. For example, small MVPDs do not have information on the existing and previous prices DirecTV charges other similarly situated MVPDs for the disputed programming. Nor do these small MVPDs know what other programmers are charging for similar programming. These programming rates may also include a "small MVPD premium," which increases the rate a small MVPD pays above a larger MVPD, based on the fact that they have fewer subscribers. While small MVPDs are generally aware of this "small MVPD premium," they are unable to accurately determine the amount of this premium. Small MVPDs also do not have information on the costs of acquiring the content that comprises the programming at issue.

Lowering their perceived odds of winning even more is the fact that this is information that DirecTV already has. Therefore, when DirecTV is estimating a fair rate as part of an arbitration, it will be more equipped to predict a successful result with significantly greater certainty. In support of its Comments concerning the Comcast-Time Warner Cable-Charter transaction, ACA submitted the Declaration of Rich Fickle, Chief Executive Officer and President of the "NCTC", a buying group through which ACA member companies purchase their programming and related services. In his Declaration, Mr. Fickle explained his experiences in negotiating programming agreements and his evaluation of the value of the Comcast-NBCU arbitration remedy for smaller MVPDs.[74] Among the points he noted, was that although a

[74] Mr. Fickle explains that NCTC is a non-profit cooperative purchasing organization for its member companies that own and operate cable systems throughout the United States and its territories. NCTC currently has approximately 910 member companies serving millions of multichannel video programming distributor (MVPD) subscribers. Members range in size from the largest serving a few million to the smallest serving "tens of" subscribers, with a median size of fewer than 1,500 subscribers. Nearly all small and medium-sized MVPDs belong to the NCTC and most purchase substantially all of their national cable programming through the group. As a buying group, NCTC negotiates standardized master agreements with programmers and technology vendors, and acts as an interface between the vendor and

programmer such as Comcast or DirecTV, generally has evidence of the value of its programming, including internal studies or discussions of the imputed value of the programming, small MVPDs who do not also distribute programming have no way of estimating these internal costs.[75]

As Mr. Fickle recited, during NCTC's most recent renewal negotiations with Comcast at the end of 2012, NCTC considered utilizing the baseball-style arbitration condition the FCC imposed on Comcast when it acquired NBCU. NCTC had reason to believe that Comcast/NBCU was not offering it fair market rates, terms, and conditions. However, after careful consideration, NCTC decided that the arbitration condition was inadequate and ineffective, even with one-way fee, to address the unfair demands of Comcast/NBCU. Most significantly, NCTC did not have the ability to reasonably evaluate the likelihood of success in arbitration, "because [NCTC] lacked critical information on key factors that an arbitrator would likely use to make its determination of fair-market value. Without this information [NCTC] could not make an informed 'final offer.'"[76]

In each stage of the arbitration process, from awareness of being treated unfairly, to deciding to enter arbitration, to proposing a fair market value for the disputed programming, smaller MVPDs' information imbalance puts them at a distinct disadvantage in their ability to

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individual MVPDs so that the vendor can deal with a single entity for purposes of negotiating contracts, determining technical standards, billing for payments, collecting payments, and marketing. Fickle Declaration, ¶¶ 3-4.

[75] In describing NCTC's decision not to use the Comcast-NBCU arbitration remedy, Mr. Fickle stated that while NCTC lacked access to evidence concerning the value of the subject programming, "[a]t the same time, Comcast/NBCU had perfect information. Comcast/NBCU possessed information on the prices it currently and formerly charged other MVPDs for its programming. It also knew the prices it granted to larger MVPDs as opposed to smaller MVPDs, and what other programmers charged for similar programming, particularly with regard to broadcast stations due to the fact that Comcast operated as an MVPD in dozens of designated market areas. We knew with all of this information available to them, they would be able to more accurately calculate a fair market value and provide it as its "final offer." Moreover, an arbitrator would find the information that Comcast had highly probative, and would likely rely upon it in determining which of the parties' 'final offer' is closer to fair market value." *Id.*, ¶ 13.

[76] *Id.*, ¶¶ 11-12.

protect themselves from the harms of a vertical merger and utilize the arbitration conditions previously made available to them.

Additionally, differences in arbitrators, and a lack of public information on similar arbitration decisions, also add to the uncertainty. This makes it almost impossible for a small MVPD to learn about the baseball-style arbitration process, and to plan for the full time and effort of the process. ACA has anecdotal evidence of small MVPDs who have reported not understanding the general process or the steps required to go through the arbitration. These MVPDs admit that they underestimated the resources necessary to navigate the process and to predict a fair rate. Without access to similar arbitration decisions, the small MVPDs are often left without any basis for comparison.

C. Small MVPDs with Fewer Subscribers and Financial Resources are Risk Averse.

The lack of information about competitive programming costs makes many smaller MVPDs pessimistic about their chances of succeeding in arbitration. Moreover, from the perspective of a small MVPD with fewer subscribers and financial resources, the high fixed costs of the arbitration process are generally in excess of any potential benefits. Arbitration involves drafting and submitting an initial filing, as well as participating in multiple hearings and producing evidence of market rates. Each of these steps in the process requires assistance from attorneys and other consultants, including economists and data analysts, which adds to the costs. Even with one-way fee shifting, if the MVPD loses, these costs are not reimbursable. Additionally, the arbitration process, from start to finish, can take one year or longer to complete, and requires key personnel to take large amounts of time from their regular jobs, further adding to the costs.

