ARNOLD & PORTER LLP

Maureen R. Jeffreys
Maureen.Jeffreys@aporter.com

+1 202.942.6608
+1 202.942.5999 Fax

555 Twelfth Street, NW
Washington, DC 20004-1206

November 12, 2014

VIA ECFS

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

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

Dear Ms. Dortch:

Pursuant to the *Amended Modified Joint Protective Order* in the above-referenced proceeding,[1] AT&T Inc. ("AT&T") and DIRECTV (together, the "Applicants") are submitting the following papers prepared by the Applicants:

- There Is No Basis for Competitive Concern About the Impact on DIRECTV Stand-Alone Video Customers;
- Content Cost Savings Will Result in Both Improved Profitability and Pass Through to Consumers;
- Why the 'Double Moral Hazard' Problem Cannot Be Resolved by Contract;
- Additional Evidence That Video and Broadband Are Complements; and
- Additional Evidence That AT&T and DIRECTV Are Not Particularly Close Substitutes.

Applicants are filing herewith, via ECFS, a ***redacted*** public version of this submission.

[1] *Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations*, Amended Modified Joint Protective Order, DA 14-1602 (MB rel. Nov. 4, 2014) ("*Amended Modified Joint Protective Order*").

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An unredacted Stamped Highly Confidential copy of this submission is being hand delivered to your office. Additional copies of the unredacted submission are being delivered to the Commission staff under separate cover.

Please contact me at (202) 942-6608 or Maureen.Jeffreys@aporter.com if you have any questions. Thank you for your assistance.

Respectfully submitted,

Maureen R. Jeffreys

Maureen R. Jeffreys
Counsel for AT&T Inc.

Enclosures

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

<u>THERE IS NO BASIS FOR COMPETITIVE CONCERN ABOUT THE IMPACT ON DIRECTV STAND-ALONE VIDEO CUSTOMERS</u>

Submitted by

AT&T Inc. and DIRECTV

November 12, 2014

I.
Overview

The econometric evidence shows that the proposed transaction will result in lower prices for both AT&T/DIRECTV broadband/video bundles and rival cable products. The same evidence establishes that the merger will preserve or enhance overall consumer welfare, even before factoring in cost savings and other transaction synergies. As Professors Berry and Haile have shown, these results are significant, robust, and driven by actual patterns of demand found in the data.

The fact that the merger simulation models also predict modest upward pressure on the "stand-alone" DIRECTV video price in overlap areas should not concern the Commission for several reasons.

First, the more refined simulations done by Professors Berry and Haile predict only a small price increase for stand-alone DIRECTV in the overlap areas. In particular, the baseline three-nesting simulation in the more refined analysis predicts an increase of less than 2% in DMAs in which the new AT&T/DIRECTV bundle will be available, and the average across all modeled specifications is less than 5%. Given the significant cost savings and product synergies not included in the simulations, this level of predicted increase would not meet the statutory standard that any lessening of competition must be "substantial," even if it made sense to consider the merger's impact on stand-alone DIRECTV video customers in isolation.

Second, the predicted price increases are overstated. The transaction will allow the combined company to market additional profitable products (such as mobile wireless services) to DIRECTV customers. As a result of this opportunity, the combined firm will have every incentive to preserve and add as many stand-alone DIRECTV customers as possible, creating additional downward pricing pressure that is outside the model.

Third, the merger simulations do not account for significant cost savings and quality improvements that will benefit DIRECTV stand-alone video subscribers. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] Even a conservative estimate of those cost savings and other benefits would easily offset the modest upward pricing pressure.

Fourth, even if small price increases did occur, only a small minority of DIRECTV's video customers could be affected. While there are few DIRECTV video customers in the overlap areas who do not also purchase broadband service, the vast majority are broadband purchasers who will *benefit* from the post-merger expansion and improvement of their choices. And, as broadband adoption and availability continue to rise (due in part to the broadband expansion the merger enables), the number of true "stand-alone" DIRECTV customers in the overlap areas will diminish even further.

Fifth, the relevant measure of the merger's effect should be the enhancement of overall consumer welfare. But, even if it made sense to consider narrower "markets" in isolation, the merger *also* improves the welfare of key subsets. Broadband customers generally, video customers generally, and even the subset of video customers who purchase DIRECTV service (both stand-alone and otherwise) in AT&T's broadband footprint are all better off with this combination than without it – again, before considering any cost savings or other synergies.

Finally, even assuming it made sense to focus only on customers within AT&T's broadband footprint who buy DIRECTV video but *not* AT&T broadband (an untenable market definition), any upward pricing pressure on stand-alone DIRECTV video is "inextricably linked" with the much larger benefits of lower DIRECTV/AT&T bundle prices and the consequently lower prices for cable bundles. The incentive to lower prices on the newly created DIRECTV/AT&T bundle and the incentive to raise prices on the associated stand-alone products are two sides of the same coin. As the DOJ and FTC Horizontal Merger Guidelines recognize, such potential harms cannot meaningfully be considered in isolation from the associated benefits.

II.
The Predicted Price Increases on Stand-alone DIRECTV Customers Are Small

The most sophisticated econometric evidence presented here indicates that any increase in stand-alone video prices from this merger would be very modest. The more refined simulations done by Professors Berry and Haile provide the most relevant evidence.[1] The most sensitive Berry-Haile simulation—the three-nesting parameter model applied to the "All DMAs"

[1] The Berry-Haile simulations include an additional version of the econometric demand model that allows for three "nesting parameters." The three-nesting parameter model is more flexible, particularly regarding the strength of substitution within and across the important category of video/broadband bundles. The Berry-Haile simulations also use a richer set of instruments to deal with the endogeneity of price and to identify the nesting parameters, which allows for more precise determinations of substitution patterns across products. Those simulations also are more geographically fine-grained, because their DMA-level shares account for the fact that customers living in different zip codes within a DMA may have access to different subsets of products. And, they incorporate much more granular product definitions and use more refined data, adding detail from additional data sources to establish more accurate product shares and prices.

specification—predicts a price increase of less than 2%.[2] And the average estimated price increase across all of the Berry-Haile model specifications is less than 5%.[3]

Every merger between rival brands eliminates competition between those brands, which in and of itself creates some upward pricing pressure. But, under any circumstances, the levels of price increases predicted here would be considered small, and would be offset by application of a standard cost efficiency. Here, as explained below, cost savings, product synergies, and downward pricing pressure that are outside the simulation models ensure that there could be no "substantial lessening of competition," even if the impacts on stand-alone DIRECTV video customers could rationally be considered in isolation from the substantial consumer welfare benefits of the transaction.

III.
The Simulations Do Not Capture the Additional Incentive To Market Other Profitable Services to DIRECTV Customers

Even the modest upward pricing pressure predicted by the model is overstated. The Berry-Haile models do not capture important synergies that would put downward pressure on the combined firm's pricing of stand-alone DIRECTV video services. In particular, the opportunity to market other profitable products—such as mobile wireless services, home security, and wireline

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2 *See Quantitative Analysis of an AT&T-DIRECTV Merger: Updated Results*, Presentation of Steve Berry and Phil Haile at 101 (filed Sept. 23, 2014) ("Berry-Haile Sept. 19 Quantitative Analysis Update Presentation"). The merger's effects within the AT&T broadband footprint are the appropriate focus because that footprint is the geographic area in which AT&T could have an incentive to raise the price of stand-alone DIRECTV service to encourage customers to purchase an integrated AT&T broadband/DIRECTV video bundle.

3 *See id.* at 101, 103, 105, 107, 157, 159.

telephone services—to DIRECTV video customers is outside the model.[4] As AT&T Home Solutions Chief Lori Lee stated in her declaration, the merger "will allow AT&T to offer innovative nationwide video packages" and enable AT&T "to market other AT&T products to a greatly expanded base."[5] As AT&T Chairman and CEO Randall Stephenson elaborated in his written testimony to Congress:

> Whether a customer wants to buy broadband or video on a stand-alone basis or in a bundle, we can serve that customer far better with DIRECTV's products and people than without them, and when this transaction closes, we will follow a sales pattern that is time-tested and proven for us. When we deployed DSL technology, we focused our sales efforts first on our existing base of telephone customers. When we deployed IP broadband, we focused our sales efforts first on our DSL base. And when we deployed U-verse video, we focused first on our IP broadband base. This merger creates bigger opportunities: DIRECTV has over 20 million video subscribers who will likely be interested in some or all that AT&T has to offer. . . . At AT&T, we know how important it is to satisfy customers and preserve opportunities to introduce them to new choices, and that drives us to ensure that *all* of our services remain competitively-priced and of the highest quality.[6]

AT&T's desire to retain those opportunities will put downward pressure on stand-alone DIRECTV video prices, because every such sale is equivalent to a decrease in the marginal cost of DIRECTV video. Given the competition from cable bundles and also cable and satellite stand-alone video

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[4] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[5] Declaration of Lori M. Lee, Senior Executive Vice President–Home Solutions, AT&T Inc. ¶ 26 (June 10, 2014).

[6] Statement of Randall Stephenson Chairman, CEO and President of AT&T Inc., *The AT&T/DIRECTV Merger: The Impact on Competition and Consumers in the Video Market and Beyond*, Testimony before the United States Senate, Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy, and Consumer Rights, at 6 (June 24, 2014).

services, any price increase that drives a DIRECTV stand-alone customer into the arms of a rival would come at a high cost, because it eliminates the opportunity to sell additional profitable services to that customer.[7]

IV.

The Small Predicted Price Increases Will Be Offset by Additional Cost Savings and Service Quality Improvements That Are Not Included in the Simulations

None of the merger simulation runs, including the "With Cost Savings" specifications, includes the likely cost savings or quality improvements that will benefit DIRECTV subscribers. However, the merger is expected to provide significant additional cost reductions and quality improvements that will benefit DIRECTV (as well as AT&T) subscribers. Through the process described below, we can demonstrate that these outside-the-model benefits will almost certainly make DIRECTV subscribers better off after the merger.

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[7] Even customers who do not defect in response to a post-merger price increase would almost certainly be less satisfied and less likely to purchase other services from the combined company.

[8] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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The cost savings and quality improvements for DIRECTV customers are almost certain to exceed those amounts.

Further content cost savings. The AT&T valuation model and the merger simulations include only the reduction of AT&T's per-subscriber video programming costs **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] Post-merger AT&T will be an integrated broadband, wireless, and video

[9] The model program and output files for the underlying calculations are provided in a DVD-ROM, which is Attachment No. 1. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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provider capable of delivering content on a national scale, across multiple screens and innovative platforms with unmatched reach. AT&T will thus provide exceptional opportunities, including "three screen" packaged video distribution arrangements, that will be attractive to video content owners.[10]

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[10] *See* Declaration of John T. Stankey, Group President and Chief Strategy Officer AT&T Inc. ¶ 23 (June 10, 2014) ("Stankey Decl."); *see also* ATT-FCC-00414403, *AT&T Video Strategy–Pre-reading Materials Strategy Session* at 13 (Apr. 3, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[11] *See* Stankey Decl. ¶ 24; Declaration of Rick L. Moore, Senior Vice President, AT&T Inc. ¶ 35 (June 10, 2014); *see also* ATT-FCC-000000002, *AT&T Video Strategy–The Evolution of OTT Video Entertainment* at 11 (Jan. 24, 2014) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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Quality Improvements. DIRECTV customers will likewise benefit from merger-specific service quality improvements that, by themselves, are likely to outweigh the simulations' predicted price increases. With a larger customer base and the ability to deliver content across multiple screens, AT&T will be well-positioned to negotiate for a broader and more diverse set of carriage rights from content owners. Customers, in turn, will receive packages better tailored to their tastes and price levels and better matched to the times and devices on which they want to watch the content.[13]

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[12] *See* Stankey Decl. ¶¶ 24-25. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] *See* Comparison of DIRECTV and Comcast ACPU 2013.xlsx (Attachment No. 2); Morgan Stanley Research, *Comcast Corporation, CMCSA Cable Operations, Annuals* (June 25, 2014); DTVFCC-01324649, Morgan Stanley Research, *DIRECTV, Subscriber Forecast, Annual* (May 20, 2014).

[13] *See* Stankey Decl. ¶¶ 23-25. More flexible distribution rights will also improve the customer experience in other ways. For example, **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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The combined company will also be able to provide improved user access, interfaces, and navigation systems. The development of interactive capabilities and user interfaces involves significant fixed costs. The combined company will be able to spread those costs over a larger subscriber base and thus be better positioned to invest in developing more sophisticated interactive services and more advanced interfaces.[14]

The merger will also benefit stand-alone DIRECTV subscribers by facilitating additional original programming. The transaction gives AT&T the increased scale to launch and market original programming and to fund more investment in new programming ventures.[15] This increased supply of original programming will also benefit consumers by increasing competitive pressures on other video providers and content creators.

Although harder to quantify, these service quality improvements will have significant value to stand-alone DIRECTV customers. Combined, **[BEGIN AT&T HIGHLY CONFIDENTIAL**

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[14] *See* Stankey Decl. ¶ 32; *see also*, *e.g.*, ATT-FCC-03185055, *OTT Industry Landscape–Framework and Profiles* at 39 (Sept. 19, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** ATT-FCC-01408994, *Over-the-Top Video–Industry Overview* at 10 (Dec. 2, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[15] *See* Stankey Decl. ¶ 59; *see also*, *e.g.*, ATT-FCC-00414403, *AT&T Video Strategy–Pre-reading Materials Strategy Session* at 7 (Apr. 3, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** ATT-FCC-00544502, *TAC Whitepapers—Summary of Contents* at Slide 4 (Jan. 20, 2014) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[END AT&T HIGHLY CONFIDENTIAL INFORMATION] will likely far exceed the few dollars required to offset any adverse effect on stand-alone DIRECTV customers suggested by the simulation model.

V.
The Number of Potentially Affected DIRECTV Customers Is Small

DIRECTV customers typically purchase both video and broadband. Those customers will benefit from the transaction through substantial improvements in product options, bundle prices, service quality, and competition. In addition to other options, they now will be able to obtain a true, integrated video/broadband bundle while keeping their preferred video service. And the merger not only will put significant downward pressure on the prices for those bundles, but enable better quality through, among other things, improved integration of the MVPD video service with Internet-enabled features.[16]

The merger will also intensify competition and drive other providers to improve their offers as well. As the simulations indicate, the combined entity's strong incentive to reduce bundle prices will put pressure on cable companies to lower their prices. The result will be that, post-merger, DIRECTV customers will also have more attractive cable options.

That leaves the relatively few DIRECTV customers in the overlap areas that purchase no broadband service at all. The number of those customers is small **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[16] *See* Stankey Decl. ¶ 29.

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Well over 70% of American households have broadband service,[17] **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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Consumers in each of those demographic groups have broadband adoption rates considerably above the national average.[19] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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Moreover, the relevant metric here is not how many customers lack broadband today, but how many of those customers will *continue* to forgo broadband after the merger closes. Broadband adoption has grown rapidly for many years, and independent analysts expect it to

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17 NTIA, *Exploring the Digital Nation: America's Emerging Online Experience* at 2 (June 2013) (72 percent as of July 2011), *available at* http://www.ntia.doc.gov/files/ntia/publications/exploring_the_digital_nation_-_americas_emerging_online_experience.pdf ("*Exploring the Digital Nation*").

18 **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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19 Pew Research Internet Project, *Broadband and Smartphone Demographics* (Aug. 27, 2013), *available at* http://www.pewinternet.org/2013/08/27/broadband-and-smartphone-adoption-demographics/ **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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continue to increase over the next few years.[20] Analysts anticipate broadband adoption rates to be even higher in the predominantly suburban and urban areas where DIRECTV's video service overlaps with AT&T's broadband service.[21] Additionally, private investment (including AT&T's merger-related investment that will expand or enhance broadband service to at least 15 million more locations), universal service funding, and other government programs will induce some of those DIRECTV customers to purchase broadband. These trends will likely accelerate as the "Internet of things" leads to more and more home-based appliances and devices that require a broadband connection.

Finally, the merger will give even the relatively small number of current DIRECTV stand-alone video subscribers an improved set of choices. Consumers who purchase stand-alone DIRECTV video service today may choose to purchase the new integrated AT&T/DIRECTV bundle when both products are available from a single supplier at a better price. Or, they might choose to purchase cable broadband (or cable bundles) at lower prices. Some of DIRECTV's video customers may also be attracted to the improved options that AT&T can offer through the fiber and fixed wireless broadband expansion enabled by the transaction or through wireless broadband/DIRECTV offerings. All of these factors indicate that the sub-sub-set of DIRECTV subscribers that may be affected is small and declining.

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[20] *See, e.g.*, IDC, *Market Analysis: U.S. Consumer Fixed Broadband Services 2013-2017 Forecast* at 15 (2013) **[BEGIN CONFIDENTIAL INFORMATION]** **[END CONFIDENTIAL INFORMATION]**

[21] *See, e.g*., *Exploring the Digital Nation* at 26.

VI.

The Merger Is Pro-Competitive Even If the Consumer Welfare Impacts on Video Purchasers, Broadband Purchasers, and Even the DIRECTV Subset of Video Customers Are Each Examined In Isolation

This merger increases consumer welfare in any plausible economic market. That is true whether the focus is on video customers, broadband customers, or even the implausibly narrow "market" of only video customers that subscribe to DIRECTV video services within AT&T's broadband footprint. Specifically, even if it made sense to examine video and broadband independently, the Berry-Haile merger simulations show that the merger will not harm either group of consumers and, in fact, is likely to benefit them—again, even before considering any cost savings or other synergies. Table 1 below shows the average post-merger price change (using pre-merger market shares) for all subscribers to video services and, separately, for all subscribers to broadband services. The average price for broadband subscribers (weighted by pre-merger shares) would decline under both the one-nesting parameter and three-nesting parameter simulations. For video subscribers, the weighted average price falls by $0.26 per subscriber per month in the one-nesting parameter model; the weighted average rises by $0.07 per month in the three-nesting parameter model. Given that average monthly charges for video service are typically in the neighborhood of **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]** a predicted seven-cent price increase represents a negligible change—**[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[22] The model program and output files for the underlying calculations are provided in a DVD-ROM, which is Attachment No. 1.