The financial risk of arbitration for a buying group like the NCTC is not much better. As Mr. Fickle explains, his research revealed that, "the average cost of baseball-style arbitration is approximately $1 million. This represents a significant cost compared to both NCTC's annual operating budget, and our best guess at how much Comcast was charging us above the fair market value of the programming."[77] As the end result, taking into account the risks posed by uncertainties as to timeframes and the lack of critical information to make an "informed 'final offer,'" NCTC found the risks and costs of baseball-style arbitration would outweigh any potential benefits obtainable through a successful arbitration.[78]

When all of the costs of the arbitration process are added together, this amounts to a relatively large share of a small MVPD's revenues, especially as compared to the average number of subscribers. The costs of proceeding through the arbitration process are relatively fixed regardless of an MVPD's number of subscribers. However, the potential benefit arising from the arbitration – lower programming fees – is directly proportional to the number of subscribers. Therefore, the smaller the MVPD, the less attractive the cost of engaging in an arbitration proceeding. The Commission recognized this reality in the *Comcast-NBCU Order.*[79]

Additionally, the MVPD risks losing the arbitration and bearing the total costs of the arbitration and the added burden of higher programming costs. With this end result, the small MVPD has expended hundreds of thousands of dollars and endless hours to go through the arbitration, only to then pay higher rates for programming. Professor Biglaiser analyzes these risks and costs in the accompanying analysis.[80] These possibilities provide a risk-averse small MVPD the incentive to save the time and effort required to go through the process, and to accede to the pressure and demands of the programmer.

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[77] *Id.*, ¶ 14.

[78] *Id.*, ¶ 15.

[79] Comcast-NBCU Order, ¶ 58 ("Given the size of their subscriber bases and financial resources, small and medium-sized MVPDs may be less able to bear the costs of commercial arbitration than large MVPDs, thus rendering the remedy of less value to them.").

[80] Biglaiser at 19-23.

D. Smaller MVPDs are at Greater Risk of Retaliation by AT&T.

ACA believes the risk of retaliation is an additional reason that arbitration is an inadequate remedy for small and mid-size MVPDs. ACA has heard anecdotal evidence from MVPDs that programmers have an incentive to make up any expenses and any lost fees from an unsuccessful arbitration through future contract negotiations. Consequently, smaller MVPDs feel that using arbitration is a "zero sum game," especially when the next time they need to negotiate the arbitration conditions have expired, or are no longer available to them. In such a case, the lack of availability of arbitration for the next negotiation is a deterrent for using the arbitration in the first instance.

E. Other Factors Add to the Problems with Use of the Arbitration Remedy by Smaller MVPDs.

A number of other factors exacerbate problems with the arbitration remedy. Smaller MVPDs experience problems getting started in the process. When conditions are first introduced and there is no track record of arbitration results, small MVPDs are especially poorly informed and consequently skeptical of the process. The first few MVPDs who test the remedy bear especially high risks. This continues to be a problem with regard to the conditions adopted to mitigate the harms of the Comcast-NBCU transaction, which for many of the reasons addressed herein have never been utilized by any small MVPDs.

Additionally, a vertically integrated programmer subject to an arbitration provision, like AT&T, is likely to outspend its opponents in arbitration. AT&T may find it both rational and profit-maximizing to outspend its opponents in the arbitration process. The programmer will have a reputational incentive to expend significant effort in its earliest arbitrations to discourage other small MVPDs from undertaking subsequent arbitrations. Moreover, since a vertically integrated programmer like AT&T will be in multiple arbitrations and can reuse many aspects of its preparations in later arbitrations, it will likely be able to do more with the money it spends.

V. AT&T'S COMMITMENT TO EXPAND BROADBAND SERVICES OBVIATES THE NEED FOR IT TO RECEIVE HIGH-COST AND CONNECT AMERICA FUND SUPPORT IN CERTAIN AREAS

In the Public Interest Statement, AT&T makes two commitments to expand its provision of broadband services by some 15 million customer locations if the transaction is approved. First, it would deploy in its existing service territory within four years its U-verse broadband service to at least two million additional locations.[81] AT&T explains that most of these are high-cost locations in areas where it likely does not offer broadband service or offers only DSL services.[82] Second, it would deploy an LTE-based fixed wireless ("WLL") broadband product to approximately 13 million locations, which are largely underserved and about 85 percent of which are outside its service territory.[83] Thus, it appears that about four million higher-cost locations in AT&T's service territory will receive broadband service or improved broadband service under these two commitments.

ACA believes the two commitments may have significant value but only if AT&T is not receiving universal service support to serve the same locations[84]. Thus, the Commission should determine for any of these "commitment" locations whether AT&T is already receiving or is already eligible to receive universal service support, including existing high-cost legacy support, existing Connect America Fund (CAF") Phase I incremental support,[85] or in the future CAF

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[81] *See* Public Interest Statement at 41.

[82] *See id.* at Exhibit A, ¶ 39.

[83] *See id*. at 44; *see also* Public Interest Statement, Declaration of John T. Stankey Group President and Chief Strategy Officer AT&T Inc., ¶ 55 (AT&T claims "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 customer locations have only one terrestrial option today. In most instances, that single option is a DSL or relatively slow cable modem service.").

[84] With respect to AT&T's voluntary commitment, ACA encourages the Commission to attach a "serve-one-serve-all requirement" where AT&T must serve all locations in any census block where it elects to serve one.

[85] *See Over $255 Million of Connect America Funding Authorized to Connect Unserved Homes and Businesses in 41 States*, Public Notice, 28 FCC Rcd 7766 (2013); *Additional $16.7 Million in Connect America Phase I Support Authorized*, Public Notice, WC Docket No. 10-90, DA 14-353 (rel. Mar. 14,

Phase II support.[86] In any instances where there is an overlap between locations in areas where AT&T receives or could receive universal service support and "commitment" locations, following the policy approach adopted by the Commission in the *USF/ICC Transformation Order*, the Commission should not permit AT&T to access universal service funding. More specifically, AT&T should in the case of legacy support not receive any support in the future, in the case of Phase I support return any received support and not receive support in the future, and for Phase II not receive support in the future.[87]

To conduct the proper analysis to address the "double-counting" question, the Commission should undertake a two-step process. First, for purposes of CAF support,[88] it should examine and determine whether the broadband services in the commitments meet the broadband performance standards for Phase I support[89] or whether the broadband services in the commitments along with a voice service meets the more stringent standards for Phase II

2104). AT&T's BellSouth Telecommunications subsidiary received approximately $100 million in Phase I support.

[86] *See Wireline Competition Bureau Releases Connect America Cost Model Illustrative Results Using Higher Speed Benchmark*, Public Notice, WC Docket No. 10-90, DA 14-833, at 4 (rel. June 17, 2014) ("Illustrative Results"). AT&T is eligible to receive over $500 million annually to serve approximately 1.4 million locations.