Table 1. Average Price Change Using Pre-Merger Shares
(Before Cost Savings)

	3-Nesting Parameter Model	1-Nesting Parameter Model
Video Subscribers	$0.07	-$0.26
Broadband Subscribers	-$0.10	-$0.43

These figures, moreover, understate the overall benefits to these groups, because (1) they do not account for cost savings and (2) they ignore the fact that consumers can and will switch to more attractive products post-merger.

Moreover, even though there is no basis to define DIRECTV video consumers as a relevant market, the merger is welfare-enhancing for that group as well. We have calculated weighted average price changes for all DIRECTV subscribers within AT&T's broadband footprint (stand-alone or otherwise) based upon pre-merger shares. In both the one- and three-nesting parameter models, Table 2 shows that the average price change for DIRECTV video subscribers is a price reduction.[23]

[23] The model program and output files for the underlying calculations are provided in a DVD-ROM, which is Attachment No. 1.

Table 2. Weighted Average Price Changes for DTV Subscribers Using Pre-Merger Shares (Before Cost Savings)[24]

	1 Nesting Parameter Model		3 Nesting Parameter Model	
	[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]	Price Change	**[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**	Price Change
DTV+Cable BB		$ 3.71		$ 0.83
DTV+ATT BB		$ (19.09)		$ (8.27)
DTV+Telco BB		$ 4.01		$ 1.12
DTV+Other BB		$ 4.42		$ 1.20
DTV stand-alone'		$ 4.42		$ 1.20
	[END AT&T HIGHLY CONFIDENTIAL INFORMATION]		**[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**	
WTD AVG		**$ (1.33)**		**$ (1.12)**

Again, these results likely understate the benefits because some customers will switch to better bundles.

VII.

Examining Any Smaller Sub-Set of Consumers <u>Would Be Both Legally and Economically Inappropriate</u>

Any attempt to evaluate this merger based on even more narrow slices of customers would be especially inappropriate. In particular, it would be unsound to define a market based on a subset of one company's customers—such as DIRECTV customers within AT&T's broadband

[24] The first column shows the types of products that include DIRECTV video service. For each of these, the table shows the pre-merger market share and predicted price change from the Berry-Haile merger simulation. The weighted average price change over all DIRECTV subscribers is shown at the bottom of the table.

footprint who do not purchase broadband (or do not purchase broadband from AT&T). But even if it were possible to define (and defend) such a relevant market, a determination that prices would likely increase for that subset of customers would not provide a sound basis for deeming the transaction anticompetitive.

There are strong policy reasons why merger analysis should be based upon overall public interest benefits.[25] Leading antitrust experts and officials emphasize that the agencies should approve any merger that provides a net benefit to consumers[26] and, moreover, that "out-of-market"

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25 Indeed, in approving mergers the FCC considers whether "the proposed transaction is likely to generate verifiable, transaction-specific public interest benefits that outweigh any identified competitive harms." *See, e.g.*, *Applications of Softbank Corp., Starburst II, Inc., Sprint Nextel Corp., and Clearwire Corp. for Consent to Transfer Control of Licenses and Authorizations*, Memorandum Opinion and Order, Declaratory Ruling, and Order on Reconsideration, 28 FCC Rcd 9642, 9678 ¶ 91 (2013); *Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corp. for Consent to Transfer Control of Licenses and Authorizations*, Memorandum Opinion and Order, 19 FCC Rcd 21,522, 21,600 ¶¶ 204-205 (2004). The Commission has recognized the potential for transactions to provide an overall net benefit to consumers, and has approved mergers where nationwide benefits, such as expanded broadband deployment and the accelerated provision of advanced wireless services, have outweighed local harms. *See, e.g.*, *Applications of Deutsche Telekom AG, T-Mobile USA, Inc., and MetroPCS Communications, Inc. for Consent to Transfer of Control of Licenses and Authorizations*, Memorandum Opinion and Order and Declaratory Ruling, 28 FCC Rcd 2322, 2342 ¶ 57 (2013) ("[W]e find the expected magnitude of the public interest benefits, as described herein, to be sufficiently large or imminent to outweigh any potential public interest harms in certain individual markets."); *Applications filed by Qwest Communications International Inc. and CenturyTel, Inc. d/b/a CenturyLink for Consent to Transfer Control*, Memorandum Opinion and Order, 26 FCC Rcd 4194, 4211 ¶¶ 35-37 (2011) (expanded broadband deployment).

26 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law*, ¶ 972c ("[W]here the threatened market is significantly smaller than the benefitted market, a tiny efficiency gain in the latter would nevertheless dwarf a significant loss in the former."); Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 Antitrust L.J. 49, 107 (2010) ("In some cases, the economic models used by the Agencies predict significant price increases only for products with relatively few sales. This is most likely to happen if a relatively unpopular product is merging with a popular product that has a larger margin. However, in such cases, the Agencies may conclude that the predicted harm to relatively few customers is not substantial enough to warrant an enforcement action, especially if the merger is expected to generate cognizable

efficiencies should be given even greater weight today given the agencies' shift to more narrowly-defined markets.[27] The alternative to that sensible approach is to conclude that a merger should be blocked even if that action harms consumers more than it helps them.

The Horizontal Merger Guidelines expressly recognize "efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s)."[28] The Guidelines further explain that "[i]nextricably linked efficiencies are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small so the merger is likely to benefit customers overall."[29]

Those principles squarely apply here. The predicted price increases for a small number of DIRECTV customers are inextricably linked to the far larger consumer welfare gains that will accrue to the vast majority of consumers. That is because the incentive to lower prices on the newly created DIRECTV/AT&T bundle and the incentive to raise prices on the stand-alone products are two sides of the same coin: they derive from the same underlying profit maximization conditions. Accordingly, the two effects cannot be separated.

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efficiencies that will benefit a larger set of customers so customers overall are likely to benefit from the merger."). *See also* U.S. Department of Justice & the Federal Trade Commission, *Horizontal Merger Guidelines* at § 1 (2010) ("Horizontal Merger Guidelines") ("The Agencies seek to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are competitively beneficial or neutral").

[27] *See, e.g.*, Judd E. Stone & Joshua D. Wright, *The Sound of One Hand Clapping: The 2010 Merger Guidelines and the Challenge of Judicial Adoption*, at 17 (Jan. 4, 2011), forthcoming in the Review of Industrial Organization ("The intellectual case in favor of excluding out of market efficiencies is a weak one; it becomes weaker still when the Agencies adopt an approach of ever-narrowing market definitions").

[28] Horizontal Merger Guidelines at n.14.

[29] *Id.*

The Guidelines thus precisely describe the situation in this case. Any divestiture of video services designed to remedy alleged stand-alone video harm would necessarily eliminate the combined entity's ability to compete by selling highly desired bundles. Other mergers that the Department of Justice has cleared are instructive. For example, the DOJ closed its investigation of a joint venture between two bakeries despite its assessment that a small group of restaurant and institutional customers in the Pacific Northwest, which faced limited competitive alternatives, could be harmed. In balancing the efficiencies against the potential harm, the DOJ observed that the potentially affected customers accounted for only 20% of the companies' sales.[30] The DOJ has also cleared airline mergers in which it identified potential harms to consumers on certain routes, but concluded that the net consumer benefits were overwhelmingly positive. In clearing the merger of Northwest Airlines and Delta Airlines in 2008, for example, the DOJ found potential competitive harm on a limited number of 2-to-1 routes, but found that the net consumer benefit of the merger was substantial:

> Nevertheless, because there were so few nonstop overlap markets and the volume of commerce on these routes was relatively small, potential harm in these city-pairs was predicted to be modest at most. This implied that if only a fraction of the efficiencies claimed by the parties from combining their large, and largely complementary, networks were found likely to be generated by the merger, these would easily exceed any potential harm from the deal.[31]

[30] U.S. Department of Justice & Federal Trade Commission, *Commentary on the Horizontal Merger Guidelines* at 57 (2006).

[31] Ken Heyer, Carl Shapiro, & Jeffrey Wilder, *The Year in Review: Economics at the Antitrust Division, 2008-09* at 7 (Nov. 12. 2009), *available at* http://faculty.haas.berkeley.edu/shapiro/DOJATR2009.pdf.

The DOJ relied on similar reasoning in clearing the merger of AirTran Airways and Southwest Airlines: "Although there are overlaps on certain nonstop routes, the division did not challenge the acquisition after considering the consumer benefits from the new service."[32]

VIII.
Conclusion

For all of the foregoing reasons, the Commission should conclude that there is no basis for competitive concern about the impact of the transaction on stand-alone DIRECTV subscribers.

[32] *See* Press Release, Department of Justice, Statement of the Department of Justice Antitrust Division on its Decision to Close its Investigation of Southwest's Acquisition of AirTran (Apr. 26, 2011), *available at* http://www.justice.gov/opa/pr/statement-department-justice-antitrust-division-its-decision-close-its-investigation.

CONTENT COST SAVINGS WILL RESULT IN BOTH IMPROVED PROFITABILITY AND PASS THROUGH TO CONSUMERS

Submitted by

AT&T Inc. and DIRECTV

November 12, 2014

I.
Overview

This paper explains how content cost savings from the transaction will result in lower prices for consumers *and* improved profit and margins for AT&T.

Section II.A below explains that AT&T analyzes the profitability of its products and services, including U-verse video and broadband, using standard financial methods, including fully allocated cost accounting consistent with Generally Accepted Accounting Principles (GAAP). As discussed in Section II.B, AT&T financial documents, prepared in the ordinary course of business, consistently confirm that, using these standard methodologies, the revenues from the stand-alone U-verse video service do not cover its costs. Finally, Section II.C identifies internal reports and studies showing that video sales lead to increased broadband sales.

Section III explains that downward pricing pressure and increased margin are not mutually exclusive. Fundamental principles of economics teach that decreases in marginal cost will result in *both* reduced prices for the consumer *and* higher profits for the supplier. As Section III.A explains, this is because, when marginal costs decline, there is not only downward pressure on prices, but the supplier's profit-maximizing output level increases. In fact, as demonstrated in Section III.B, the merger simulations in this matter confirm this outcome. Professors Berry and Haile have concluded that, at **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** in cost savings per subscriber per month, the combined AT&T/DIRECTV will pass through more than **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** of those savings, while

AT&T's overall video margins and total video profits would increase. This is all in addition to other transaction-specific consumer benefits, which are discussed in Section III.C.

II.
<u>AT&T's Video Business Is Unprofitable</u>

A. How AT&T Measures Profitability and Allocates Costs and Revenues

AT&T tracks the profitability of U-verse video, U-verse broadband, and bundles including those services in terms of earnings before interest, taxes, depreciation, and amortization ("EBITDA") and operating income (EBITDA less depreciation and amortization).[1] To determine earnings for purposes of these profitability calculations, AT&T must determine its revenue and costs.

AT&T attributes revenue to each element of a bundle separately, rather than recording revenue for the bundle as a whole.[2] Consistent with GAAP, the revenue, net of discounts, is allocated based on each product's relative list price. Thus, revenue for each product is recognized as the list price minus the product's share of the discount.[3] **[BEGIN AT&T CONFIDENTIAL INFORMATION]**

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1 *See, e.g.*, ATT-FCC-01445197, *U-verse Product Margins* (2014) **[BEGIN AT&T CONFIDENTIAL INFORMATION]**
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2 U-verse video revenue consists of both customer subscription fees and AdWorks advertising sales revenue, which is wholly allocated to the video product but is not broken down by customer, as AdWorks revenue comes from advertisers rather than U-verse customers.

3 *See, e.g.*, Financial Accounting Standards Board Accounting Standards Update No. 2009-13—Revenue Recognition (Topic 605) ("The amendments in this update . . . require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. The relative selling price method allocates any discount in the arrangement proportionately to each deliverable on the basis of each deliverable's selling price.")

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In determining costs, AT&T uses fully allocated cost accounting to measure and manage the U-verse business. That methodology allocates all of the costs associated with the product or service, including both variable costs, such as direct labor and materials, and fixed costs, such as corporate overhead.

Certain costs are directly allocable to a single product. For instance, content acquisition costs are fully allocable to U-verse video because that is the only service that uses the content. Other costs such as those of the common network used for U-verse video, broadband, and VoIP must be apportioned among those products. AT&T also allocates support service costs, such as those of the AT&T human resources and legal departments, among the various U-verse products.

Under AT&T's standard accounting protocols, there are different allocation formulas and methodologies that apply to different common costs in the ordinary course. Those allocation formulas and methodologies are reviewed regularly by the Finance Department with the various businesses to ensure costs are allocated in a principled and economically rational way.

In most cases, AT&T business units allocate common costs to products using one of three methods as it determines makes the most sense in the ordinary course of business, *i.e.*, consistent with how AT&T manages that business on a day-to-day basis. First, costs may be divided proportionally among products based on the relative revenue of each product to the enterprise. Second, allocation may be based on the number of customers using each product. Third, costs may be divided based on estimates and studies of the time spent by shared services employees supporting each product.

For example, common variable network costs—such as costs associated with customer-initiated technician repair or an installation technician's time installing U-verse video and broadband equipment at a customer location—are allocated using the methods described above. Customer-initiated technician repair is allocated based on the second method described above. The overall number of repair hours for U-verse broadband, video, and voice products are disaggregated according to the count of customers for each product. Installation technician time is allocated based on the third method described above. The costs of a technician's time installing a bundle of products is allocated to each product by applying the ratio of the installation times required for each product to the total installation time.

Common fixed network costs are similarly allocated by the number of customers using the product. To determine how fixed costs should be allocated, AT&T divides its network both geographically (a maintenance depot with a defined service area) and by the components of the network, *e.g.*, fiber and copper. AT&T treats each subscriber and service equally as a single unit, without weighting. **[BEGIN AT&T CONFIDENTIAL INFORMATION]**

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B. AT&T Documents Confirm U-verse Video Is Not Profitable

Internal AT&T data, using the standard methodologies described above, confirm that U-verse video is not, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** a profitable service.[4] These product-level profit and loss statements are prepared monthly as backup for reports to management on the U-verse business.

The reports show that **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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Of course, AT&T managers, like many businesses, sometimes use other measures to get particular views of certain aspects of their operations. **[BEGIN AT&T CONFIDENTIAL INFORMATION]**

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4 *See, e.g.*, ATT-FCC-01445197, *U-verse Product Margins*.

5 *Id.*

6 *Id.*

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C. AT&T Sells Video To Sell Broadband

AT&T has studied the impact of sales of AT&T products, such as U-verse video, on the sales or profitability of other products, such as U-verse broadband. AT&T has produced numerous reports and studies addressing that issue to the Commission.[7] Those studies show that **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]—** and, therefore, most valuable to AT&T—as a complement to broadband service as part of a bundle.[8] FCC Chairman Tom Wheeler recently commented on the same correlation, stating:

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[7] *See, e.g.*, ATT-FCC-00739712, *Consumer Research: Part I, Bundling Strategy* at 15 (Feb. 2011) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** *See also, e.g.*, ATT-FCC-00414403, *AT&T Video Strategy* at 10 (Apr. 3, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** (parentheses in original); ATT-FCC-00541257, *Video Strategy: U-verse Evolution* at 2 (May 17, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** Declaration of Lori M. Lee, Senior Executive Vice President–Home Solutions, AT&T Inc. ¶15 (June 10, 2014) (stating that offering bundles allows for the recovery of high content costs for video services from a larger revenue base).

[8] *See generally* discussion in *Additional Evidence That Video and Broadband Are Economic Complements*, AT&T Inc., MB Dkt No. 14-90 (filed Nov. 12, 2014).

> Those seeking to deploy new competitive broadband networks tell us that it's hard to provide new high-speed Internet access without also being able to offer a competitive video package as well.[9]

III.
<u>The Merger Will Result in Pass Through of Efficiencies to Consumers</u>

AT&T will pass through content cost savings from the merger to consumers *and* will use those savings to improve video's profitability. The conclusion that both consumers and AT&T will benefit from those savings is compelled by basic economic principles recognized by the Commission and the antitrust agencies. Here, moreover, that result is strongly confirmed by sophisticated econometric analysis. In particular, Professors Berry and Haile have shown that, in addition to downward pricing pressure created by the combination of complementary products and assets, content cost savings will create additional strong downward pricing pressure. The result is that, at **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]** of content cost savings per subscriber per month, more than **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]** of those cost savings would be passed on to consumers, while AT&T's overall video margins and total video profits would increase.[10] In other words, the prices paid by consumers will fall at the same time that AT&T's

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[9] Tom Wheeler, FCC Chairman, *Tech Transitions, Video, and the Future*, Official FCC Blog (Oct. 28, 2014), *available at* http://www.fcc.gov/blog/tech-transitions-video-and-future.

[10] *Quantitative Analysis of an AT&T-DIRECTV Merger*, Presentation of Steve Berry and Phil Haile at 14-18 (filed July 17, 2014) ("Berry-Haile July 15 Quantitative Analysis Presentation"); *Quantitative Analysis of an AT&T-DIRECTV Merger: Additional Discussion of Modeling Choices, Data, and Results,* Steven T. Berry and Philip A. Haile at 8 (filed Sept. 23, 2014) ("Berry-Haile Quantitative Analysis"); *Quantitative Analysis of an AT&T-DIRECTV Merger: Updated Results*, Presentation of Steve Berry and Phil Haile at 16-18 (filed Sept. 23, (Continued...)

margin rises. Both consumers and AT&T will benefit from the content cost savings.