[87] *See Connect America Fund et al*., 26 FCC Rcd 17663, ¶ 146 (2011) ("*USF/ICC Transformation Order*"). The Commission adopted this policy approach for the CAF Phase I process, where it concluded that "incremental support will not be sued to satisfy any merger commitment or similar regulatory obligation." ACA submits that the Commission should inquire further of AT&T as to why it could not provide at least the WLL service more extensively inside its service territory (85 percent of the locations are outside at that area) since it would be reasonable to assume that AT&T could provide such service more efficiently where it already has very extensive wireline and wireless infrastructure and operations. If the costs to provide the WLL service in-territory are equally or even more favorable than out of territory, the Commission should seek to expand the commitment. Depending upon the locations and whether the WLL service meets the CAF performance standards, this may result in a substantial reduction in CAF expenditures, and this support could then be used where it would be more needed.

[88] Both the GigaPower and WLL services should be presumed to meet high-cost legacy support requirements.

[89] *See Connect America Fund*, Report and Order, WC Docket No. 10-90, ¶ 25 (rel. May 22, 2013) ("a carrier must offer broadband service to such locations of at least 4 Mbps downstream and 1 Mbps upstream, with latency sufficiently low to enable the use of real-time communications…and with usage allowances, if any, associated with a specified price for a service offering that are reasonably comparable to comparable offerings in urban areas.").

support.[90] For the GigaPower service, which is relatively robust, the presumption should be that it meets both the Phase I and Phase II standards. For the WLL service, the presumption should be that it meets the standard for Phase I, since the Commission largely requires that the speed for the broadband service be at least 4/1 Mbps and AT&T claims that "even customers at the cell edge will experience speeds greater than 10 Mbps more than 90 percent of the time."[91] For Phase II, the question is more difficult because a fixed wireless service may not be as robust, although the Commission permits a Phase II provider to use any network technology so long as it meets the performance standards. ACA suggests the Commission inquire of AT&T to answer this question.

The second step is for the Commission to determine the specific census blocks for the locations AT&T plans to serve in the commitments. The Commission need to conduct this inquiry at the census block level since it does not have a mechanism enabling it to identify the amount of support on the basis of an individual location. The Commission can then determine whether there is an overlap between these "commitment" census blocks and those in areas where AT&T receives legacy support, has received and will receive Phase I support, and could receive Phase II support because the Commission has determined these areas are high-cost areas unserved by the requisite broadband and voice services. For these "overlap" census blocks, the Commission should not permit AT&T to receive universal service support to serve any locations in them.

In sum, ACA does not oppose AT&T's two broadband service commitments. In fact, they have the potential to bring more capable broadband service to more locations sooner than the universal service programs and without using government support. ACA only wants to

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[90] *See Connect America Fund*, Report and Order, WC Docket No. 10-90, ¶ 2 (rel. Oct. 31, 2013). In this decision, the Commission provides detailed requirements for latency, data usage, and broadband and voice service pricing.

[91] *See* Public Interest Statement at Exhibit A, ¶ 49.

ensure that any commitments accepted by the Commission serve the public interest by not "double-counting" the commitment and universal service support.

VI. CONCUSION

The Applicants propose a significant expansion of distribution combined with important regional sports programming assets. The proposed transaction will exacerbate the harms that already exist in DirecTV's current vertical integration. This will result in higher costs to consumers and reduced competition, especially with the smallest MVPDs. Without adequate remedies, consumers and competition will suffer. Should the Applicants be unable to develop and propose enforceable commitments to address the harms identified by ACA, the Commission must do so to protect competition and consumers.

Respectfully submitted,

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Exhibit A

The Harms of AT&T-DirecTV Merger

By Professor, Gary Biglaiser

The Harms of AT&T-DirecTV Merger*

Gary Biglaiser**

September 15, 2014

* Prepared for the American Cable Association.

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Table of Contents

I. Introduction

The proposed merger between AT&T and DirecTV will undermine competition in the multichannel video programming distributor (MVPD) market and harm consumers. The combination of AT&T and DirecTV's distribution and programming assets will result in MVPDs paying higher prices for the merged entity's programming than would be paid in absence of the merger. In this paper, I will demonstrate that the merged entity will have even greater opportunity costs when selling its programming to MVPDs than exist today, and by employing the bargaining framework adopted by the Federal Communications Commission (FCC) in its review of the Comcast-NBCU merger, show how these higher costs will result in higher programming fees for MVPDs.[1] These higher wholesale prices will cascade down to consumers. The increased opportunity cost will arise from both the alleged efficiencies that will be generated by the merger and the increased bargaining power that the new entity will have to purchase programming at lower cost than prior to the merger. I will also explain how the now-expired remedies previously imposed by the FCC to alleviate the harms due to DirecTV's ownership of "must have" programming assets were inadequate as adopted, and would now be even less able to ameliorate the vertical harm engendered by AT&T's acquisition of DirecTV.

My analysis is a follows. In Section II, I will describe the transaction, and the firms that will be affected by the proposed merger. Next, in Section III, I will present the framework that I will use to analyze the harms. The harms of the merger will be demonstrated in Section IV.

[1] *In the Matter of Applications of Comcast Corp., General Electric Co. and NBC Universal, Inc. for Consent to Assign Licenses and Transfer Control of Licensees, MB Docket No. 10-56*, Memorandum Opinion and Order, 26 FCC 4238, ¶ 46 & Appendix B, Technical Appendix, Section I.B. (2011) ("*Comcast-NBCU Order*").

Finally, I will argue that potential remedies for the harms must go beyond those previously employed by the FCC.

II. Description of Transactions

AT&T proposes to acquire DirecTV in its entirety, merging DirecTV into a wholly owned subsidiary of AT&T that, post-transaction, will retain the name "DirecTV." AT&T will therefore become the parent of DirecTV.