A. Fundamental Economics Teaches That Marginal Cost Savings Derived from Efficiencies Are Passed Through to Consumers

It is a foundational principle of economics that marginal cost savings benefit consumers.[11] When marginal costs decrease, each additional unit of output that a firm can supply is less costly, creating an opportunity for the firm to increase its profits by expanding output. All else equal, when supply increases, prices fall and consumer surplus increases.[12] That is why the Commission has stated that "reductions in marginal cost are more likely to result in lower prices to consumers."[13] Similarly, the Antitrust Division of the Department of Justice and the FTC have recognized that "[e]conomic analysis teaches that price reductions are expected when efficiencies reduce the merged firm's marginal costs."[14] Thus, some pass through of cost

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2014) ("Berry-Haile Sept. 19 Quantitative Analysis Update Presentation"); Reply Declaration of Michael L. Katz ¶ 24 & n.46 (Oct. 15, 2014) ("Katz Reply Decl."); *see also* Declaration of Michael L. Katz ¶¶ 85-92 (June 11, 2014) ("Katz Decl.") (describing the positive effects of the transaction on consumer welfare).

[11] *See, e.g.*, Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* at 571 (4th ed. 2005).

[12] *See, e.g.*, Robert S. Pindyck & Daniel L. Rubinfeld, *Microeconomics* at 26-27 (7th ed. 2009).

[13] *AT&T and BellSouth Corporation, Application for Transfer of Control*, Memorandum Opinion and Order, 22 FCC Rcd 5662, 5761 ¶ 202 (2007). *See also*, *e.g.*, *Applications of AT&T Inc. and Atlantic Tele-Network, Inc., for Consent to Transfer Control of and Assign Licenses and Authorizations*, Memorandum Opinion and Order, 28 FCC Rcd 13,670, 13,706 ¶ 66 (WTB/IB 2013).

[14] U.S. Department of Justice & Federal Trade Commission, *Commentary on the Horizontal Merger Guidelines* at 57 (2006). Indeed this basic principle underlies the theory that a merger of firms selling substitute products leads to upward pricing pressure ("UPP"). UPP following a merger derives from an increase in the marginal cost of selling an additional unit of output. *See* Katz Reply Decl. ¶ 21 n.40. In particular, the marginal cost effectively increases when sales are (Continued...)

savings in the form of lower prices is entirely consistent with increased firm profit.

Moreover, the pass through rate is not positively correlated with how competitive the industry is.[15] As Professor Katz explains:

> It is a well-established principle taught in freshman economics courses that even a monopolist–which the merged entity manifestly would not be–has incentives to pass through marginal cost decreases to consumers in whole or in part. In fact, economic theory does not generally predict that a firm competing in a concentrated market will likely pass through less of the cost savings than a firm in a more competitive market.[16]

Thus, regardless of the level of competition in the industry, marginal cost savings from a merger will put downward pressure on prices.

Consistent with these basic tenets of economics, the Horizontal Merger Guidelines recognize that "incremental cost reductions may reduce or reverse any increases in the merged firm's incentive to elevate price" and that "[e]fficiencies also may lead to new or improved products, even if they do not immediately and directly affect price."[17] Here, the Katz and Berry-Haile merger simulations demonstrate that, even before cost savings are taken into account, there

diverted from the merger partner. By the same reasoning, a marginal cost decrease creates downward pricing pressure.

[15] Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 971b ("In virtually all circumstances a firm with market power pockets some of the gains resulting from efficiencies and passes some on . . . .").

[16] Katz Reply Decl. ¶ 21. *See also generally* Jeremy I. Bulow & Paul Pfleiderer, *A Note on the Effect of Cost Changes on Prices*, 91 J. Pol. Econ. 182 (1983); Paul L. Yde & Michael G. Vita, *Merger Efficiencies: Reconsidering the "Passing-On" Requirement*, 64 Antitrust L.J. 735 (1996); Nathan H. Miller, Matthew Osborne & Gloria Sheu, *Pass Through in a Concentrated Industry: Empirical Evidence and Policy Implications*, Mimeo (Oct. 6, 2014).

[17] U.S. Department of Justice & the Federal Trade Commission, *Horizontal Merger Guidelines* at 29 (2010).

is *no* consumer harm to offset.[18] The pass through of content cost savings to customers is over and above the benefits that will accrue because of complementarities in the products supplied by the combined firms.[19]

B. The Berry-Haile Analysis Predicts That Consumer Prices Will Fall and AT&T's Video Profits Will Improve

The Berry-Haile merger simulation demonstrates that the pass through of savings to consumers is likely to be quite significant. The simulation does not *assume* pass through, but demonstrates it through the demand estimations driven by industry data. To derive the simulation's implied pass through rate, Professors Berry and Haile compared the post-merger change in the price of the AT&T video and broadband bundle assuming a **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]** per subscriber per month reduction in content costs with the price of the same bundle assuming no change in those costs. That analysis found that, for a **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]** reduction in video costs, AT&T would pass on **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T**

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[18] *See generally* Berry-Haile July 15 Quantitative Analysis Presentation; Berry-Haile Sept. 19 Quantitative Analysis Update Presentation; Katz Reply Decl. ¶¶ 2, 56-58.

[19] Berry-Haile Quantitative Analysis at 7-8 ("[A]n unusual feature of this merger is the presence of complementarities that work against the usual pricing pressures that can result from a merger. As a consequence, even before consideration of merger efficiencies, the sign of the effect on consumer welfare is ambiguous from theory alone. The results in [our modeling] indicate that with no cost efficiencies the merger would still be beneficial (or at least neutral) for consumers.").

HIGHLY CONFIDENTIAL INFORMATION] to consumers in the form of lower prices.[20] AT&T would retain only the remaining **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]** of cost savings as increased profits and margin.

The simulation also estimates the combined company's increase in output and the amount of total incremental profit earned on existing and incremental subscribers. It indicates that **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]** in cost savings would produce nearly **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]** additional subscriptions and approximately **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]** in total incremental profit. Thus, the analysis bears out economic theory that the combined company will split the cost savings between lower consumer prices and improved video profits and margins.

The lower price and higher profit effects hold across a range of content cost decreases. While the degree of pass through will vary at different levels of cost savings based on the shape of the demand curve, at any amount there will be some pass through as well as some profit improvement. To illustrate this point, we examined the annual content cost savings modeled by AT&T in its valuation of the transaction, and used the merger simulation model to calculate the associated pass through rates. AT&T's internal synergies model **[BEGIN AT&T HIGHLY**

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[20] Berry-Haile Sept. 19 Quantitative Analysis Update Presentation at 100c, 102, 111; *see also* Katz Reply Decl. ¶ 24 & n.46.

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[END AT&T HIGHLY CONFIDENTIAL INFORMATION] Table 1 depicts the corresponding effect that savings at these levels would have on prices, shares, output, profit margins, and total incremental profit implied by the Berry-Haile merger simulation.[22]

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21 *See* ATT-FCC-01640438; ATT-FCC-01645622 at Tab "Content Costs".

22 The calculations were run using the Berry-Haile simulation with three nesting parameters. The price, share, output, profit margin, and total incremental profit margin are reported based on the merger simulation's output at a projected level of cost savings. The simulation does not account for dynamic changes over time. Thus, projections are based on the associated level of pass through assuming the given cost savings were achieved today.

23 Incremental profit has two components. First, for each unit it sells, the company earns an additional profit (measured by the profit margin effect times the total units sold). Second, because the company lowered prices and increased output, it sells more units and earns a profit on each unit (measured by the output effect times the total profit).

The data thus confirm that each year prices will go down while profits increase and margins improve.

C. The Transaction Will Lead to Increased Output and Improved Quality

Consumers will also benefit from the cost savings through broadband infrastructure expansion.[24] As a result of the cost savings created by the merger, AT&T will expand Fiber to the Premises wireline broadband service to at least 2 million more customer locations than it would absent the merger. Those same cost savings will lead the combined company to deploy fixed wireless local loop technology to bring high-speed broadband to approximately 13 million largely rural customer locations. This, in turn, will lead to lower quality-adjusted prices in addition to those predicted by the merger simulation, which will stimulate even greater demand.

AT&T also will have increased incentives to invest in improved video services. For example, by combining DIRECTV's engineering expertise, experience in video packaging, and set-top box technology with AT&T's broadband networks and experience, the merged company will be better positioned to provide an improved video product, including more sophisticated interactive services, OTT services, and user interfaces. AT&T expects these improvements will be attractive to consumers and as a result, more consumers will buy bundles of integrated services.

[24] These benefits have been described extensively in AT&T's prior submissions to the Commission. *See, e.g.*, Description of the Transaction, Public Interest Showing, and Related Demonstrations at 39-45 (June 11, 2014); Declaration of John T. Stankey, Group President and Chief Strategy Officer AT&T Inc. ¶¶ 33-55 (June 10, 2014); Katz Decl. ¶¶ 125-35; Joint Opposition of AT&T Inc. and DIRECTV to Petitions to Deny and Condition Reply to Comments at 19-27 (Oct. 16, 2014); Katz Reply Decl. ¶¶ 34-45.

IV.
Conclusion

For the foregoing reasons, this merger will make AT&T's unprofitable video service more profitable and will also result in lower prices, enhanced quality, and expanded output.

WHY THE 'DOUBLE MORAL HAZARD' PROBLEM CANNOT BE RESOLVED BY CONTRACT

Submitted by

AT&T Inc. and DIRECTV

November 12, 2014

I.
Overview

As explained in the Public Interest Statement, the parties sell a "synthetic" bundle of DIRECTV satellite video service and AT&T broadband services. However, the synthetic bundle has been an inadequate substitute for the integrated video and broadband bundles offered by other providers. By combining, AT&T and DIRECTV will be able to replace synthetic bundles with truly integrated services offered by a single company. That improved bundle will benefit consumers. This paper explains that the consumer benefits from the integrated bundle are merger-specific, because overcoming the synthetic bundle's shortcomings is impractical if not impossible to achieve via contract.

AT&T and DIRECTV began selling bundles of DIRECTV video service and AT&T broadband service in 2009. Economic literature recognizes that where, as here, two independent firms jointly offer complementary products, a "double moral hazard" issue arises. That is, the parties have differing and misaligned incentives that weigh against investing in a joint offering in a way that will make it fully competitive with comparable offerings by vertically integrated firms. This phenomenon is borne out not only by economic theory, but also by AT&T's and DIRECTV's years of unsuccessful attempts to make the synthetic bundle more competitive.

Section II of this paper begins by discussing the economic literature regarding double moral hazard and explaining how separate firms that contract to jointly supply complementary services will inevitably have limited and misaligned incentives to invest in the joint offering. As economic theory would predict, the fundamental problem AT&T and DIRECTV face is that, so long as they remain separate firms, each ignores the benefits enjoyed by the other from the synthetic bundle, which leads to underinvestment in the bundle as a whole. As a consequence, neither party will invest at the optimal level necessary to promote the synthetic bundle or to remedy the poor customer experience it provides.

AT&T's and DIRECTV's multiple good-faith efforts to improve the shortcomings of the synthetic bundle have failed, confirming that the double moral hazard problem is insoluble for them. **[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION] In each attempt, the parties have been unable to overcome the structural problems inherent in their contractual relationship.

Then, Section III demonstrates that these issues are not unique to the particular relationship between AT&T and DIRECTV. The same problems plague AT&T's and DIRECTV's other synthetic bundle relationships. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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

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[1] ATT-FCC-03119760, *Marketing and Service Referral Agreement Number 20061208.002.C* (May 28, 2014) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**
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Finally, Section IV describes **[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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In sum, the evidence here demonstrates that, because of the double moral hazard problem, the parties cannot offer a synthetic bundle that is competitive with the offerings of cable companies and other integrated bundle providers. Thus, the synergy of creating an integrated bundle is merger-specific.

II.

The Joint Supply of Complementary Services by Separate Firms Poses a "Double Moral Hazard Problem" That Cannot Be Overcome by Contract

Independent firms that contract to jointly supply complementary products or services confront what economists have labeled a "double moral hazard problem:" the actions Firm A takes to increase demand for its own product also create a benefit for Firm B, but Firm A does not reap the benefits that its actions confer on Firm B. Firm A counts only its share of the profits from investments in the joint product offering and ignores the benefits and costs to Firm B when making decisions that affect the demand for both parties' products.[2] Because each party receives

[2] For a general discussion of the "moral hazard" problem, *see*, *e.g.*, Stephen A. Ross, *The Economic Theory of Agency: The Principal's Problem*," 63 Am. Econ. Rev., 134-139 (1973);

only a part of the benefits from any investment, each partner invests less than the total returns for both products in the bundle would justify if supplied by an integrated firm. In addition, each partner has an incentive to rely as much as possible ("to free ride") on investment from the other partner. This phenomenon results in lower investment in the joint offering—for example, in promotion, product quality, and customer service—as compared to a vertically integrated firm offering all the services in an integrated bundle.[3]

One variation of the double moral hazard problem is "double marginalization," in which each independent firm in a supply chain applies its own mark-up. The result is a higher price than a vertically integrated firm would charge.[4] This leads to pricing above what would be the profit-maximizing level for an integrated firm, so the joint offering is less competitive in the marketplace.[5]

Bengt Holmstrom, *Moral Hazard and Observability*, 10 Bell J. of Econ. 74–91 (1979); Francine Lafontaine, *Agency Theory and Franchising: Some Empirical Results*, 23 RAND J. of Econ. 263 (1992); Kenneth Arrow, *Essays in the Theory of Risk-Bearing* (1971).

[3] *See* Sue H. Mialon, *Product Bundling and Incentives for Merger and Strategic Alliance*, 2-3 (2011) (hereinafter "Product Bundling and Incentives"), *available at* http://www.suemialon.com/research/mb.pdf ("Allied firms do not gain from mixed bundling due to their free-riding incentives. Each firm wants to free ride on the other firm's bundle discount offer to increase the sales of bundled products. Thus, no discount is offered in the end."); Richard J. Arend, *Conditions for Asymmetric Information Solutions when Alliances Provide Acquisition Options and Due Diligence*, 82 J. of Econ. 281, 287-88 (2004) ("Alliances fundamentally possess the shared feature of ongoing mutual interdependence, a condition in which one party is vulnerable to another whose behavior is not under control of the first. . . . While the parties enter into an alliance seeking mutual benefits from their shared inputs, each party has an incentive to cheat to gain at the other's expense once inputs are committed. . . . The result is a game of Prisoners' Dilemma where alliance instability and feature are the usual outcomes.") (internal citations omitted).

[4] The underlying economic principle of the "double marginalization" problem was recognized by Cournot in 1838. Antoine Augustin Cournot, *Researches into the Mathematical Principles of the Theory of Wealth* (1897); *see also* Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* at 415-420 (2005).

[5] John Thanassoulis, *Is Multimedia Convergence to be Welcomed*?, 49 J. Indus. Econ. 225, 237 (2011) ("As B consumers who buy from Y1 also buy from X1, and X1 has raised her price,

As we demonstrate below, both economic theory and the parties' experience—in their synthetic bundle relationship and in their relationships with other parties—establish that these problems cannot be resolved by further efforts to negotiate a different contractual relationship.

A. Economic Literature Shows Inherent Weaknesses in Contracts as a Solution for Moral Hazard

The economic literature recognizes inherent difficulties in trying to overcome the double moral hazard problem through a contract between the parties because independent firms are unable to predict, specify, and monitor performance of the other party.

As the literature explains, contracts between independent parties can be ineffective mechanisms to achieve the efficiencies and benefits of vertical integration.[6] Contracts are a standard mechanism for parties to organize their marketing and distribution functions to capture the efficiencies of vertical integration,[7] but they do not change all the underlying incentives of the individual parties. When Firm A agrees to promote Firm B's product in exchange for a payment, the primary benefit Firm A receives is the payment, not the value of the sale of Firm B's product. Although Firm A's incentives to undertake promotion would increase if it were to

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the demand from B consumers is diminished. To counter this effect, Y1 must counteract some of the price rise from X1 by lowering her price. She doesn't counteract it all as such a price drop is loss making for the small AY type consumers. On balance therefore Y1 lowers her price, but not by as large a margin as X1 raised hers.").

6 Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. of Pol. Econ. 691 (1986); Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 Am. Econ. Rev. 112 (1971); Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents and the Competitive Contracting Process*, 21 J. of L. & Econ., 297 (1978); Armen Alchian and Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 Am. Econ. Rev. 777 (1972); Bengt Holmstrom and John Roberts, *The Boundaries of the Firm Revisited*, 12 J. of Econ. Perspectives 73 (1998); Philippe Aghion and Richard Holden, *Incomplete Contracts and the Theory of the Firm: What Have We Learned over the Past 25 Years?*, 25 J. of Econ. Perspectives 181 (2011).

7 *See, e.g.*, Carlton & Perloff, *Modern Industrial Organization* at 395-396.

receive a larger payment from Firm B whenever a sale is made, the existence of such a payment would *lower* Firm B's incentive to promote the product. Despite the existence of a contract, therefore, the two firms' incentives remain misaligned, and the double moral hazard problem remains unsolved.

Moreover, contracting parties generally cannot contract for every contingency that may affect the success of their efforts. There are high transaction costs associated with predicting, analyzing, and negotiating possible contingencies.[8] Particularly in rapidly changing, dynamic, and technology-driven industries such as those at issue here, it is extremely difficult for contracting parties to anticipate, and therefore account for, all possible contingencies and changing marketplace dynamics. As a consequence, even when parties attempt to address the double moral hazard problem through contract, it still does not enable them to respond swiftly and effectively to changes in competitive conditions.[9]

Furthermore, the economic literature indicates it is often infeasible to contractually specify, monitor, and enforce such future performance. For example, if Firm A agrees to pay Firm B a commission for each new Firm A customer Firm B secures, Firm B continues to

[8] *See, e.g.*, *id.* at 400 ("The more unpredictable the future and the more complicated the contract, however, the harder it is to specify contractual terms. People have *bounded rationality*: a limited ability to enumerate and understand all future possibilities. In complicated contracts, it is often too difficult to specify all possible contingencies, and a signed contract may contain provisions that turn out to be undesirable to one of the parties."). In addition, when a contractually unspecified contingency arises, contractual relationships can lead to opportunistic rent-dissipating behavior by one or both parties, further inhibiting incentives to invest in the relationship. This can be particularly problematic when the actions of either or both parties are difficult to observe. *See, e.g.*, Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 Am. Econ. Rev. 112 (1971).