DirecTV is the second largest MVPD in the country, and makes its service available nationally via direct broadcast satellite (DBS). It has approximately 20 million subscribers. It also owns important programming assets. In particular, DirecTV owns or manages three regional sports networks (RSNs) that carry live game telecasts of professional sports teams: Root Sports Pittsburgh,[2] Root Sports Rocky Mountain (based in Denver),[3] and Seattle-based Roots Sports Northwest.[4]

AT&T, one of the largest corporations in the world, provides wireline video, broadband, and voice services in the United States. Along with Verizon, AT&T is also one of the two dominant national wireless carriers in the United States, providing mobile voice and broadband. Currently, AT&T is the fifth largest MVPD in the nation with approximately 5.7 million video subscribers for its IPTV U-verse service. AT&T does not provide video service in any of the regions served by DirecTV's RSNs. AT&T is also a large broadband provider with 11 million

[2] The Root Sports Pittsburgh network broadcasts games of the Pittsburgh Pirates and Penguins and college sports from the Big East, Northeast and Atlantic Coast conferences.
[3] The Root Sports Rocky Mountain network broadcasts the Colorado Rockies and Utah Jazz professional teams and college sports including the Big Sky, Big 12, Western Athletic and Mountain West Conferences.
[4] Root Sports Northwest broadcasts such professional sports as the Seattle Mariners, Supersonics and Sounders and the Utah Jazz, and they also broadcast major college sports from the Pac-12, Mountain West, Western Athletic, and West Coast Conferences.

subscribers offered through its wireline U-verse service. As part of its public interest statement, AT&T has stated that the company plans to increase both its U-verse broadband and video distribution footprints.

Since filing its license transfer application with the Commission, AT&T and DirecTV have announced they are in the process of jointly purchasing a Houston RSN, Comcast SportsNet Houston, from Comcast. The network carries live games from the region's professional sports teams.[5] Once the deal is consummated, AT&T will own 40% and DirecTV will own 60% of the Houston RSN. AT&T operates in the region where Comcast SportsNet Houston is made available.

The subscription television marketplace includes nearly a dozen large MVPDs, and more than 900 small and medium-sized cable operators. In addition to DirecTV and AT&T, the largest MVPDs include Comcast, DISH, Time Warner Cable, Verizon, Charter, Cox, Cablevision, Bright House Networks, and Suddenlink. All of these large MVPDs compete against DirecTV, and most also compete with AT&T in one or more areas. The large MVPDs who operate in the service areas of the DirecTV Root Sports RSNs and/or the Comcast SportsNet Houston generally purchase this programming.

The American Cable Association (ACA) represents the vast majority of the nation's small and medium-sized cable operators. It has more than 840 members that provide video programming to approximately 7 million subscribers. All ACA members compete with DirecTV, and some compete against AT&T U-verse. Of these members, many purchase

[5] Comcast SportsNet broadcasts professional games of the Houston Rockets, Astros, and Dynamo.

regional sports programming from one of DirecTV's Root Sports Networks. Specifically, ACA is aware of 42 members who purchase Root Sports Pittsburgh, 35 members who purchase Root Sports Rocky Mountain, and 44 members who purchase Root Sports Northwest. Furthermore, ACA is aware of 5 members who purchase Comcast SportsNet Houston. For the Root Sports RSNs and the Comcast SportsNet Houston RSN each ACA member negotiates, respectively, directly with either DirecTV or Comcast.

III. Framework to Analyze the Harms of the AT&T-DirecTV Merger

I will demonstrate that the merger of AT&T and DirecTV will lead to higher costs for MVPDs buying this RSN programming and that some, and likely most, of these costs will be passed onto the subscribers of these members.

A. Framework to Analyze the Harms of the AT&T-DirecTV Merger

As the Commission found in its Comcast-NBCU merger review, the combination of MVPD distribution assets and "must have" programming assets gives a vertically integrated firm an incentive and ability to charge rival MVPDs higher prices for its programming. As a result of the AT&T-DirecTV transaction, the existing vertical harm of DirecTV owning the Root Sports RSNs will grow larger because the merged entity will have even greater opportunity costs when selling its programming to rivals. The higher opportunity costs for selling its programming to rivals will result in AT&T charging higher rates for this programming than DirecTV charged before the deal. There are two ways in which the merged entity's opportunity cost increases. One is due to the alleged efficiencies of the merger. The other is from the increased bargaining power in buying programming when AT&T and DirecTV bargain as one entity. Both of these lead to higher profit margins for the merged entity, and thus a higher opportunity cost of selling programming to rival MVPDs.

I begin by describing the bargaining model framework adopted by the Commission that calculates the increased opportunity cost that a vertically integrated MVPD has in selling its programming to rivals MVPDs.

B. Bargaining Framework to Analyze Vertical Harms.

In analyzing the competitive vertical harms of the combination of Comcast and NBCU, the Commission relied on a bargaining model framework.[6] The framework computes the opportunity cost that an MVPD incurs by selling affiliated programming to a rival MVPD. A higher opportunity cost for providing programming to a rival gives an incentive to the vertically integrated MVPD to raise its price for that programming.

The opportunity cost for an MVPD to sell its programming assets to a rival MVPD, C, is equal to

$$C = \alpha d \pi$$

In this formula, the vertically integrated MVPD's monthly profit if it attracts the consumer away from a rival MVPD is π. The probability that a given consumer leaves the rival provider, d, is referred to as the diversion rate. The share of subscribers that leave the rival MVPD due to a withdrawal of that programming that will go to the vertically integrated MVPD, instead of another rival MVPD provider, is α.

In the bargaining framework used to analyze the Comcast-NBCU transaction, the FCC assumed that the profit derived from obtaining a customer from a rival did not depend on which rival it came from, and the diversion rate did not change due to the merger. It is also assumed,

[6] Comcast-NBCU Order, ¶ 46 & Appendix B, Technical Appendix, Section I.B.

following the Nash Bargaining Solution, that each dollar increase in the opportunity cost would result in a 50-cent increase in the cost of programming.[7] That is, the vertically integrated MVPD would capture one half the gains from the increase in opportunity cost when negotiating with a rival MVPD.