[9] For instance, if a competing cable company offers a short-term promotion that reduces the price of its bundles, the parties would have to jointly negotiate an agreement on how to respond. This renegotiation would include the overall amount of the price reduction, whether one party or both would offer a price reduction, and the logistics of implementing the price reduction.

exercise its own discretion over many aspects of its sales operations, including how to compensate and otherwise direct its sales personnel who are selling Firm A's product. So long as Firm B has the ability to act on incentives to prioritize its own interests above those of Firm A, it will do so. And because no contract can anticipate or govern every aspect of the parties' performance, each firm will retain discretion to act accordingly.

The fact that each party to an inherently incomplete contract retains discretion over its conduct explains why, in economic theory as well as in practice, contracts often do not accomplish efficient vertical integration.[10] Separate parties have the ability and incentive to take advantage of contractual incompleteness to underperform or fail to optimize support for sales of the joint offering.[11] The incompleteness of contracts therefore allows parties to continue to act in their own interest, even at the expense of their joint offering.[12] Thus, double moral hazard remains a persistent obstacle to integration by parties to an arm's-length transaction.

B. The Parties' Experience with the Synthetic Bundle Confirms They Cannot Resolve Their Problems Through Contract

The experience of AT&T and DIRECTV with synthetic bundles vividly illustrates why contracts generally cannot overcome the inherent double moral hazard.

AT&T and DIRECTV have made numerous attempts to restructure their contractual relationship with the goal of making synthetic bundles more competitive. None of these efforts

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[10] *Id*.

[11] *See, e.g.*, Bengt Holmstrom & John Roberts, *The Boundaries of the Firm Revisited*, 12 J. of Econ. Perspectives, 73 (1998); Bengt Holmstrom & Paul Milgrom, *The Firm as an Incentive System*, 84 Am. Econ. Rev. 972 (1994); Armen Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 Am. Econ. Rev. 777 (1972). These economic theories focus on the incentive problem associated with worker performance in the context where desired worker performance cannot be fully observed and enforced.

[12] *See, e.g.*, Carlton & Perloff, *Modern Industrial Organization* at 400 ("When [transaction costs] are high, a firm may engage in opportunistic behavior… Each side may try to interpret the terms of a contract to its advantage, especially when terms are vague or even missing.").

has succeeded. **[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION] Moreover, despite the parties' efforts over the past six years,[15] customers of the parties' synthetic bundles continue to be subject to inconvenient and confusing sales, service, billing, and installation processes.

1. Commissions

Despite attempts to create commission arrangements that would boost each party's incentive to sell the other's offering, the parties have not been able to achieve that goal.

[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

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13 ATT-FCC-01492954, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

14 Declaration of Paul Guyardo, Executive Vice President and Chief Revenue and Marketing Officer, DIRECTV, ¶ 20 (June 10, 2014) ("Guyardo Decl.").

15 The current arrangement began in 2009. **[BEGIN AT&T & DIRECTV CONFIDENTIAL INFORMATION]**

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Because AT&T receives only a **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** of that value from the commission it receives, its incentive to invest in selling DIRECTV service is limited. Investing in the sale of DIRECTV video is particularly unattractive as compared to investing in sales of AT&T's own services, for which AT&T reaps the full value of a new subscriber. Unsurprisingly, AT&T spends up to **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** more (per subscriber) to acquire a new U-verse video subscriber than it spends to acquire a new DIRECTV subscriber.[18] AT&T likewise offers larger

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[16] **[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION] Declaration of Michael L. Katz ¶ 101 n.173 (June 11, 2014) ("Katz Decl.").

[17] Katz Decl. ¶ 102 n.175. Of course, the parties benefit in other ways from offering a synthetic bundle—for example, synthetic bundle customers may be less likely to churn to cable than stand-alone broadband or video customers. *See generally, id.* ¶¶ 100-103.

[18] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

discounts for its U-verse integrated bundles than for AT&T/DIRECTV synthetic bundles.[19]

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[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

Increasing the size of the commission payments would not solve the double moral hazard problem the parties face. In theory, AT&T could increase commission payments to reflect the full value to AT&T of each new AT&T broadband subscriber DIRECTV acquires, and DIRECTV could increase the commission it pays to AT&T to reflect the full value to DIRECTV of each new DIRECTV video subscriber AT&T acquires. Such commission payments would reflect the amounts a vertically integrated firm would consider when deciding whether to promote or invest in its bundle. But because they are separate providers, each incremental dollar that AT&T pays DIRECTV in the form of a commission raises the cost and lowers the profit of each AT&T broadband sale through DIRECTV, and thereby reduces AT&T's incentive to invest in the synthetic bundle; for the same reason, each additional dollar of commission that

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[END AT&T HIGHLY CONFIDENTIAL INFORMATION] *See* ATT-FCC-01350581, *Home Solutions Lifetime Values (LTV) 1Q2014* at 4 (2014).

[19] Declaration of Lori M. Lee, Senior Executive Vice President–Home Solutions, AT&T Inc. ¶ 56 (June 10, 2014) ("Lee Decl.").

[20] Guyardo Decl. ¶ 29.

[21] ATT-FCC-01469537, *DTV Churn* at 1 (Sept. 27, 2012) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

DIRECTV pays AT&T for selling DIRECTV video reduces DIRECTV's incentive to promote or invest in the joint offering. Neither party would pay commissions to the other party that match the full value of each new subscriber because the party paying such a commission would no longer profit from the synthetic bundle arrangement. This is the insurmountable dilemma of the double moral hazard problem: neither party captures the full value of its investment, and therefore neither party has sufficient incentive to invest consistent with joint profit-maximization.

2. Incentives To Sell Higher Broadband Speed

[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

22 ATT-FCC-03142475, *MSRA* (2009), § 2.8.1 and Appendix 1.9.

23 *See* Lee Decl. ¶ 58 **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

24 ATT-FCC-01322464, *MSRA* (2013), Appendix 2.8.1, § 1.3.

[END AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

These results are directly attributable to the double moral hazard problem, since each party's primary concern and source of profit is the sale of its portion of the bundle. **[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

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[25] ATT-FCC-00531887, *AT&T|DIRECTV Brief* at 2 (July 22, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[26] ATT-FCC-01487183, *Quarterly Business Review: Q2 2013* at 7 (Aug. 7, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[27] ATT-FCC-01267047, *2014 Q1 Quarterly Business Review* at 10 (Feb. 26, 2014). **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** Lee Decl. ¶ 58 **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[28] *See generally*, Katz Decl. ¶¶ 100-103.

3. Pricing

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[END AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION] These discounts are small as compared to discounts customers receive when they purchase integrated bundles.[29]

Because of the double marginalization problem, each party has limited incentive to invest in additional discounts. If AT&T invests in a promotion for the synthetic bundle, it will drive increased sales of DIRECTV's service, but the reward AT&T receives for that sale would be much lower than the reward DIRECTV receives.

The parties have also tried to implement various promotions to make their synthetic bundle more competitive:

- **[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[29] Guyardo Decl. ¶ 21; Lee Decl. ¶¶ 4, 54.

[30] ATT-FCC-01281728, *What are the issues associated w [sic] DTV selling BB* at 1 (Feb. 1, 2012).

[31] ATT-FCC-01454155, *Direct TV offer and launch activities* at 1 (Feb. 8, 2012).

[32] *Id.*

[33] ATT-FCC-01266443, *2014 Q1 Quarterly Business Review* at 14 (Feb. 26, 2014) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-03850057, *Bundles Program, Q1 2013 Business Review Breakout* at 25 (undated) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-03250722, *AT&T Bundles Program, Q3 2012 Business Review* at 36 (undated) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-03250722, *Q3 2012 Business Review* at 24 (undated) (describing upfront fees associated with synthetic bundle).

[34] ATT-FCC-00531887, *AT&T/DIRECTV Brief* at 3 (July 22, 2013).

[35] ATT-FCC-01267047, *2014 Q1 Quarterly Business Review* at 13 (Feb. 26, 2014).

[36] ATT-FCC-01445831, *Bundles Program, Q3 2012 Business Review* at 24 (Sept. 27, 2012) (describing upfront fees associated with synthetic bundle).

[END AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

4. Common Set-Top Box

Advanced set-top boxes that take advantage of the complementary features of video and broadband are a key area of competition for bundled services. These devices include features such as integrated OTT services and additional channels delivered via broadband. Time Warner Cable, Verizon, and Comcast have all invested aggressively in this new technology.[39] **[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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37 Lee Decl. ¶ 58.

38 *See, e.g.*, ATT-FCC-01266443, *2014 Q1 Business Review* at 4 (Feb. 26, 2014) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** ATT-FCC-01487183, *Q2 2013 Business Review* at 12 (Aug. 7, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

39 **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** ATT-FCC-01466264, *U-verse 101: High Level Product and Marketing Overview* at 33 (undated).

[END AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

5. Improved Customer Experience

One reason customers value integrated bundles is the added convenience such bundles offer,[41] including a single bill and a single point of contact for customer service.[42] By contrast, the synthetic bundle sales process often requires two separate calls.[43] Prospective synthetic bundle customers report numerous problems with the ordering process.[44] Troubleshooting and billing also are more difficult where there are two companies to contact. **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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40 ATT-FCC-01461312, *AT&T DIRECTV Transition Document* at 3 (May 16, 2013).

41 ATT-FCC-00743296, *Benefits of Bundling* at 2 (undated) (citing J.D. Power 2013 Residential TV Service Study).

42 Description of the Transaction, Public Interest Showing, and Related Demonstrations at 31(filed June 11, 2014) ("Public Interest Statement"). **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** ATT-FCC-00743296, *Benefits of Bundling* at 3 (undated) (citing J.D. Power 2013 Residential TV Service Study); *see also* DTVFCC-00394451, *Bundles Vulnerability* at 7, 13 (Nov. 26, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

43 Public Interest Statement at 27 n.73.

44 Guyardo Decl. ¶ 35; DTVFCC-03040504, *Bundles Journey*, at 6 (undated); DTVFCC-00670255, *Customer Experience—Steering Committee* at 9, 14 (Apr. 1, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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In addition, customers of the synthetic bundle typically require two installation appointments. Although the parties try to schedule installation appointments on the same day, **[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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[45] DTVFCC-00670255, *Customer Experience—Steering Committee* at 16 (Apr. 1, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[46] DTVFCC-02626878, *DIRECTV, Bundles vs. Pure play challenges*, at 1 (undated) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[47] ATT-FCC-01279645, *AT&T-DIRECTV Bundles Program, Q1 2013 Business Review Breakout*, at 10 (undated) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[48] DTVFCC-00670255, *Customer Experience—Steering Committee* at 13 (Apr. 1, 2014).

[49] *Id*. at 15.

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Despite these initiatives, the parties have been unable to match the customer experience offered by integrated providers. Many synthetic bundle customers still are required to talk to multiple call center employees for billing and service. Customers who purchase AT&T

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[50] *Id*.

[51] ATT-FCC-00531887, *AT&T-DIRECTV Brief* at 3 (July 22, 2013).

[52] *Id*.

[53] ATT-FCC-01454155, *Direct TV offer and launch activities* at 1-2 (Feb. 8, 2012).

[54] ATT-FCC-01471872, *2013 Marketing Plans—Advertising, Promotion, Product, Pricing and Retention Strategies* at 14 (undated).

[55] ATT-FCC-00531887, *AT&T-DIRECTV Brief* at 3 (July 22, 2013).

[56] *Id*.

[57] *Id.* **[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[58] *Id*.

broadband through DIRECTV continue to receive two bills, which for many do not reflect **[BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

The parties have not fixed these problems because there is not a sufficient economic incentive to do so: **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

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59 DTVFCC-00670255, *Customer Experience—Steering Committee* at 10-11, 13 (Apr. 1, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

60 DTVFCC-03310155, *Discussion of Business Models for DIRECTV Bundles* at 3-4 (May 3, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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III.

The Parties' Experience in Other Synthetic Bundling Relationships Further Demonstrates Their Inherent Limitations

The difficulty of overcoming the inherent limitations of synthetic bundling is also evident in AT&T's and DIRECTV's other synthetic bundle relationships.

A. AT&T/DISH

[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

61 ATT-FCC-003119760, *Marketing and Service Referral Agreement Number 20061208.002.C* (May 28, 2014) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**
[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

62 ATT-FCC-01267040, *Wired Inwards March 2014 Report* (2011-2013 broadband sales figures).

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] Indeed, DISH has announced a new strategy, choosing to invest in its own broadband and partnering with cellular network providers such as Sprint to offer wireless broadband.[64]

B. DIRECTV's Other Broadband Bundle Relationships

DIRECTV has agreements to provide synthetic video and broadband bundles with CenturyLink, Verizon, Exede (owned by ViaSat), HughesNet, Windstream, Cincinnati Bell, and Mediacom.[65] **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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[63] ATT-FCC-01278881, *DISH and channel metrics* at 5 (July 13, 2012) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[64] Charles Ripley, *Sprint and DISH Network Cut the Broadband Cord*, PCWorld, (Dec. 17, 2013), http://www.pcworld.com/article/2081128/sprint-and-dish-network-cut-the-broadband-cord.html (describing DISH-Sprint Network partnership to offer broadband through Sprint's 4G LTE network); Trefis Team, *Dish Network Sweeps H-Block Spectrum Auction for $1.56 Billion*, Forbes (Mar. 5, 2014), http://www.forbes.com/sites/greatspeculations/2014/03/05/dish-network-sweeps-h-block-spectrum-auction-for-1-56-billion/ (describing DISH's successful bid for wireless broadband frequencies in 176 markets); Marina Lopes, *Sprint in Talks With Dish on Broadband Partnership*, Reuters, (Mar. 27, 2014), http://www.reuters.com/article/2014/03/27/us-softbank-son-dish-idUSBREA2Q21220140327 (describing planned Dish-Sprint partnership on broadband offering).

[65] DTVFCC-03259882, *Bundles Marketing* at 4 (July 18, 2014); DTVFCC-00670255,*DIRECTV, Customer Experience—Steering Committee* at 10 (Apr. 1, 2014). DIRECTV also had a wholesale relationship with WildBlue, a satellite broadband provider, from 2006 to 2012, which ended because of an exceptionally high customer churn rate. Guyardo Decl. ¶ 25. "This was primarily due to WildBlue's technological limitations, and in particular its maximum download speed of only 1.5 Mbps." *Id.*

[66] **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-03259882, *Bundles*

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] The problems DIRECTV faces consistently across all its synthetic bundle partnerships are its inability to provide a competitive broadband speed, sell at a competitive price, or offer convenient customer service.[68] DIRECTV and its other broadband partners have limited incentive to make investments that would improve sales or the marketability of these bundles. **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

Marketing, at 4 (July 18, 2014); DTVFCC-00670255, *Customer Experience – Steering Committee*, at 10 (Apr. 1, 2014).

[67] DTVFCC-03259882, *Bundles Marketing*, at 4 (July 18, 2014).

[68] Guyardo Decl. ¶ 21; *see also* DTVFCC-02883718, *DIRECTV 2013 Strategy Context*, (July 24, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

[69] *See, e.g.*, DTVFCC-01725060, *Mid-Year Business Review*, at 16 (July 15, 2013).

[70] DTVFCC-01725060, *Mid-Year Business Review*, at 16 (July 15, 2013).

[71] DTVFCC-01720997, *Unresolved Billing and Horrible Customer Service* (May 24, 2013). **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

[72] DTVFCC-02878099, *Bundles Marketing* at 4 (July 18, 2014); DTVFCC-00670255, *Customer Experience—Steering Committee*, at 10 (Apr. 1, 2014).

[73] DTVFCC-00993312, *Sales & Marketing Strategy: A More Segmented Approach* at 23 (July 2011).

[74] DTVFCC-01725060, *Mid-Year Business Review* at 16 (July 15, 2013).

[75] WHIM-001-0494, *DIRECTV 2013 Strategy Context* (July 24, 2013).

[76] *See* DTVFCC-00670053, *All-Connect Data Summary* (May 31, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] Incidents such as this—and their mere potential to occur—lessen providers' incentives to make significant investments in a partnership of limited duration.

DIRECTV's various partnerships to supply a synthetic bundle suffer **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] of DIRECTV's new video subscribers purchased a synthetic bundle from DIRECTV or any of its partners in 2013.[78] **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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77 *See id.* **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-03248441, *Bundles Monthly Review* at 2 (July 31, 2012) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

78 Guyardo Decl. ¶ 20.

79 *Id.* ¶ 14.

80 *Id.* ¶ 35.

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

IV.

The Parties' Unsuccessful Attempts to [BEGIN AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION] [END AT&T & DIRECTV HIGHLY CONFIDENTIAL INFORMATION] Further Illustrate the Intractable <u>Double Moral Hazard Problem They Face</u>

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81 *Id.*

82 ATT-FCC-00515970, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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84 DTVFCC-00708575, **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

85 DTVFCC-03279494, *AT&T IPDSL Wholesale Proposal* (undated) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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[86] *Id.*

[87] *Id*

[88] *Id.* **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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[89] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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91 ATT-FCC-00125578, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

92 ATT-FCC-00134163, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

93 ATT-FCC-00515305, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

94 ATT-FCC-00556691, *ATT DTV Weekly Meetings* at 1 (May 21, 2014).

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95 Letter from Maureen R. Jeffreys, Counsel for AT&T Inc., to Marlene H. Dortch, Esq., Secretary, Federal Communications Commission (filed June 27, 2014). (describing household living units served by AT&T IPDSL service).