C. Evaluation of Existing Vertical Harms Due to DirecTV's Vertical Integration

Before determining the incremental harm of the AT&T/DirecTV merger, I note that DirecTV is vertically integrated today. For more than a decade its RSNs were subject to conditions imposed by the FCC to mitigate these harms, and the company was only recently relieved of these conditions under the terms of the Commission's *Liberty Media-DirecTV Order*.[8]

The only reason the conditions no longer apply to DirecTV is because they have expired by their terms. When the conditions expired the FCC performed no formal evaluation of whether or not DirecTV still had the same incentives and abilities to charge higher prices for its programming to rivals as it had when they were first imposed. However, based on the bargaining framework that the Commission adopted in the *Comcast-NBCU Order*, it is clear that DirecTV has the same incentives and abilities now as when the programming first became affiliated with DirecTV. These harms are significant for a number of reasons. First, the programming assets affiliated with DirecTV are regional sports networks that are considered "must have" programming. This means that consumers are more likely to leave a rival if the

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[7] *Comcast-NBCU* Order at ¶ 46; Appendix B, Technical Appendix, Section I.B. (2011).

[8] *News Corp. and DIRECTV Group, Inc. and Liberty Media Corp. for Authority to Transfer Control*, 23 FCC Rcd 3265, ¶ 88 (2008) ("*Liberty Media-DIRECTV Order*"). Additionally, conditions in this Order subjected DirecTV to the program access rules with respect to all its affiliated non-regional sports and national programming assets. The program access rules are otherwise applicable only to cable operators and cable-affiliated programmers. Id. at ¶¶ 77-83.

programming is unavailable compared to other programming. Second, DirecTV's profit's per subscriber is among the best in the business. I have reviewed data from respected Wall Street analyst, Craig Moffett, MoffettNathanson Research, that showed the estimated video gross profit dollars per subscriber for DirecTV is $55, which is significantly higher than the average video gross profits of other vertically integrated operators, like Comcast, which according to Moffett are estimated to be about $37 per subscriber. Third, DirecTV has a nationwide footprint, which means it competes in these markets for all households in the markets of its regional sports networks with all other MVPDs in these markets. This means that all MVPDs in the market are potentially harmed by DirecTV's vertical integration.

For all of these reasons, competition and consumers are already significantly harmed by the existing vertical integration of DirecTV and the three RSNs. However, the current deal makes these harms even worse.

D. Determination of Incremental Harm Due to the Merger

To determine the incremental harm to rival MVPDs and their subscribers from AT&T's ownership of the Root Sports RSN programming and Comcast SportsNet Houston, I have simplified the bargaining framework used by the Commission.

Since AT&T's acquisition of DirecTV and its programming assets will not itself alter the content of DirecTV's RSN programming, in calculating incremental harm due to the transaction, I can assume the diversion rate, d, does not change as a result of the deal. Moreover, since AT&T does not provide video service in the markets where the DirecTV RSNs are available, I can also assume that α, the share of subscribers that would become DirecTV customers if these RSNs are withheld from DirecTV's rivals, will not change as a result of the deal. Furthermore, even though AT&T does provide U-verse service in the market of the Comcast SportsNet Houston, due to the fact that AT&T and DirecTV will each have an ownership stake in this RSN prior to the Commission approving their transaction, I can also assume that α does not change in this market either.[9]

The incremental harm due to the merger will therefore be based only on the increased profits, π, that the merged entity will be able to make from a rival's subscriber. In the regions of the merged entity's RSN programming, where AT&T U-verse is not available, the incremental harm will be based on the increase in DirecTV's video profits per subscriber. In the regions where AT&T U-verse is available, the incremental harm will be based on the increase in the profitability of a subscriber that can choose to subscribe to either AT&T or DirecTV.[10] Thus, the incremental increase in harm by the merged entity selling the Root Sports and Comcast SportsNet Houston programming to a rival MVPD is

$$H = (\pi_M - \pi_N) dN\alpha\, /2 \qquad (1)$$[11]

This harm has several aspects. The monthly profit per subscriber before the merger is π_N while the profit per subscriber after the merger is π_M. The number of subscribers that a rival

[9] Since AT&T will own 40% and DirecTV 60% of Comcast SportsNet Houston, the RSN would be expected to choose the optimal prices and bargaining positions as if the RSN was owned by a single entity resembling AT&T/DirecTV. My reasoning for this assumption is that even before the merger, the RSN would act optimally to maximize the joint profits of both AT&T and DirecTV when negotiating with a rival MVPD. The two firms would then be expected to use transfers between themselves to divide the maximum profit from selling the programming. This would be particularly natural for AT&T and DirecTV before the merger due to their existing relationships, such as their joint marketing agreement.

[10] As discussed in footnote 9, Comcast SportsNet Houston will negotiate with rivals of AT&T and DirecTV where both services are made available per-merger as if AT&T and DirecTV were merged. Thus, one need only focus on the increased profitability of a subscriber that has a choice of subscribing to either AT&T U-verse or DirecTV, and to the extent that both AT&T U-verse and DirecTV's video profits per subscriber increases, then treating them together would increase as well.

[11] To calculate the aggregate harm in all areas where the merged entity's RSNs are offered,, one would use different inputs for areas where DirecTV is only available and areas where DirecTV and AT&T are available.

MVPD has is N. The diversion rate is d. The 2 represents half of the increased opportunity cost that will be passed on as a higher cost to the MVPD. The α represents the proportion of subscribers that leave a rival MVPD that go to AT&T.

IV. The Harms

In this section, I discuss how the alleged efficiencies that AT&T claims for the merger will increase the merged entity's profits per video subscriber, thus raising its opportunity cost of providing programming to rival MVPDs. Next, I discuss how the increased bargaining power that the new AT&T will have with programmers will also increase its profits per video subscriber and raise the opportunity cost of supplying programming to rival MVPDs.

A. Higher Profits Per Subscriber Due to Alleged Efficiencies

AT&T spends a great deal of effort describing the potential efficiencies of the merger in its Description of Transaction, Public Interest Showing, and Related Demonstrations. These efficiencies come from opportunities to either reduce costs, increase sales, or both.

For example, AT&T-DirecTV's economic expert, Professor Katz, identifies the opportunity to offer better service at lower costs as a reason for the merger. With respect to billing, Katz states such "considerations apply to integrated billing, which is a higher-quality service that has lower costs."[12]

[12] Katz Declaration at ¶ 105.

As AT&T explains:

> The combination of AT&T's and DirecTV's respective expertise and technological capabilities . . . also is likely to result in further cost savings and consumer benefits. Together, these efficiencies will create a better experience for both U-Verse video and satellite video customers.[13]

Furthermore elimination of redundancies in the employee base, particularly with regard to high paid DirecTV executives and middle managers, will lower the costs of the offering DirecTV service. AT&T also explains:

> [B]oth parties will obtain additional marketing and sales channels through the merger. AT&T will be able to market AT&T Mobility products to existing DIRECTV subscribers, as well as use DIRECTV's retail distribution network to market those services. Similarly, DIRECTV will be able to utilize AT&T retail distribution channels to expand consumer access to DIRECTV video products.[14]

A further benefit of the merger is the opportunity for DirecTV to take advantage of the AT&T LTE network that covers nearly the same footprint of DirecTV in ways that increase the value of the DirecTV service to customers. Currently, DirecTV relies upon their customers to have a phone line or broadband connection to download content to their customers set top boxes to offer on demand options or to upgrade their boxes with the latest firmware or software. With the purchase of DirecTV by AT&T, customer set top boxes can be built to receive AT&T's LTE network and AT&T will be able to offer consumers this option without the need of a phone line

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[13] AT&T-DIRECTV Description of Transaction, Public Interest Showing, and Related Demonstrations at page 39.
[14] AT&T-DIRECTV Description of Transaction, Public Interest Showing, and Related Demonstrations at page 39.

or broadband connection. This will enable DirecTV to better retain consumers, and will increase the opportunity cost of selling the RSN programming to rivals.

In markets where AT&T offers voice and broadband Internet services, as in the Comcast SportsNet Houston market, there are even greater efficiencies, such as savings on installation costs:

> The proposed transaction will allow AT&T and DIRECTV to combine the two installation visits into one visit. Because installation costs also are a marginal cost of adding subscribers, reducing the number of necessary installation visits from two to one can be expected to lead to lower prices being charged to consumers.[15]

Furthermore, AT&T repeatedly stresses that consumers are much more likely to choose a bundle of AT&T broadband services than either just AT&T's U-Verse service or just the DBS service of DirecTV. This will increase the profits of the separate components of the bundle.

The efficiencies from the merger need not only occur in the markets of the RSNs to increase the profitability per subscriber in those markets. Given that DirecTV is generally considered a fixed cost business, to the extent the AT&T-DirecTV merger results in DirecTV having more subscribers than it would have absent the merger, these additional subscribers will lower the overall cost of doing business across the country, and increase the profitability per subscriber for all subscribers.

If some or all of these alleged efficiencies come to pass, it will generate higher profits per subscriber post-merger and thus a higher opportunity cost of selling its programming to rival

[15] Katz Declaration at ¶ 104.

MVPDs. This will lead the merged entity to charge higher prices for its programming, and result in higher prices for subscribers of these MVPDs.

B. Increased AT&T Bargaining Buying Power in the Programming Market

The new AT&T will have approximately 26 million subscribers. This is an increase of approximately 20 million subscribers for AT&T, which currently serves 6 million subscribers. AT&T's subscriber growth post-transaction will lead to lower programming prices for the merged entity.

By obtaining lower prices, the merged entity will increase the profitability per subscriber for its video service and using equation (1), this will lead to an increase in the opportunity cost for the company to sell its programming to rival MVPDs. This will lead to higher RSN programming prices for the vertically affiliated RSNs for these MVPDs and these increases in costs will in part be borne by subscribers.

In his testimony, Professor Katz agrees the merged entity will likely receive better programming rates due to its size than either the old AT&T or the old DirecTV. When Katz discusses the price that programmers and MVPDs negotiate for programming, he couches it in a bargaining model and the relevant profits or "disagreement points" that each side would have if they did not come to an agreement. Katz states:

> Bargaining theory identifies two broad mechanisms through which a merger can enable the merging parties to negotiate lower content fees. First, a content owner may enjoy benefits of scale in selling to a larger video service provider. In this situation, the monetary value license fee per subscriber falls with increased scale because the video provider is creating benefits for the content owner in other ways. Such benefits of increased scale include the content owner's ability to earn greater advertising revenue per subscriber. For example, advertisers prefer one-

> stop shopping with a video service provider that can offer broad exposure. Because a large video service provider can give a content owner greater distribution, this enhances the value that it can offer advertisers.[16]

Continuing, Katz adds:

> Second, to the extent that the disagreement point is more than proportionately worse for a content owner bargaining with a larger buyer, the resulting license fees will be lower. Such scale effects may arise because the loss of a large buyer is more than proportionately disruptive to the content owner's business model.[17]

I agree with Professor Katz that despite the theoretical possibility, there is no evidence in the MVPD market today that buyers with more bargaining power pay *higher* programming prices for programming than those that are smaller. Instead, the fact is that larger MVPDs pay much lower prices than smaller MVPDs.[18] 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.

Operators of small cable systems insist, based on their experiences, AT&T obtaining lower prices will result in smaller MVPDs paying higher prices. Empirical data indicate that this is in fact what happens in the marketplace today when programmers do not receive what they expect from AT&T in their negotiations. The data suggest this effect would continue and be

[16] Katz Declaration at ¶ 112.
[17] Katz Declaration at ¶ 113.
[18] Katz Declaration at ¶ 114; see Tasneem Chipty and Christopher Snyder, "The Role of Firm Size in Bilateral Bargaining: A Study of the Cable Television Industry," Review of Economics and Statistics, (1999) 81(2):326-340. Their study showed that there is a theoretical possibility that merging can hurt a buyer's bargaining power; if the seller's gross surplus selling function is convex and demonstrate that this is often the case in their study. There are problems with using this study. For example, they make an assumption that buyers –MVPDs – do not compete with other MVPDs, which is clearly not true given the overlap between many if not most MVPD coverage areas. The assumption of MVPDs not competing may have been reasonable given that the data set they used ended in 1993, but it is clearly not a reasonable assumption now. See also Alexander Raskovich (2003), "Pivotal buyers and bargaining position," *The Journal of Industrial Economics*, **51**(4): 405-426.