96 ATT-FCC-00134163, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION] [END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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V.
Conclusion

AT&T and DIRECTV have spent more than half a decade trying to contract around the double moral hazard problem to compete for customers who strongly prefer integrated bundles. They have failed, despite repeated attempts to offer seamless and competitive pricing, billing, customer support, installation, and innovative features. As the economic literature would predict, the parties simply do not have the incentives to make the same investments that an integrated provider would.

Through the proposed acquisition, the parties would be able to eliminate double moral hazard and act on a common profit-maximizing incentive to provide new, enhanced, and more competitive products.

ADDITIONAL EVIDENCE THAT VIDEO AND BROADBAND ARE COMPLEMENTS

Submitted by

AT&T Inc. and DIRECTV

November 12, 2014

I.
Overview

As explained in the Public Interest Statement, the proposed transaction will promote competition in part due to the complementary nature of MVPD and broadband services. This paper provides further explanation and documentation of three types of complementarity of MVPD and broadband services: (i) intrinsic complementarity, (ii) complementarity from the existence of bundles, and (iii) supply-side complementarity.

First, consumer behavior, industry behavior, and econometric analysis all strongly support the intrinsic complementarity of MVPD and broadband services. Consumers routinely use and overwhelmingly buy the two services together, typically from the same seller in an integrated bundle. Content owners, technology companies, and electronics manufacturers likewise rely on the inherent complementarity in making investment decisions. The econometric analysis previously provided by the parties also confirms that the two services are intrinsic complements.

Second, economic literature confirms that complementarity can result from competing with bundles, as described by Professors Berry and Haile in the Applicants' September 23, 2014 submission to the Commission. The presence of bundle discounts for broadband and video offered by cable providers means that an increase in the price of either AT&T broadband or DIRECTV MVPD service will drive down demand for the other service. Such an increase will induce consumers who currently purchase both services on a stand-alone basis to switch to the discounted cable bundle. We explain that conclusion in depth below, including by formal proof based upon economic literature.

Third, there are important supply-side complementarities in the provision of MVPD and broadband services. These complementarities relate to the shared use of certain network facilities, the supply of video-on-demand and other complementary video services, the targeting of advertisements, and the provision of customer service (such as installation, billing, and customer care).

II.
Intrinsic Complementarity

As one writer put it, "TV and internet are the PB&J of residential services— they just go well together."[1] FCC Commissioner Wheeler recently noted that "[t]hose seeking to deploy new competitive broadband networks tell us that it's hard to provide new high-speed Internet access without also being able to offer a competitive video package as well."[2] These statements capture the essential truth here: combining the technological and other features of MVPD and broadband services enables an enhanced consumer experience that cannot be obtained from using either service in isolation.[3]

In this section, we demonstrate the intrinsic complementarities of broadband and MVPD services using evidence from the existing record and from new sources regarding: (1) consumer behavior; (2) industry behavior, including the parties' own conduct and documents; and (3) econometric analysis.

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[1] *See* Becky Bracken, *Video Delivery: Why Fiber Works*, PIPELINE Vol. 10:2 (2013), *available at* http://www.pipelinepub.com/video_optimization/fiber_networks.

[2] Tom Wheeler, *Tech Transitions, Video, and the Future*, Official Federal Communications Commission Blog (Oct. 28, 2014), http://www.fcc.gov/blog/tech-transitions-video-and-future.

[3] *See* Alfred Oxenfeldt, *Product Line Pricing*, Harvard Business Review at 142-43 (July/August 1966) (discussing complementarity from "related use," enhanced value," and quality supplements," among other factors).

A. Consumer Behavior Demonstrates That MVPD and Broadband Are Complements

Consumer Usage. An MVPD subscriber without broadband connectivity usually can only passively watch the available content that the MVPD transmits on the few devices (television sets) connected to the MVPD service. Adding a broadband connection changes that consumer experience significantly.

For example, by converting a one-way connection into a two-way connection, consumers can communicate with the MVPD and use their broadband connection to receive the MVPD programming on demand, and thus on their own schedule, not the video provider's. Subscribers can also stream video content transmitted by the MVPD to computers, tablets, and phones, so they are no longer limited by the location of a connected television. And they can use that full array of devices to access additional video content from over-the-top video (OTT) providers.

Providers also can and do offer customers who have both an MVPD service and a broadband connection the ability to watch the same content across multiple screens. For instance, with MVPD service and a broadband connection, a subscriber can watch the first part of a video program on television and the rest later on a tablet or laptop.

In addition, connecting broadband directly to the set-top box enables MVPD subscribers to access many more features. Those features include interactive television, e-commerce, social media, OTT video, and fantasy sports statistics or other relevant information delivered while the consumer is watching a sporting event or other live programming.

Another example of the complementary relationship between MVPD and broadband services involves consumers' use of a "second screen"—a laptop or mobile device—*at the same* *time* they are watching television.[4] According to one source, 59% of TV viewers simultaneously participate in social networking sites and forums to discuss the shows they are watching, and 49% of viewers use apps or browse the internet to find out more about the content they are watching.[5]

Many broadband apps offer even further integration. Content providers are offering downloadable applications that enable viewers to "interact with and learn more about what they're watching on TV, in some cases syncing the application with the TV show."[6] For example, football fans can use ESPN's fantasy football app to track the performance of their fantasy team and interact with other fans while watching the game live on television, interactions that simply cannot occur without the broadband connection.[7] NASCAR's mobile app allows fans watching a race on television to get a deeper experience through "dynamic views of the

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4 *See, e.g.*, Google, *The New Multi-screen World: Understanding Cross-Platform Consumer Behavior* at 25, 28 (Aug. 2012), *available at* http://www.slideshare.net/smobile/the-new-multiscreen-world-by-google-14128722 (reporting that television viewers are also using a smartphone or computer 77% of the time, and that 22% of this simultaneous usage is complementary); Nielsen, *In the U.S., Tablets Are TV Buddies While EReaders Make Great Bedfellows* (May 19, 2011), http://www.nielsen.com/us/en/insights/news/2011/in-the-u-s-tablets-are-tv-buddies-while-ereaders-make-great-bedfellows.html (reporting that approximately 70% of tablet and smartphone owners used their devices while watching television).

5 Ericsson Consumer Insight Summary Report, *TV and Media: Identifying the Needs of Tomorrow's Video Consumers*, at 3, 5 (Aug. 2013), *available at* http://www.ericsson.com/res/docs/2013/consumerlab/tv-and-media-consumerlab2013.pdf.

6 Breeanna Hare, *Twice as Much TV? How Networks Are Adapting to the Second Screen*, CNN (Sept. 15, 2012), http://www.cnn.com/2012/09/15/showbiz/tv/second-screen-tv-our-mobile-society.

7 Rimma Kats, *ESPN Strengthens Second Screen Experience with iPad App*, Mobile Marketer (Sept. 7, 2012), http://www.mobilemarketer.com/cms/news/content/13717.html.

track and drivers, customized news and headlines, a leaderboard, and live cameras at the track."[8] Popular crime drama series *Breaking Bad* offered viewers an official website featuring interactive games, trivia quizzes, and a "crime scene evidence" file where viewers could collect and analyze data as it was reviewed on the show.[9] And ABC had great success with its "Backstage Pass" app, which offered Oscars award show viewers "'all-access' . . . beyond what they could see at any one time on their television screens."[10]

The addition of MVPD service likewise enhances a consumer's broadband connection. Broadband consumers devote a great deal of their Internet usage to discussing television content, watching (and re-watching) old episodes of television shows, and accessing sports news and fantasy sports websites. All of the Internet content relating to television programming, such as the *Breaking Bad* online content referenced above, would be substantially less useful without an MVPD service delivering new *Breaking Bad* episodes. In addition, audio podcasts that tie in to popular television shows frequently rank among the most popular on Apple's iTunes service.[11]

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[8] Mark Sullivan, *NASCAR Wants Your Phone To Be a Vital Second Screen During Races*, Venture Beat (July 9, 2014), http://venturebeat.com/2014/07/09/nascar-wants-your-phone-to-be-a-vital-second-screen-during-races/.

[9] AMC, *Breaking Bad*, *available at* http://www.amctv.com/shows/breaking-bad (last visited October 25, 2014).

[10] Breeanna Hare, *Twice as Much TV? How Networks Are Adapting to the Second Screen*, CNN (Sept. 15, 2012), http://www.cnn.com/2012/09/15/showbiz/tv/second-screen-tv-our-mobile-society (citing Albert Cheng, chief product officer and the executive vice president of digital media for Disney/ABC Television).

[11] *See, e.g.*, *'ESPN Fantasy Focus Football' American iTunes Chart Performance*, iTunes Charts, http://www.itunescharts.net/us/artists/podcast/espn/podcasts/espn-fantasy-focus-football/ (last visited Oct. 10, 2014); *'The Daily Show Podcast Without Jon Stewart' American iTunes Chart Performance*, iTunes Charts, http://www.itunescharts.net/us/artists/podcast/comedy-central/podcasts/the-daily-show-podcast-without-jon-stewart/ (last visited Oct. 10, 2014); *'NPR: Pop Culture Happy Hour Podcast' American iTunes Chart Performance*, iTunes Charts,

Purchasing Behavior. Consumers overwhelmingly purchase MVPD and broadband services together. More than 70% of U.S. households subscribe to both services.[12] Consumers frequently purchase the two services as part of a bundle that may include other services, such as wireline voice.[13] Further, consumers do not purchase bundles in these numbers merely because providers offer MVPD and broadband services together. Rather, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] And consumers who bundle MVPD and broadband are more likely to be satisfied and continue those services longer.[16] The fact that

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http://www.itunescharts.net/us/artists/podcast/npr/podcasts/npr-pop-culture-happy-hour-podcast/ (last visited Oct. 10, 2014).

[12] *See* Nielsen, *Shifts in Viewing: The Cross-Platform Report* at 17 (Sept. 2014), *available at* http://www.nielsen.com/content/dam/corporate/us/en/reports-downloads/2014%20Reports/q2-2014-cross-platform-report-shifts-in-viewing.pdf.

[13] *See* Tony Lenoir, *Cable's triple-play penetration of basic video subs doubled in the last 5 years*, SNL Kagan (Sept. 12, 2013) (stating that, in second quarter of 2013, 78% of cable video subscribers purchase at least a double-play bundle of services and 42% take a triple-play bundle); Declaration of Lori M. Lee, Senior Executive Vice President–Home Solutions, AT&T Inc. ¶ 12 (June 10, 2014) ("Lee Decl.") (noting that 97% of U-verse video customers subscribe to a bundle).

[14] ATT-FCC-01586899, *Video Strategy Working Team Meeting–Core Beliefs and Proof Points Discussion* at 4, 15 (Feb. 5, 2013) (emphasis added) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[15] *Id.* at 4.

[16] *See* FCC, Working Paper, *Broadband Decisions: What Drives Consumers to Switch– or Stick with—Their Broadband Internet Provider* at 8-9 (Dec. 2010), *available at* http://www.fcc.gov/encyclopedia/broadband-speed (reporting that 54% of users who switched

consumers purchase (and retain) bundled MVPD and broadband is strong evidence that the two services are complements.[17]

Increase in Cord Cutting Does Not Undermine the Intrinsic Complementarity. Although Internet video accounts for a substantial portion of consumer IP traffic in terms of bandwidth, the actual amount of time consumers spend viewing video is relatively small compared to social networking and other activities.[18] Additionally, OTT services such as Netflix, Hulu, Amazon Prime, and AppleTV are designed to complement traditional MVPD services in terms of available content. Indeed, the CEOs of both Netflix and Hulu have described their services as

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Internet providers cited the availability of a bundle as either a major or minor reason for the switch, while 44% of customers considering switching providers cited "having to change your current bundle" as a "major" reason not to change); Jeffrey Prince, Time Warner Cable Research Program on Digital Communications, *The Dynamic Effects of Triple Play Bundling in Telecommunications* at 26 (Winter 2012), *available at* http://www.twcresearchprogram.com/publications.php (reporting that bundling reduces "churn" rates for all "triple-play" services); Ernst & Young LLP, The Bundle Jungle: A Closer Look at Consumer Attitudes Towards Buying Broadband, Telephone and TV at 3 (2013), http://www.ey.com/UK/en/Industries/Telecommunications/The-Bundle-Jungle#.VEt3TphOX4Y (surveying UK customers and reporting that bundle customers have a lower propensity to switch service providers).

[17] *See* Hongju Liu, Pradeep K. Chintagunta & Ting Zhu, *Complementarities and the Demand for Home Broadband Internet Services* at 5–6 (Chicago Booth Sch. Bus., Working Paper No. 08-30, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1275624 (follow "Download This Paper" hyperlink; then follow "Chicago Booth" hyperlink) ("We find evidence for strong complementarities between consumption of cable television and cable modem, and between local telephone and DSL, after controlling for the effects of price and for preference correlations. The main source of such complementarities is the convenience to households in having a single provider for multiple services. In the absence of such a single-provider effect for phone companies, the share of their DSL services on the broadband market would have reduced by 48%. . . . In fact, if phone companies gave no discount on the local telephone + DSL bundle, the market share for their DSL services would drop by only 19%.").

[18] Nielsen, State of the Media: U.S. Consumer Usage Report 2 (Jan. 7, 2013), *available at* http://www.nielsen.com/content/corporate/us/en/insights/reports/2013/state-of-the-media--u-s--consumer-usage-report.html (showing 20.1% of time spent on social networks/blogs, 8.1% on online games, 7.1% on e-mail, and 5.2% on videos/movies).

"complementary" to traditional pay TV.[19] Those services provide MVPD subscribers *additional* options without replacing their MVPD service. The Netflix catalog, for example, has only limited overlap with the content available through U-verse video on demand.[20]

Consumers who rely on broadband video alone tend to be "cord nevers," including young adults who show a "growing propensity . . . to never sign up for cable TV in the first place."[21] The presence of this relatively small, if growing, number of cord nevers does not undermine the intrinsic complementarity of broadband and MVPD. In analyzing that complementarity, the key question is whether an increase in the price of one service will decrease demand for the other (and vice versa).[22] As to the vast majority of consumers, the answer to that question is yes, and the evidence of consumer usage and purchasing behavior discussed above demonstrates that fact.

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[19] *See Netflix's CEO Presents at the UBS 39th Annual Global Media and Communications Conference*, Event Transcript (Dec. 6, 2011), http://seekingalpha.com/article/313020-netflixs-ceo-presents-at-the-ubs-39th-annual-global-media-and-communications-conference-event-transcript?part=single (Netflix CEO Reed Hastings stating "we're very complementary to the classic MVPD service"); Sam Thielman, *Character Study*, Adweek 40 (Apr. 28, 2014) (quoting Hulu CEO Mike Hopkins stating "the majority of our customers are pay TV customers as well. We're a complementary product for them.").

[20] *See* ATT-FCC-00933269, *AT&T and Netflix* at 3 (May 27, 2014).

[21] *See* Steve Peterson, *Cord-Cutting Continues to Grow*, Video Ink (Sept. 15, 2014), http://www.thevideoink.com/news/cord-cutting-continues-grow/#.VEtQS5hOX4Y; *see also* Press Release, N.Y. Times Co., *Results of the New York Times Customer Insight Group's 2013: The Year of Video Survey* (Oct. 17, 2013), *available at* http://www.nytco.com/results-to-the-new-york-times-customer-insight-groups-2013-the-year-of-video-survey/ (reporting that 34% of millenials are watching "mostly online video/no broadcast TV").

[22] *See, e.g.*, Declaration of Michael L. Katz ¶ 67 (June 11, 2014).

B. Industry Participants, Including AT&T and DIRECTV, Recognize That MVPD and Broadband Are Complements and Manage Their Businesses Accordingly

Recognizing the inherent complementarity of these products, competitors across the industry are investing heavily to respond to consumer demand to buy and use MVPD and broadband services together.

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

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] In the same vein, AT&T's documents make clear that its "overriding strategic goal is to increase broadband sales by offering [an MVPD/broadband] bundle . . . even if it means the video component is not an AT&T product."[26] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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23 ATT-FCC-00530007, *Video Strategy Projects for 2013* at 3 (Mar. 7, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

24 ATT-FCC-00521977, *May Strategy Offsite: Day 1* at 6 (May 30, 2013).

25 ATT-FCC-00642367, *U-verse Evolution* at 1 (May 23, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

26 Lee Decl. ¶41.

27 ATT-FCC-00521977, *May Strategy Offsite: Day 1* at 12 (May 30, 2013).

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[28] ATT-FCC-00521625, *TAC Whitepapers – Summary of Contents* at 9 (Feb. 6, 2014).

[29] ATT-FCC-01838191, *TVE: U-verse Everywhere* at 8 (Mar. 2013).

[30] ATT-FCC-03447902, *AT&T Video Strategy Discussion* at 19 (Nov. 22, 2013).

[31] ATT-FCC-01838191, *TVE: U-verse Everywhere* at 8 (Mar. 2013).

[32] ATT-FCC-00414403, *AT&T Video Strategy* at 12 (Apr. 3, 2013).

[33] *Id.* For example, one AT&T document notes that **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] ATT-FCC-01618650, *AT&T vs. the Competition Offer Comparison* at 2 (Mar. 21, 2013). Other AT&T documents cite the need **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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AT&T is providing an integrated and interactive video experience through its "U-verse Enabled" program, which encourages third parties to develop "second screen" applications aimed at complementing the U-verse video experience.[34] For example, a U-verse Enabled tablet app can run in parallel to U-verse TV programming and automatically share information with the customer's friends on social networking sites and supply complementary content while the customer watches.[35]

AT&T is also working with third-party OTT providers to integrate their products into AT&T's MVPD service.[36] AT&T has also launched service offerings that bundle MVPD and OTT services. AT&T recently introduced a first-of-its-kind bundle that packages a one-year Amazon Prime subscription with 18 Mbps broadband, U-basic TV, and HBO.[37] In addition,

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INFORMATION] *See* ATT-FCC-00541257, *Video Strategy: U-verse Evolution* at 3 (May. 17, 2013).