made worse as AT&T's bargaining power increases, almost to the same level as Comcast, the largest MVPD. From an economic standpoint, one way this assertion can be explained is as follows: when publicly held programming firms address market analysts they often promise to achieve a given rate of return in order to convince the analysts to recommend to their clients that they buy the programmer's stock. In other words, the programmers tell a revenue growth story. This is a commitment by the programmer to achieve higher rates of return. If the programmer does not meet Wall Street's expectations, it could lead to a drop in the programmer's stock. It is much more difficult for a programmer to try negotiate a substantial price increase from a large MVPD than a smaller MVPD, because the large MVPD is seen as being a "must have" program distributor, whereas a programmer would not be hurt as much if a smaller MVPD did not carry its programs. Accordingly, if the programmer must give the new AT&T a lower price in return for carriage of its programming, then it will be inclined to turn to other buyers, particularly those with less bargaining leverage – the smaller MVPDs – to make up the difference or the revenue-growth story told to Wall Street becomes invalid. This ability to commit to given rates of return provides an economic linkage between the prices paid by rival MVPDs and AT&T.

The bottom line is that the largest MVPDs get lower programming prices and this will raise the opportunity costs for AT&T selling its RSN programming to rival MVPDs.

V. Problems with the FCC's Arbitration Remedy

In its 2008 *Liberty Media-DirecTV Order*, the FCC conditioned its approval of licenses transfers associated with an exchange of ownership interests between News Corp. and Liberty Media, resulting in the transfer of control to Liberty Media Corporation of all of News Corp.'s ownership interest in DirecTV and the three RSNs, on DirecTV's continued submission of carriage disputes for its RSN programming to commercial "final offer" or "baseball style" arbitration.[19] In this merger, like others before and after, the Commission recognized that vertically integrated programmers have an incentive and ability to charge higher prices to MVPD rivals of its affiliated MVPD. Under the form of arbitration chosen by the FCC to ameliorate this harm, each side presents an arbitrator with a proposed resolution – its "final offer" – and the arbitrator picks the proposal that most closely approximates the "fair market value" of the programming.

Despite the fact that the Commission has made an arbitration remedy available to smaller operators as a condition of approval for various vertical mergers since 2004, the vast majority of smaller MVPDs have not found it worthwhile to even try to use them. The few mid-sized MVPDs that have tried arbitration either would not do so again or would be reluctant to go to arbitration. Therefore, smaller MVPDs effectively have lacked any remedy for the recognized competitive harms created by all previous mergers with vertical effects.

A. Smaller MVPDs Lack Critical Information Necessary to Help Themselves

One reason the arbitration conditions have not been effective for smaller MVPDs is due to a lack of information about the fair market value of programming. Due to widespread use of non-disclosure agreements, a smaller MVPD will know only the prices, terms, and conditions for

[19] Liberty Media-DirecTV Order, ¶ 88, 99-95; Appendix B, Conditions, Section IV, Additional Conditions Concerning Access to Regional Sports Networks (extending arbitration condition imposed in the 2004 News Corp-Hughes Order to address and eliminate concerns regarding access to RSNs owned now or in the future by Liberty Media or DirecTV for six years in addition to Liberty Media's agreement to comply with restrictions embodied in the program access rules in the event the RSNs are no longer subject to the rules due to changes in John Malone's common interests in Liberty Media and Liberty Cable Puerto Rico).

the national cable networks, regional sports networks, and broadcast stations it carries.[20] It will not know how much similarly situated MVPDs have paid for the same programming.

This lack of information makes it difficult for smaller MVPDs to know when the programmer is acting on its incentive and ability to charge them higher prices. Even when they sense the programmer might be overcharging them, the lack of information leads smaller MVPDs to believe their chances of prevailing in arbitration are low. They are pessimistic about their odds of winning because they lack the information needed to submit an informed final offer. The following is some of the information a smaller MVPD lacks that is relevant to an arbitrator when determining if the smaller MVPD's final offer is closest to fair market value: (i) the previous prices that the programmer charged to other MVPDs for its programming; (ii) how its programming prices varied with MVPD size, that is the size of the "bargaining premium" paid by small MVPDs; and (iii) the programmer's cost of acquiring the programming. Smaller MVPDs have limited access to this data and believe their chances to be low of choosing a final offer that is close to the fair market value of the programming that is subject to the arbitration.

Exacerbating the lack of critical information is that fact that the programmer will likely have more and better information about what is fair market value for the programming that it sells, because it possesses all the contracts that it has with the other MVPDs that carry its programming, and thus the market in general. This gives the programmer a strong advantage

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[20] Most smaller cable operators operate in only a single market, and so it will only carry a single RSN, and a single affiliate of each of the Big 4 broadcast networks (e.g. ABC, NBC, CBS, and FOX). In contrast, a DBS provider will have contracts for all the RSNs across the country, and all or nearly all of the broadcast stations. As a result, smaller cable operators are often the least informed negotiators.

over a smaller MVPD in how it makes its offer in a baseball-style arbitration process. This makes a smaller MVPD feel that their odds of winning an arbitration to be even lower.

AT&T, which will now include DirecTV, will recognize that MVPDs purchasing its programming, particularly those that are small, lack critical information and will negotiate without fear that the arbitration condition will be invoked against them. This undermines a key reason why the FCC imposes its arbitration conditions, leaving rival MVPDs subject to paying a higher price or facing less reasonable terms or conditions as a result of the AT&T-DirecTV merger because the arbitration remedy will place zero constraint on the combined entity's pricing decisions.

B. Other Problems with the Arbitration Process

There are other reasons why the arbitration process is stacked against smaller MVPDs. First, an MVPD has to have the ability to finance the cost of arbitration. For a small firm this is not necessarily an easy thing. The legal costs of arbitration can be quite high, at about $1 million, and the process may take many years to reach a resolution. For a small MVPD with relatively low capitalization, the liquidity constraints that it may face may make the possibility of fronting this legal cost infeasible. Therefore, the option to take on a very well capitalized firm such as AT&T is not possible no matter how strong its case is and no matter how large the potential gain that it expects to achieve through arbitration. That is, even if a small MVPD is convinced of the probability that it will win the arbitration and eventually be compensated for all its legal fees, it will still not be able to afford to bring the case, no matter how badly AT&T is treating the MVPD.

Second, most of the smaller MVPDs are not publicly traded corporations. For the majority of them, the MVPD business represents a large portion of the owners' business portfolios. In such cases, the firm is likely to behave in a risk-averse manner. This suggests that the owners of these companies have a low tolerance for risk. Having a low tolerance for risk makes such companies less likely to choose arbitration, because the company will face the chance of a getting a very bad outcome if it loses the arbitration and then must pay the fee increase in addition to paying all of the legal fees it incurred in the arbitration process.

Finally, because a programmer negotiates with every MVPD in the footprint of its programming asset and possibly faces arbitration with each of them, it has an incentive to establish a reputation of being very difficult to take to the arbitration process. A company like AT&T has both the ability and incentive to spend vast amounts of resources in terms of time and money if it is taken to arbitration in order to signal to all MVPDs that the arbitration process will be very costly. AT&T is likely to do this, and this will be observed by all the other MVPDs, greatly reducing their incentives to engage in the arbitration process with AT&T. AT&T has an incentive to punish an MVPD for taking it to arbitration so that it gains a reputation of being tough so that other MVPDs will be deterred from bringing a dispute with AT&T to arbitration.

C. Algebraic Representation of Inadequacies of Arbitration Process for Smaller MVPDs

I will now show algebraically, that even without the above concerns, the arbitration process as it is currently designed is inadequate for smaller MVPDs. Even assuming the MVPD believes it has a 50/50 chance of winning the arbitration, which as described above would be extremely optimistic of a smaller MVPD, and even if the FCC adopted a one-way fee shifting condition for smaller MVPDs as it did in the Comcast-NBCU merger where if Comcast was the losing party in the arbitration it paid the MVPD its arbitration costs, a smaller MVPD still will not utilize the arbitration condition. This helps explain why no small MVPDs have taken Comcast to the arbitration process since its acquisition of NBCU, and why it would be the case if the same remedy were imposed on AT&T.

Suppose that an MVPD and AT&T are in a dispute and the MVPD is thinking of taking AT&T to arbitration. Assume that the MVPD and programmer have agreed that they will enter into a three-year agreement, and the only issue of dispute is the amount of money the MVPD will pay the programmer. The amount of money per subscriber per month that AT&T is demanding above p that the MVPD thinks is appropriate is Δp. The number of subscribers that the MVPD has is s, and the probability that the MVPD thinks that it will win in arbitration is q. Finally, assume that the MVPD's expected legal costs are L.

The MVPD's costs if it does acquiesces to AT&T's demand of a price of $p+\Delta p$ is

$(p + \Delta p)*36s$

This is the three-year cost of complying with AT&T's demand. If the MVPD takes AT&T to arbitration, then its expected cost is

$$q(36ps) + (1 - q)[(p + \Delta p)36s + L].$$

The first term is the probability that the MVPD expects to win the arbitration, q, times the annual cost of the MVPD's offer. By winning the arbitration, the MVPD does not have to pay Δp, the increase demanded by AT&T, or for its legal fees. The second terms represent the probability that the MVPD loses in arbitration times the costs in fees paid to AT&T $(p + \Delta p)36s$ plus its legal fees, L.

Taking AT&T to arbitration is better for the MVPD if and only if

$$(1 - q)L \leq 36sq\Delta p.$$

This says that the MVPD will consider taking AT&T to arbitration only if its expected legal costs do not exceed its expected cost of acquiescing to AT&T's (from the MVPD's point of view) unreasonable demands.

Next, I present a realistic example of parameter values. Suppose that the MVPD has 10,000 subscribers, s, the price increase demanded by AT&T is $0.25, Δp, the probability that the MVPD expects to win the arbitration case is 50%, q, and the expected legal costs that the MVPD expects to incur are $1 million. Assume that the MVPD thinks the proper price for AT&T's service should be a dollar ($1.00), the value of p. Then the MVPD will not take AT&T to arbitration, because

$$(.50) * (\$1{,}000{,}000) = 500{,}000 > 45{,}000 = 36 * (10{,}000) * (.50) * (\$0.25)$$

Thus, even though the MVPD thinks it has a 50% chance of winning in arbitration, there is one-way fee shifting, and the price increase is 25 cents, or 25% above what the MVPD thinks is the appropriate price for the services that AT&T is providing, it is not a rational decision for the MVPD to take AT&T to arbitration.

Another way to think about the cost of arbitration is to look at the legal costs as a fraction of the per-subscriber payments. In the example above, there are 10,000 subscribers and the legal cost of arbitrating is one million dollars. Thus, the legal costs are equivalent to 100 dollars per subscriber. Amortized over a year, this would be equivalent to a monthly fee of $2.77 per month per subscriber even when amortized over 3 years.

This example is actually conservative with respect to the costs an MVPD faces when considering arbitration. It does not include any of the non-pecuniary costs that a firm will incur when going through arbitration, such as senior management opportunity costs. The arbitration process, together with any appeals, can last for years and require an enormous amount of executive time. Clearly, for medium and small MVPDs, this is a substantial amount of capital.

VI. Conclusion

In this paper, I demonstrated that the AT&T-DirecTV merger will cause harm to competition and consumers in the video distribution market. The incremental harms the alleged efficiencies of the merger and to the lower programming prices that the new AT&T will have due to its increased bargaining power in the market with programmers. Both of these benefits to the merged entity will increase the combined company's opportunity cost of selling its programming to rival MVPDs and thus will raise the price to the MVPDs and part, if not most, of this increase will be passed on to their subscribers. The arbitration remedy for aggrieved MVPDs previously imposed on DirecTV and its RSNs has expired. However, this arbitration remedy should not be used again because it was ineffective as adopted. Nor is the revised arbitration condition imposed on Comcast-NBCU—that was designed to be better for smaller and medium-sized MVPDs—any more effective for them for the reasons discussed above, including most critically the lack of critical information available to smaller MVPDs.