[34] The Software Development Kit ("SDK") for third-party developers is available for download on AT&T's developer website. *See* Get AT&T U-verse Enabled SDK, AT&T, http://developer.att.com/developer/legalAgreementPage.jsp?passedItemId=10100309 (last visited Oct. 24, 2014).

[35] AT&T, *Start Up Quickly Creates Innovative Social TV Application*, AT&T U-verse Enabled Case Study at 3, *available at* http://developer.att.com/static-assets/documents/u-verse-enabled/att-miso-case-study.pdf.

[36] Lee Decl. ¶ 46.

[37] *See* AT&T, Speed + HBO and Amazon, https://www.att.com/shop/tv/hbo-offers.html#fbid=y5NUYDZpiVU (last visited Oct. 24, 2014); *see also* ATT-FCC-01899101, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] Amazon is not AT&T's only partner in delivering third-party OTT content. AT&T offers content from Hulu's video library through Uverse.com, an

AT&T earlier this year launched an "Internet + HBO" discount bundle, which includes 18 Mbps broadband, local broadcast channel MVPD service, and HBO and its OTT companion service, HBO Go.[38] Those offerings demonstrate AT&T's understanding that customers, above all, demand access to high-quality video programming, whether that programming is delivered via their broadband or their MVPD service.

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OTT platform where both AT&T and non-AT&T subscribers can access over 350,000 free videos. Uverse.com also serves as AT&T's TV Everywhere platform, where U-verse TV subscribers can access authenticated content anytime, anywhere.

[38] Lee Decl. ¶ 46.

[39] ATT-FCC-03461997, *Draft Outline–Digital Content Experience Strategy* at 1–2 (July 18, 2014).

[40] *See generally id.* at 2-3 **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[41] *Id.* at 2-4.

DIRECTV. DIRECTV likewise recognizes the complementary relationship between MVPD and broadband services. Although it does not have its own broadband service, it has undertaken numerous efforts to make broadband connectivity available to its video subscribers.

Because it lacks a broadband service of its own,[42] DIRECTV has sought to meet the consumer demand for complementary broadband service by selling synthetic bundles with various partners.[43] Although, as the parties have described, synthetic bundles do not offer a compelling customer experience,[44] DIRECTV continues to market them because it has no other way to meet consumers' demand for broadband service.

DIRECTV also has felt compelled to invest in numerous broadband-enabled services—which its subscribers can take advantage of using broadband connections obtained through synthetic bundles or from other providers—and it is developing many more. "DIRECTV On Demand," offers 2,000 available titles, including movies, music, popular TV programs,

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[42] *See* DTVFCC-00993312, *Sales & Marketing Strategy: A More Segmented Approach* at 28 (July 2011) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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[43] *See, e.g.*, DTVFCC-01795707, *2012 Sales & Marketing Objectives* at 7 (Mar. 5, 2012) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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[44] *See* Declaration of Paul Guyardo, Executive Vice President and Chief Revenue and Marketing Officer DIRECTV ¶¶ 18-38 (June 10, 2014) ("Guyardo Decl."); Lee Decl. ¶¶ 53-60; *Why the 'Double Moral Hazard' Problem Cannot Be Resolved by Contract* (filed Nov. 12, 2014).

animation, cartoons and more, to users with a broadband connection.[45] Similarly, DIRECTV offers "TV Apps," which enable customers to access online content on their television screens by clicking a button on their remote controls.[46] TV Apps content includes weather information; sports scores, standings, and schedules for all major sports; social media, such as from Facebook and Twitter; and fantasy football statistics.[47] Additionally, DIRECTV offers music streaming (such as through Pandora) and video streaming (such as through YouTube) on the televisions of customers who have broadband connections.[48] **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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[45] DIRECTV, About DIRECTV on DEMAND, https://www.directv.com/dod/faq.html (last visited Oct. 25, 2014); DIRECTV, DIRECTV ON DEMAND, http://www.directv.com/technology/on_demand (last visited Oct. 25, 2014) ("To start enjoying DIRECTV On Demand, you just need an HD DVR connected to the Internet"); DTVFCC-00993312, *Sales & Marketing Strategy: A More Segmented Approach* at 30 (July 2011) **[BEGIN DIRECTV CONFIDENTIAL INFORMATION]** **[END DIRECTV CONFIDENTIAL INFORMATION]**

[46] DIRECTV, What are the DIRECTV TV Apps and how do I access them on my TV?, https://support.directv.com/app/answers/detail/a_id/1969/~/what-are-the-directv-tv-apps-and-how-do-i-access-them-on-my-tv%3F (last visited Oct. 25, 2014).

[47] DIRECTV, What interactive features are available with NFL SUNDAY TICKET on my TV?, https://support.directv.com/app/answers/detail/a_id/1666/~/what-interactive-features-are-available-with-nfl-sunday-ticket-on-my-tv%3F (last visited Oct. 25, 2014); DIRECTV, NFL Sunday Ticket, http://www.directv.com/sports/nfl (last visited Oct. 25, 2014).

[48] DIRECTV, *Connect to the internet*, http://www.directv.com/DTVAPP/content/directv/technology/mediashare (last visited Oct. 26, 2014).

[49] DTVFCC-00173673, *OTT Strategy* at 13 (July 23, 2014).

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Additionally, DIRECTV's GenieGO product enables customers with broadband connections to simultaneously record five different programs and watch their video content through secondary devices, such as laptops, tablets, and mobile phones.[53] **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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50 *See, e.g.*, DTVFCC-02775359, *DIRECTV Content Strategy: Full Strategy Document* at 19 (2Q 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-00112375, *Disruption strategic risk assessment and implications for DIRECTV* at 21 (July 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

51 DTVFCC-00997432, *New Product Roadmap: TV Everywhere, Mobile, OTT* at 9 (June 30, 2010).

52 *See Why the 'Double Moral Hazard' Problem Cannot Be Resolved by Contract* at 16-17 (filed Nov. 12, 2014).

53 DTVFCC-02748409, *DIRECTV GenieGO* (July 18, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** *see generally* DIRECTV U.S., *Business Strategy*, http://investor.directv.com/overview/business-strategy/directv-us/default.aspx (last visited Oct. 25, 2014) (stating DIRECTV's "vision is to provide customers with the best video experience in the United States").

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These initiatives thus demonstrate DIRECTV's understanding that these services are complementary. DIRECTV recognizes that customers want to be able to use broadband to enhance the capabilities of their MVPD service and that DIRECTV must satisfy that customer preference, even though that means encouraging DIRECTV's customers to watch video content through means that DIRECTV does not provide.

Competitors Recognize the Complementarity of These Bundles and Likewise Operate Their Businesses Accordingly. A broad spectrum of industry participants shares the parties' view that broadband and video offerings complement each other. Windstream's CEO recently summed up the behavior of many participants by observing, "If you're going to pull customers to your broadband and other services, you've got to lead with video."[55]

DISH. Like DIRECTV, DISH recognizes that a "broadband connection . . . is necessary to power the online and on-demand features that supplement traditional pay-TV offerings."[56] As DISH has said quite directly, "To succeed over the long term, DISH must expand beyond offering 'linear' video distribution services and provide consumers with bundles that include

[54] DTVFCC-00997432, *New Product Roadmap: TV Everywhere, Mobile, OTT* at 4 (June 30, 2010).

[55] *See* Brian Fung, *Here's the Single Biggest Thing Holding Google Fiber Back*, Washington Post, Oct. 6, 2014, *available at* http://www.washingtonpost.com/blogs/the-switch/wp/2014/10/06/video-is-holding-google-fiber-back/.

[56] Petition to Impose Conditions of DISH Network Corporation at 3 (Sept. 16, 2014).

fixed as well as mobile video, voice, and data."[57] DISH has invested huge sums to accumulate spectrum for a wireless broadband service to replace inferior synthetic bundles with an integrated bundle of broadband service and pay TV.[58] DISH also has launched its "Virtual Joey" application, which delivers access to DISH's pay TV services over wireline or wireless broadband networks through LG Smart TVs and PlayStation 3 devices.[59]

Comcast. The Comcast X1 platform is advertised as a state-of-the-art cloud-based user interface that allows consumers to seamlessly access nearly all of Comcast's entertainment offerings across multiple devices.[60] Comcast has invested a significant portion of its marketing

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57 *Service Rules for Advanced Wireless Services in the 2000-2020 MHz and 2180-2200 MHz Bands*, WT Dkt No. 12-70, Comments of DISH Network Corporation, at 7 (filed May 17, 2012).

58 *See* Brian Nichols, *Dish Networks Might Finally Get the Prize It Always Wanted*, Motley Fool (Aug. 14, 2014), http://www.fool.com/investing/general/2014/08/14/dish-networks-might-finally-get-the-prize-it-alway.aspx.

59 Press Release, DISH Network Corp., Dish App Delivers Hopper Experience on LG Smart TVs (Jan. 5, 2014), *available at* http://about.dish.com/press-release/products-and-services/dish-app-delivers-hopper-experience-lg-smart-tvs; DISH, Virtual Joey, http://www.dish.com/technology/virtual-joey/ (last visited Nov. 7, 2014); Richard Lawler, *Virtual Joey app arrives with satellite TV for your PS3*, Engadget (May 20, 2014), http://www.engadget.com/2014/05/20/dish-virtual-joey-ps3/.

60 *See* Comcast, XFINITY on the X1 Entertainment Operating System, http://www.comcast.com/x1 (last visited Oct. 23, 2014).

budget on promoting X1,[61] and it has accelerated deployment of the platform, with the rollout of X1 set-top boxes nearly doubling in the second quarter of 2014.[62]

TWC. Time Warner Cable's TWC TV application allows subscribers to watch linear and on-demand video content on any device with a broadband connection.[63] Time Warner Cable recently reported that consumer use of this application has increased 70% from last year.[64] Time Warner Cable, moreover, continues to improve the application, including recently blending in a VOD guide within its live TV guide on Roku's platform.[65]

Other MVPD providers. Other MVPDs have recognized the complementary nature of broadband and MVPD service. For example, in its comments to the Commission regarding the proposed transaction at issue, Cox endorsed the Commission's recognition that "the benefits to consumers of receiving bundled services and research shows that many consumers want such

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61 *See, e.g.*, Shalini Ramachandran, *Xfinity? Comcast Sets Out to Explain Bundled Service*, Wall St. J. (July 27, 2012), *available at* http://online.wsj.com/news/articles/SB10000872396390444840104577551272296910812 (noting that Comcast launched a marketing campaign costing at least $170 million "aimed at improving consumer understanding of the Xfinity brand, introduced by Comcast in 2010 as the name for its overall umbrella of services that include TV, phone, and Internet access").

62 Comcast Corp., Transcript of Q2 2014 Results Earnings Conference Call (July 22, 2014), *available at* http://finance.yahoo.com/news/comcast-corporations-cmcsa-ceo-brian-183304897.html; Brian Santo, *Comcast Ups Investments in X1 and Infrastructure in Q2*, CED Magazine (July 22, 2014), http://www.cedmagazine.com/news/2014/07/comcast-ups-investments-in-x1-and-infrastructure-in-q2.

63 *See* Time Warner Cable, TWC TV, http://www.timewarnercable.com/en/tv/features/twc-tv.html (last visited Oct. 24, 2014).

64 Time Warner Cable Inc., Transcript of Q2 2014 Results Earnings Call (July 31, 2014), *available at* http://seekingalpha.com/article/2364135-time-warner-cables-twc-ceo-robert-marcus-on-q2-2014-results-earnings-call-transcript.

65 Mike Robuck, *TWC Updates App to Include VOD Guide on Roku*, CED Magazine (Oct. 10, 2014), http://www.cedmagazine.com/news/2014/10/twc-updates-app-to-include-vod-guide-on-roku.

services."[66] Similarly, Hawaiian Telecom reported to the Commission that "approximately 91% of [its] video customers also subscribe to broadband" and that the company "generally focuses on selling a video/broadband bundle, not on selling stand-alone video."[67]

Other competitors have acted on this industry trend as well. Verizon plans to increase its integrated broadband/video offerings and products in the first half of 2015 following its purchase of the Intel OnCue video platform.[68] Meanwhile, smaller MVPDs and overbuilders like RCN, Grande, and Atlantic have not only offered a bundle of broadband and video but they also have worked with TiVo to integrate consumer access to Netflix.[69]

Google. Google Fiber has likewise responded to consumer demand by entering the broadband market with a bundled Internet service and television package. Although Google faced significant challenges in offering a pay TV service, it understood that a television package

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66 Petition to Condition Consent of Cox Communications (filed Sept. 16, 2014) (citing *Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming*, Fifteenth Report, 28 FCC Rcd 10,496, 10,538 ¶ 93 (2013)).

67 *Applications of Comcast Corp, Time Warner Cable Inc., et al. To Assign and Transfer Control of FCC Licenses and Other Authorizations*, MB Docket No. 14-57, Comments of Hawaiian Telcom Services Company, Inc. (filed Aug. 25, 2014).

68 Transcript of Verizon Communications Inc. at Goldman Sachs Communacopia Conference (Sept. 11, 2014), *available at* http://www.verizon.com/about/investors/goldman-sachs-23rd-annual-communacopia-conference/ ("[A]nd then I think there is going to be some integration between the FiOS offering and the mobile offering. . . . [W]e do see that the millennials really want to look at this content over the iPads and the other tablet devices and their smartphones.").

69 *See* Todd Spangler, *Netflix to Launch on Three U.S. Cable Operators Via TiVo*, Variety (Apr. 24, 2014), http://variety.com/2014/digital/news/netflix-to-launch-on-methree-u-s-cable-operators-via-tivo-1201163379/.

is a necessary part of an attractive offering for residential consumers.[70] As the Google executive in charge of the Fiber project has explained, "TV was a stumbling block for us but you simply can't sell a residential broadband service without a competitive TV product."[71] In the cities where Google Fiber is available, consumers can now select an Internet and pay TV "double-play" bundle that includes over 150 traditional TV channels, Netflix as a built-in over-the-top TV option, and the ability to record up to eight TV shows at once with two terabytes of DVR storage space.[72]

Hardware Manufacturers. The increasing prevalence of hardware designed to handle both video and broadband services reinforces those services' complementarity.[73] According to industry estimates, the number of Internet-connected TV sets will reach 965 million by 2020, up

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[70] *See* Marguerite Reardon, *Google Exec Sees Google Fiber as a "Moneymaker"*, CNET (May 30, 2013), http://www.cnet.com/news/google-exec-sees-google-fiber-as-a-moneymaker/. *See also* Brian Fung, *Here's the single biggest thing holding Google Fiber back*, Washington Post (Oct. 6, 2014), http://www.washingtonpost.com/blogs/the-switch/wp/2014/10/06/video-is-holding-google-fiber-back/ (noting that Google must offer MVPD service along with broadband service to be successful "[b]ecause "as important as Internet access is, Americans still love their triple-play bundle. You can't sell Internet these days without also offering a TV package.").

[71] *See* Marguerite Reardon, *Google Exec Sees Google Fiber as a "Moneymaker,"* CNET (May 30, 2013), http://www.cnet.com/news/google-exec-sees-google-fiber-as-a-moneymaker/.

[72] *See, e.g.*, Google Fiber, Gigabit + TV Plan, https://fiber.google.com/cities/kansascity/channels/ (last visited Oct. 24, 2014); Google, Overview of Fiber Devices, https://support.google.com/fiber/answer/2464928?hl=en (last visited Oct. 24, 2014).

[73] *See* ATT-FCC-00414403 *AT&T Video Strategy* at 6 (Apr. 3, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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from 103 million at the end of 2010 and a projected 339 million in 2014.[74] Peripheral devices like gaming consoles that enable broadband connectivity for otherwise unconnected TVs are also growing rapidly.[75]

Major television manufacturers like Samsung, LG, and Panasonic are now designing and building the next generation of smart TVs, in order to capitalize on consumers' preference for a connection between broadband and video. Samsung "has focused on smart TV sales based on forecasts that consumers' desire to acquire internet information from TVs will increase."[76] LG is "seeing increasing consumer interest in IP-based home entertainment and connected home services."[77] Both companies' smart TVs now allow Verizon FiOS TV subscribers, for example, to stream live channels and on-demand content to their televisions through the Verizon FiOS TV App.[78]

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[74] Press Release, Digital TV Research, Nearly 1 Billion TV Sets Internet Connected by 2020 (Sept. 17, 2014), *available at* http://www.digitaltvresearch.com/press-releases?id=98.

[75] The number of Internet-connected gaming consoles like XBOX, Wii, and PlayStation will double between 2013 and 2020, reaching a projected total of 202 million. The number of TV sets that are Internet-connected through OTT set-top boxes like Roku, Amazon Fire TV, and Google Chromecast will reach 183 million by 2020, up from only 4 million in 2010. *See* Press Release, Digital TV Research, Nearly 1 billion TV sets Internet connected by 2020 (Sept. 17, 2014), *available at* http://www.digitaltvresearch.com/press-releases?id=98.

[76] *See* Samsung Electronics Co., *2014 Half Year Report 20* (Aug. 14, 2014), *available at* http://www.samsung.com/us/aboutsamsung/investor_relations/financial_information/downloads/2014/2014_business_quarter02.pdf.

[77] *See* Press Release, LG, LG Shows Smart Set-Top Boxes and Innovative Connected Home Products at Cable Show (Apr. 29, 2014), *available at* http://www.lg.com/us/press-release/lg-shows-smart-set-top-boxes-and-innovative-connected-home-products-at-cable-show (quoting Byunghoon Min, senior vice president, LG Electronics Home Entertainment).

[78] *See*, *e.g.*, Verizon, Verizon FiOS TV App for Samsung Devices, http://www.verizon.com/Support/Residential/TV/FiosTV/Other+Hardware/OtherDevices/SamsungDevices.htm (last visited Oct. 24, 2014); Verizon, Verizon FiOS TV App for LG Devices,

Apple TV, which Steve Jobs once described as a mere "hobby" for the company,[79] has sold 20 million units since launching in 2007.[80] In 2013, the device accounted for more than $1 billion in revenue from sales of the hardware and content purchased directly through the device, forcing current Apple CEO Tim Cook to clarify that "it didn't feel right . . . to refer to something that's over a billion dollars [in sales] as a 'hobby.'"[81] Both Google and Amazon have also launched their own set-top boxes, entering a market that analysts forecast will see 24 million installed units in the United States by the end of the year—up from 16 million last year and 10 million in 2012.[82] And Roku recently announced reaching the 10-million-unit domestic sales mark for its boxes,[83] as well as the launch of a TV that integrates Roku directly into the display hardware.[84] These smart devices serve to further enmesh broadband/MVPD complementarity. If

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http://www.verizon.com/support/residential/tv/fiostv/other+hardware/otherdevices/lgdevices.htm (last visited Oct. 24, 2014).

79 John Paczkowski, *Apple CEO Steve Jobs Live at D8: All We Want to Do Is Make Better Products*, All Things D (June 1, 2010), http://allthingsd.com/20100601/steve-jobs-session.

80 Aaron Tilley, *Apple TV Continues to Evolve as a Smart Home Hub*, Forbes (Oct. 10, 2014), http://www.forbes.com/sites/aarontilley/2014/10/10/apple-tv-continues-to-evolve-as-a-smart-home-hub.

81 Todd Spangler, *Apple Has Sold 20 Million Apple TV Set-Tops to Date: CEO*, Variety (Apr. 23, 2014), http://variety.com/2014/digital/news/apple-has-sold-20-million-apple-tv-set-tops-to-date-ceo-1201162424.

82 Press Release, IHS, Entering Fray, Google's Android TV Could Shake Up Streaming Media Player Market Now Dominated by Roku and Apple TV (Aug. 11, 2014), *available at* http://press.ihs.com/press-release/design-supply-chain/entering-fray-googles-android-tv-could-shake-streaming-media-player.

83 Andrew Wallenstein, *The Race Too Early to Call: Roku, Apple TV, Fire TV, Chromecast*, Variety (Sept. 15, 2014), http://variety.com/2014/digital/news/the-race-too-early-to-call-roku-apple-tv-fire-tv-chromecast-1201303129.

84 Andrew Tarantola, *TCL Roku TV Review: A Decent Smart TV for a Great Price*, Gizmodo (Sept. 29, 2014), http://gizmodo.com/tcl-roku-tv-review-a-decent-smart-tv-for-a-great-price-1634202171.

the price of either MVPD or broadband services dropped, more consumers would sign up for that service and would purchase more of these dual-functional devices, thereby creating more demand for the other service.

C. Cutting-Edge Econometric Analysis Demonstrates Intrinsic Complementarity

Professors Berry, Haile, and Katz have demonstrated econometrically what is clear from this real-world evidence. In particular, as Professors Berry and Haile explained in a submission to the Commission, although their demand model implies some "minimal degree of complementarity," the estimates obtained by fitting the model to the data imply *much more* complementarity than the minimum.[85] Thus, the model's design has not forced the results, and the demand estimates reveal significant complementarity between DIRECTV's video service and AT&T's broadband service.[86]

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85 *Quantitative Analysis of an AT&T-DirecTV Merger: Additional Discussion of Modeling Choices, Data, and Results*, Steven T. Berry and Philip A. Haile (filed Sept. 23, 2014) ("Berry-Haile Quantitative Analysis").

86 This intrinsic complementarity is distinct from the benefits of purchasing both services from a single firm. Thus, to demonstrate that MVPD and broadband services are complements, one need not demonstrate that consumers value the ability to purchase "true bundles" of the two services in a single package from the same provider. Notably, the merger simulations submitted by the parties focused on the intrinsic complementarities between MVPD and broadband services. For example, the "bundle" products in the merger simulation models include all of the choices available to consumers to purchase the two products together, not just "true" bundles of products sold in a single package by a single provider. Because the merger simulation models do not account for the incremental bundling-related benefits, the positive consumer welfare effects of the transaction likely are even greater than shown by the simulations. *See* Reply Declaration of Michael L. Katz ¶ 56 (Oct. 15, 2014) (noting that the Berry-Haile model shows "strong evidence of consumer benefits taking into account content-cost savings efficiencies, but ignoring other merger-specific benefits such as improved bundle characteristics").

III.
Bundle-Driven Complementarity

By definition, two goods are complements if an increase in the price of one good causes a reduction in the demand for the other.[87] If it is true that an increase in price for an unbundled good decreases demand for the other unbundled good, these goods are *complements by definition*.

More importantly, the significance of complementarity in evaluating this merger arises from the fact that an increase in the price of the DIRECTV video service drives down demand for AT&T broadband (and vice versa). This negative cross-price derivative creates the double-marginalization problem whose elimination through the merger will result in downward pricing pressure.

Thus, independent of the definition of complements, the relevant question is whether an increase in the price of DIRECTV drives down demand for AT&T broadband (and vice-versa). As described below, based on economic reasoning, as well as a formal proof building upon the academic literature, AT&T broadband and DIRECTV video have become complements due to the presence of price discounts for cable bundles, even apart from their intrinsic complementarity.

87 More precisely, such goods are "gross complements." *See*, *e.g.*, Andreu Mas-Colell, Michael D. Whinston & Jerry R. Green, *Microeconomic Theory* (1995). The distinction between "complements" and "gross complements" concerns whether the demand in question is the compensated (Hicksian) or uncompensated (Marshallian) demand. As the discussion below makes clear, it is the concept of gross complements that is relevant here.

A. The Underlying Economics

To explain, we start from an artificial world in which consumers view broadband and video as independent goods. Although tastes for the two goods may have arbitrary correlation, consumption of one good does not affect the desirability of the other good. Further, assume that there is no provider offering an integrated bundle of the two services. In this hypothetical world, AT&T broadband and DIRECTV video would be independent goods and appropriately could be analyzed entirely separately.

But that changes once a cable bundle is introduced at a discount relative to the sum of the stand-alone cable broadband and video prices. The effect of an increase in the price of AT&T broadband on demand for DIRECTV video is clear: some consumers who had been purchasing both AT&T broadband and DIRECTV video will now consider dropping AT&T broadband, and some of these customers will consider switching to cable broadband. A consumer who switches to cable broadband could retain DIRECTV video service. But by switching *both* services to cable, she would gain the bundle price discount. Some fraction of the consumers dropping AT&T broadband will therefore also drop the DIRECTV video service and switch to the cable bundle.[88] Thus, the two products are complements.

The forces at play here can be seen clearly in this example:

There is a market in which AT&T offers broadband service, DIRECTV offers video service, and Cable offers both. Suppose there are 100 consumers, each placing a value of $40 (per month) on each type of service (broadband or video), regardless of the provider.

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88 A symmetric argument applies to the effect of an increase in the price of DIRECTV video on demand for AT&T broadband.

Consumers value the combination of video and broadband at $80. Suppose that initially the Cable provider charges $30 for each stand-alone service and $55 for the bundle. AT&T charges $28 and DIRECTV charges $28. At these prices, all consumers select the Cable bundle. AT&T sales are zero.

But if DIRECTV lowers its price to $25 (while all other prices are unchanged) every consumer will switch to buying AT&T broadband and DIRECTV video. Thus, a cut in the DIRECTV price drives up AT&T sales. Because a symmetric argument applies to the response of DIRECTV sales to the AT&T price, the two goods are complements.

Although the focus here is on the presence of a bundle discount offered by the cable provider, exactly the same analysis applies if there were no discount, but consuming cable broadband and video together offers the consumer greater utility than the sum of the utilities for the stand-alone cable products. The bundle discount is, in fact, just one way that cable providers ensure that the value a consumer gets from purchasing both services exceeds the sum of the values of the stand-alone services. This “superadditivity” of the cable bundle utilities is responsible for the AT&T-DIRECTV complementarity.[89]

It is important to emphasize, however, that although the cable utilities are superadditive in the examples above, the utilities from AT&T broadband and DIRECTV video are assumed to be additive. This assumption is made in order to illustrate an important point: whereas in elementary settings complementarity between two goods can be equated with superadditivity of

[89] For another example in which independent goods can become complements (for reasons different from those here), *see* Aviv Nevo, Daniel L. Rubinfeld & Mark McCabe, *Academic Journal Pricing and the Demand of Libraries*, 95 Am. Econ. Rev. 447 (2005).

these goods' utilities, this is not true in general. This is discussed further below, where we also connect the logic above to standard formal analytical frameworks from the economics literature.

B. Formal Analysis

The academic literature provides the foundation for a more formal discussion and proof of the complementarity introduced by cable bundles. A natural starting point is Gentzkow's 2007 analysis of complementarity in a discrete choice setting.[90] Gentzkow considered an environment with only two goods and showed that these goods are gross complements if and only if consumers' utilities for the pair are superadditive. A minimal extension of Gentzkow's model allows a formal analysis relevant to the present setting. In particular, if Gentzkow's model is extended to the case of four goods (Cable broadband, cable video, AT&T broadband, and DIRECTV video), the same type of analysis used to prove Gentzkow's result confirms the logic outlined above: superadditivity of the cable bundle utilities creates strict complementarity between AT&T broadband and DIRECTV video. In the Appendix we provide the formal analysis, including a complete description of Gentzkow's model, a proof of his result, and a proof that AT&T broadband and DIRECTV video are strict complements in the four-good extension of Gentzkow's model.

IV.
Supply-Side Complementarity

In the September 23, 2014 submission, Professors Berry and Haile explained that firms have incentives to jointly produce (and offer price discounts on) products that are supply-side

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90 Matthew Gentzkow, *Valuing New Goods in a Model with Complementarity: Online Newspapers*, 97 Am. Econ. Rev. 713 (2007).

complements (*i.e.*, when there are economies of scope).[91] It is less costly for a single firm to manufacture and supply those complements together than it is for distinct firms to do so separately. That is because supply-side complements often involve shared investments, production facilities, or other inputs, all of which may reduce the total cost of production.[92]

As Professors Berry and Haile explained in the September 23, 2014 submission, that logic applies most obviously to firms that offer broadband Internet access and MVPD services over the same transmission facilities.[93] Those supply-side complementarities provided one basis, in addition to intrinsic complementarity, to analyze video and broadband services together. The economies associated with the use of shared transmission facilities for wireline broadband and video service do not apply when, as here, the MVPD service uses satellite delivery.

There are, however, other important supply-side complementarities in this case. As shown below, these complementarities relate to shared use of other network facilities, supply of video-on-demand and other complementary video services, targeting of advertisements, and provision of customer service (such as installation, billing, and customer care).

Shared use of network facilities. Although DIRECTV delivers video services to the customer's premises by satellite, it makes substantial use of land-based network facilities.

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91 Berry-Haile Quantitative Analysis at 5.

92 *See*, *e.g.*, Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* at 21 (2005) ("Firms that engage in different but complementary activities may benefit from mergers because of synergies or economies of scope: It is less costly for one firm to perform two activities than for two specialized firms to perform them separately."); M. Ishaq Nadiri, *Joint Production*, *The New Palgrave: A Dictionary of Economics* (1987), accessed through *The New Palgrave Dictionary of Economics Online*; Mark Hirschey, *Fundamentals of Managerial Economics* at 600 (2009).

93 Berry-Haile Quantitative Analysis at 5.

DIRECTV uses those facilities, called "broadcast centers," to receive, process, and package content from video programming suppliers before that content is "uplinked" to DIRECTV's satellites.[94] DIRECTV also uses third-party wireline networks to transport video content between various terrestrial facilities (this is called "backhaul").[95] Likewise, AT&T uses land-based network facilities (called "super hub offices" or "SHO") for acquiring, processing, packaging, and formatting video content (including encryption, conversions between HD and SD, and ad insertion).[96] AT&T also uses extensive backbone distribution and other wireline network facilities that deliver both video and broadband Internet access.[97] The combined entity

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[94] DIRECTV currently operates two digital broadcast centers and six uplink facilities. Those facilities receive programming via a combination of satellite and wireline technologies and prepare it for transmission to DIRECTV's satellites. DIRECTV also operates so-called local receive facilities ("LRFs") that collect local broadcast programming in a particular DMA. (DIRECTV 2013 Annual Report at 9; Federal Communications Commission, "Second Report of the Video Programming Accessibility Advisory Committee on the Twenty-First Century Communications and Video Accessibility Act of 2010 - Video Description," April 9, 2012 at 15-16.)

[95] DIRECTV 2013 Annual Report at 9; Written Testimony of Derek Chang Executive Vice President, Content Strategy and Development, DIRECTV, Inc. Before the House Committee on Energy and Commerce Subcommittee on Communications, Technology and the Internet, June 16, 2009 at 12, available at http://democrats.energycommerce.house.gov/sites/default/files/documents/Testimony-Chang-CAT-Satellite-Home-Viewer-Extension-Reauthorization-2009-6-16.pdf.

[96] Federal Communications Commission, "Second Report of the Video Programming Accessibility Advisory Committee on the Twenty-First Century Communications and Video Accessibility Act of 2010 - Video Description," April 9, 2012 at 18-19.

[97] *See, e.g.*, 2013 AT&T Annual Report at 13, 47 ("This [wireline] segment uses our regional, national and global network to provide consumer and business customers with data and voice communications services, U-verse high-speed broadband, video, voice services and managed networking to business customers.").

will be able to consolidate these types of land-based production facilities and reduce DIRECTV's reliance upon third-party wireline network facilities.[98]

Provision of video services through a broadband network. The ability to deliver some video services through a broadband connection enhances satellite video service. For example, satellite transmission of VOD has limited capacity, so only some of the most popular content is "pushed" to set-top boxes via satellite.[99] DBS providers such as DIRECTV therefore generally transmit other VOD content over broadband networks. The integrated firm will realize supply-side efficiencies by providing VOD services using AT&T's Internet backbone and broadband infrastructure.[100] In addition, the merger will allow the parties to use AT&T's broadband network to provide valuable redundancy. That redundancy will enhance a customer's experience where his or her satellite reception is temporarily not functioning (including at the time of the

98 *See, e.g.,* Declaration of Rick L. Moore, Senior Vice President, AT&T Inc. ¶ 22 (June 10, 2014) ("Moore Decl.") ("There will be opportunities to integrate video and broadband servers and equipment in ways that will reduce costs (*e.g.*, elimination of duplicative routers).").

99 *See, e.g.,* Declaration of Patrick T. Doyle, Executive Vice President and Chief Financial Officer, DIRECTV ¶¶ 19, 21 (June 10, 2014).

100 Although in theory, such functions may be provided through a third-party broadband distribution network, there are important practical and technical efficiencies of an integrated broadband network related to the ability to "manage" the broadband network to allow better-quality delivery of video. *See, e.g.*, Declaration of John T. Stankey, Group President and Chief Strategy Officer AT&T Inc. ¶ 21 (June 10, 2014) ("DIRECTV today must rely on third parties for the delivery of most of its video-on-demand content. After the merger, DIRECTV will be able to use AT&T's Internet backbone and broadband infrastructure to provide higher-quality service at reduced cost, through measures such as more efficient use of caching to store content closer to the customer.").

initial sale, before the dish is installed) and to supply live linear channels that DIRECTV may not have sufficient satellite capacity to provide.[101]

Targeting of video advertising. Broadband networks can be used to target advertisements more effectively to viewers based on their interests or needs. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] The effective targeting of advertisements increases advertising revenues per subscriber, which, all else being equal, leads to lower video service prices. The merged company will utilize **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** to help customize and more effectively target advertisements to DIRECTV subscribers.[102]

Installation, billing, and customer care. Installation of DIRECTV-AT&T synthetic bundles currently requires two separate "truck rolls," one for satellite video and one for

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[101] As with the provision of VOD, there are efficiencies of an integrated broadband network compared to performing these functions through a third-party network. (*See supra* note 99.)

[102] *See, e.g.*, Moore Decl. ¶ 30 ("AT&T also plans to improve DIRECTV's advertising platform to enhance the combined company's ability to reach consumers with advertising that is tailored and compelling. By combining AT&T's broadband access with DIRECTV's satellite platform, the combined company will be better able to customize advertising and **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

broadband.[103] The proposed transaction will allow AT&T and DIRECTV to combine those two visits into one, thereby saving significant costs.[104]

In addition, many assets of the parties, such as customer service centers and billing systems, can perform their functions for both video and broadband. By consolidating these operations and combining general and administrative functions (such as billing and provisioning), the combined entity will realize important supply-side efficiencies.[105]

V.
Conclusion

Based on the evidence submitted, the Commission should conclude that video and broadband are complements in all three forms.

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[103] Lee Decl. ¶ 57, Guyardo Decl. ¶ 32.

[104] *See, e.g.*, Moore Decl. ¶ 24 ("AT&T plans to consolidate the two companies' installation and service operations, thereby reducing costs while also providing customers with better and more seamless installation and repair services. We expect meaningful efficiencies through the consolidation of installation and service operations generally. If, as is expected, the combined company is also able to perform multiple installation services (*e.g.*, DBS service, broadband, voice, etc.) with a single truck roll, the efficiencies will be even greater.").

[105] *Id.* ¶ 25 ("AT&T plans to consolidate the two companies' broadcast centers. AT&T will integrate DIRECTV's and AT&T's video infrastructure, utilizing AT&T's IP distribution network in addition to DIRECTV's satellite network. We also expect to achieve additional cost savings in our operation of DIRECTV's and AT&T's super hub offices ('SHOs'), where video programming is gathered and redistributed to network facilities for delivery to subscribers, and in customer call center operations. AT&T's and DIRECTV's information technology ('IT') systems and operations will be integrated to reduce the combined company's IT expenses for IT business support, provisioning, billing, and remittance. AT&T projects that the combined company will realize cost savings from the consolidation of general administrative and headquarters functions and services.").

APPENDIX

The academic literature provides the foundation for a more formal discussion and proof of the complementarity between AT&T broadband service and DIRECTV video service introduced by cable bundles. We follow the analysis in Gentzkow (2007),[106] which considers complementarity in a discrete choice setting.

1. Two Goods

Gentzkow considers a model with two goods, A and B, and defines complementary as we have (see his Definition 1). Consumers in his model can purchase A alone, B alone, or a bundle of A and B. He specifies the (conditional indirect) utilities of the two goods, u_A and uB_B, as randomly distributed across consumers. Although he assumes a normal joint distribution for concreteness, this distributional assumption plays no role in his analysis other than easing exposition by ensuring that there are consumers on all margins of indifference. Each utility u_j accounts for the price of good j; so, for example, an increase in the price of good A corresponds to a reduction in u_A for each consumer.[107] Gentzkow specifies the utility for the bundle as

$$u_{AB} = u_A + u_B + \Delta$$

[106] Matthew Gentzkow, *Valuing New Goods in a Model with Complementarity: Online Newspapers*, 97 Am. Econ. Rev. 713 (2007).

[107] To demonstrate his argument about complements, Gentzkow specifies each u_j as linear in price, a product-specific constant, and a product-component specific taste shock for each consumer, although none of this is essential to his argument. As noted below, and consistent with the Berry-Haile merger simulation, when Gentzkow turns to the empirical specification he adds an idiosyncratic taste shock for each product, including the joint-product bundle. He justifies this on the grounds that it is necessary to explain consumer choices.

where Δ is constant across consumers. We consider the case $\Delta \geq 0$. Strictly positive values of Δ could be due to "intrinsic complementarities" in consumption of the two products, or to price discounts offered to consumers purchasing the bundle. Note that a consumer in this model is characterized by a pair (u_A, u_B), *i.e.*, a point in $\mathbb{R}^2$, and consumers in different regions of $\mathbb{R}^2$ will make different choices. By examining how price changes alter the share of consumers in each region, Gentzkow shows the following result.[108]

Proposition 1. Goods *A and B are strict gross complements if and only if* $\Delta > 0$.

For the Proof, see below.

Intuition for this result can be seen in Figure 1, which illustrates the product choice regions in the Gentzkow model with $\Delta \geq 0$.[109] The thick diagonal line segment is the set of consumers who are indifferent between the bundle and the outside good. When the price of good B increases, a mass of consumer utilities will move downward across the diagonal line segment, with the associated consumers then switching from the bundle to the outside good.

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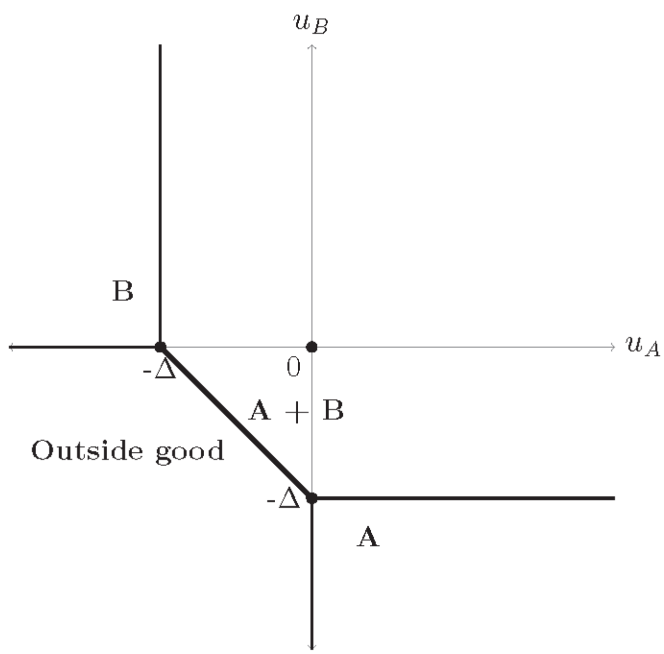
108 Gentzkow also shows that the goods are strict gross substitutes if and only if $\Delta < 0$.

109 This graph is also found as the $\Delta > 0$ panel of Figure 1 of Gentzkow.

Figure 1. Regions of Product Choices in the Two-Good (Gentzkow) Model



This substitution between the bundle and the outside good is the source of strict complementarity here. Note that for consumers whose utility from good A lies outside the domain of the diagonal line segment, a change in u_B has no effect on the decision to purchase A. This can be seen by observing that when $u_A < -\Delta$ good A is never purchased (regardless of the value of u_B), whereas when $u_A > 0$ good A is always purchased (regardless of u_B). These regions drive the general logic of the formal proof as well.

2. Competing Product Combinations

Proposition 1 shows that in the case of two goods there is an equivalence between complementarity and superadditivity of bundle utilities, *i.e.*, the condition that $u_{AB} > u_A + u_B$. This equivalence breaks down when there is more than one pair of goods that consumers may combine, although the concept of superadditivity still plays an important role.

We demonstrate this with a minimal extension of Gentzkow's model, allowing four product components instead of two. Here we label these components Cable broadband, Cable video, AT&T broadband, and DIRECTV video. The conditional indirect utilities for these services are, respectively, u_C^b, u_C^v, u_A^b, and u_D^v. As in Gentzkow, these utilities are net of prices, vary at random across consumers in the population, and are assumed to have support $\mathbb{R}^4$.[110] Without loss we normalize the utility from the outside good to zero, so that consumers are now represented by points in $\mathbb{R}^4$.

In addition to the outside good, the choices available to the consumer consist of four stand-alone products and four joint products that combine either AT&T or Cable broadband with either DIRECTV or Cable video.[111] Following the theoretical analysis in Gentzkow, we specify the utilities for combinations of service components as linear functions of the component utilities. In particular, except for the Cable bundle, utilities for bundle products are additive in the utilities of the two components. For example, the AT&T-DIRECTV combination gives utility

$$u_A^b + u_D^v$$

while the combination of AT&T broadband and Cable video would give utility

$$u_A^b + u_C^v.$$

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110 This assumption is standard (*e.g.*, it is satisfied by all multinomial logit and probit models, including those with arbitrary numbers of random coefficients) but stronger than necessary for our argument, which uses this condition only to ensure that there are consumers on all margins of indifference.

111 We assume for simplicity that no consumer considers purchasing two video services or two broadband services. This is not essential.

We specify the utility for the Cable bundle as superadditive, with utility

$$u_C^b + u_C^v + \Delta \tag{1}$$

where $\Delta > 0$.

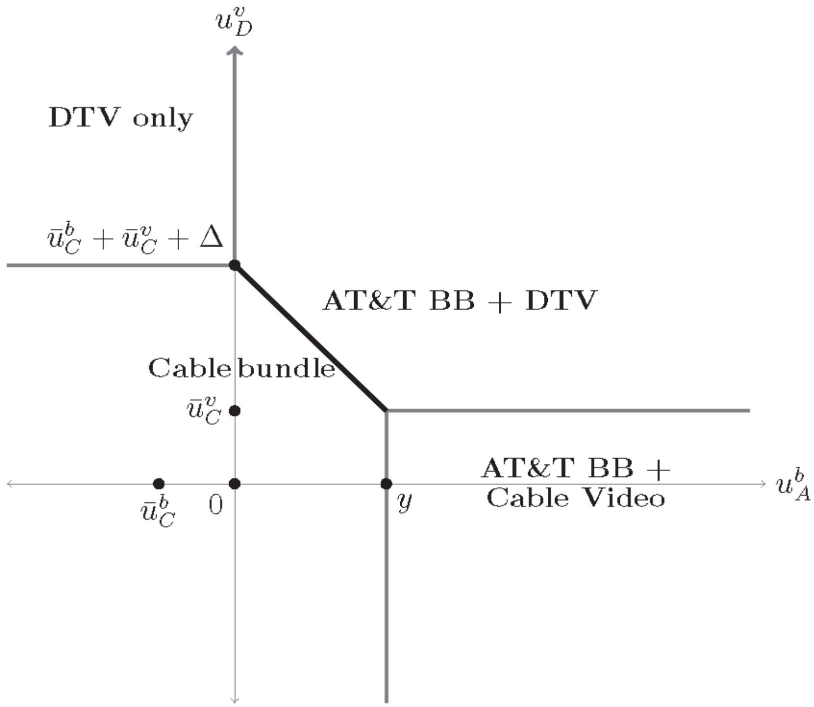
Just as in Gentzkow, Δ can represent either the bundle discount offered by Cable or "intrinsic complementarities" obtained by consumers purchasing both services from the Cable provider. Formally, these two phenomena are equivalent as they each raise the value consumers get from purchasing the Cable bundle above the sum of the values they would get from purchasing each stand-alone Cable service.

Proposition 2 *AT&T broadband and DIRECTV video are strict gross complements. For the Proof, see below.*

Figure 2 shows product choice regions for the four-good model with $\Delta>0$, conditional on specific illustrative values of the Cable utilities. The graph is in the space of the non-Cable utilities (u_A^b, u_D^v), holding the Cable utilities fixed at $(\bar{u}_C^b, \bar{u}_C^v)$. The various regions are derived in detail in the formal proof, where we see that different values of the Cable utilities create different graphs and product choices. In Figure 2, the Cable utilities are set so that the Cable bundle is the preferred choice among the Cable products—that is, the Cable utilities are chosen from the analog of the $A + B$ region in Figure 1. Putting aside the location of the product choice regions relative to the origin, the shape and basic logic of Figure 2 are the same as Figure 1.[112]

[112] The quantity y is defined in the proof.

Figure 2. Regions of Product Choices in the Four-Good Model



In Figure 2, the Cable bundle plays much the same role as the outside good in Figure 1 except that now the Cable bundle is the source of the complementarity.[113] In Figure 2, consumers in the lower left region choose the Cable bundle and in the upper right region they choose the AT&T-DIRECTV combination. The thick diagonal line segment defines the consumers who are indifferent between the Cable bundle and the AT&T-DIRECTV combination. Just as in our earlier intuition and examples, substitution between those two pairs of services creates the strict complementarity of AT&T broadband and DIRECTV video. Note that away from that line of indifference, a reduction in the DIRECTV utility (as from an increase in the DIRECTV price)

[113] Another complication is the presence of service combinations, *e.g.*, AT&T broadband plus Cable video, beyond the Cable bundle and AT&T-DIRECTV combination. This adds some complexity in the proof, but does not alter the basic shape of the graph or logic of the argument.

has no effect on the demand for AT&T broadband. To illustrate this, note that AT&T broadband is never purchased when $u_A^b < 0$, whereas when $u_A^b > y$ AT&T broadband is purchased regardless of the value of DIRECTV. The logic of these regions drives the broad outline of the formal proof.

Finally, we point out that the model employed by Gentzkow in his empirical analysis incorporates idiosyncratic taste shocks for every product combination—A, B, and $A + B$. The empirical model used in the Berry-Haile merger simulation follows Gentzkow in this regard. The presence of distinct shocks for each service combination introduces the possibility that some stand-alone DIRECTV subscribers would switch to stand-alone AT&T broadband when faced with a DIRECTV price increase. Although one would expect the number of such consumers to be small, this is an empirical question. Likewise, although the theoretical analysis here demonstrates why the cable bundle is expected to introduce complementarities between AT&T broadband and DIRECTV video, the magnitude of this complementarity is an empirical question. Importantly, then, the demand estimates obtained by Berry and Haile when fitting the empirical model to the actual patterns of the data reveal substantial complementarity between AT&T broadband and DIRECTV video. As they demonstrate, this leads to substantial post-merger downward pricing pressure.

3. Competing Product Combinations

Return to consideration of the two-good case in which purchasing a bundle give rises to positive benefits beyond the sum of the stand-alone utilities.

Proof of Proposition 1. If $u_A > 0$, then A is purchased (either alone or together with B) regardless of the price of B. If $u_A < -\Delta$, then A will not be purchased regardless of the price of B. Thus, the only region in which the price of B might affect demand for A is that in which

$$-\Delta \leq u_A \leq 0. \tag{2}$$

When (2) holds, A will be purchased only together with B, *i.e.*, A is purchased if and only if

$$u_A + u_B + \Delta \geq 0$$

or, equivalently,

$$u_B \geq -u_A - \Delta. \tag{3}$$

The probability of purchasing A is then

$$\rho + \int 1\{-\Delta \leq u_A \leq 0\} \Pr\left(u_B > -u_A - \Delta \mid u_A\right) dF(u_A) \tag{4}$$

where F denotes the distribution of u_A and $\rho = Pr(u_A \geq 0 \mid u_A)$ is the part of demand that does not depend on p_B. If $\Delta = 0$, this implies that the demand for A does not change with the price of B; *i.e.*, the goods are then independent. When $\Delta > 0$, however, it is immediate from (4) that a stochastic decrease in u_B (as will result from any increase in p_B) strictly reduces the demand for A. Thus, when $\Delta > 0$ the goods are strict gross complements.

Now consider the four-product model.

Proof of Proposition 2. We derive an expression for the total demand for AT&T broadband and show that an increase in the price of DIRECTV reduces that demand. (A symmetric argument applies to the effect of the AT&T broadband price on DIRECTV demand.) For simplicity we will refer to AT&T broadband as "A." If $u_A^b < \max(0, u_C^b)$, A will not be purchased regardless of u_D^v, so a change in the DIRECTV price will have no effect on demand for A. Thus any such effect must be in the region of utilities where

$$u_A^b \geq \max(0, u_C^b). \tag{5}$$

Note that the definition of this region does not depend on u_D^v. If u_A^b satisfies both (5) and

$$u_A^b > u_C^b + u_C^v + \Delta - \max(0, u_C^v) \tag{6}$$

then A will be purchased with probability one regardless of u_D^v.[114] So again a change in the DIRECTV price has no effect on demand for A. Now consider the remaining region, defined by the intersection of condition (5) with the complement of (6). Define an indicator for this region as

$$\Psi(u_A^b, u_C^b, u_C^v) = 1\left\{\max\left\{0, u_C^b\right\} \leq u_A^b \leq u_C^b + u_C^v + \Delta - \max\left\{0, u_C^v\right\}\right\}.$$

It is easily verified that when $\Psi(u_A^b, u_C^b, u_C^v) = 1$, the Cable bundle is preferred to all options except the AT&T-DIRECTV combination, which may or may not be preferred.[115] Therefore, on

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114 To confirm this, consider any product that excludes A and check that under (5) and (6) some product that includes A is preferred with probability one. In particular, (5) rules out any product excluding A except the cable bundle and (6) rules out the cable bundle.

115 The first inequality inside the indicator function rules out the outside good, stand-alone cable broadband, cable broadband with DIRECTV video, stand-alone DIRECTV video, or stand-alone cable video. The second inequality rules out both stand-alone A and A combined with cable video.

the region in which, $\Psi(u_A^b, u_C^b, u_C^v) = 1$, the price of DIRECTV determines the demand for A: for sufficiently high values of u_D^v, the AT&T-DIRECTV combination will be preferred, and otherwise the cable bundle will be preferred. The set of values of (u_A^b, u_C^b, u_C^v) such that $\Psi(u_A^b, u_C^b, u_C^v) = 1$ contains an open subset of R^3. To see this, let Γ denote the set of cable utilities such that the Cable bundle is preferred to the outside good and to the stand-alone cable services. This is the same set defined by Gentzkow, *i.e.*,

$$\Gamma = \{(u_C^b, u_C^v) : u_C^b > -\Delta, u_C^v > -\Delta, u_C^b + u_C^v + \Delta > 0\}.$$

For any (u_C^b, u_C^v) in the open set Γ it is easily confirmed that

$$\{u_A^b : \Psi(u_A^b, u_C^b, u_C^v) = 1\}$$

defines a nonempty interval of values for u_A^b.[116] Note that the definitions of Γ and $\Psi(u_A^b, u_C^b, u_C^v)$ do not depend on u_D^v. Finally, recall that in the region where $\Psi(u_A^b, u_C^b, u_C^v) = 1$, A is purchased if and only if

$$u_A^b + u_D^v \geq u_C^b + u_C^v + \Delta$$

i.e.,

$$u_D^v \geq u_C^b + u_C^v + \Delta - u_A^b.$$

116 In Figure 2, the quantity y corresponds to the upper bound of the interval $\{u_A^b : \Psi(u_A^b, \bar{u}_C^b, \bar{u}_C^v) = 1\}$.

The total demand for A is therefore

$$\rho + \int \Psi(u_A^b, u_C^b, u_C^v)\Pr\left(u_D^v \geq u_C^b + u_C^v + \Delta - u_A^b \mid u_A^b, u_C^b, u_C^v\right) dF\left(u_A^b, u_C^b, u_C^v\right) \tag{7}$$

where F now denotes the joint distribution of $\left(u_A^b, u_C^b, u_C^v\right)$ and ρ denotes the part of demand that does not depend on u_D^v. From (5) and (6),

$$\rho = \Pr\left(u_A^b \geq \max(0, u_C^b), u_A^b > u_C^b + u_C^v + \Delta - \max\{0, u_C^v\}\right).$$

It is immediate from (7) that demand for A will strictly decline if the price of DIRECTV increases, because this reduces $\Pr\left(u_D^v \geq u_C^b + u_C^v + \Delta - u_A^b \mid u_A^b, u_C^b, u_C^v\right)$ at all values of $\left(u_A^b, u_C^b, u_C^v\right)$

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ADDITIONAL EVIDENCE THAT AT&T AND DIRECTV ARE NOT PARTICULARLY CLOSE SUBSTITUTES

Submitted by

AT&T Inc. and DIRECTV

November 12, 2014

I.
<u>Overview</u>

The proposed transaction will promote rather than harm competition because, among other things, AT&T and DIRECTV's MVPD services are not particularly close substitutes. **[BEGIN AT&T AND DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T AND DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

Section II below discusses the ordinary-course internal documents and other business materials confirming that each party does not see the other as a close competitor for its MVPD service. As the documents confirm, broadband is the focus of AT&T's marketing efforts and its competitive strategy. AT&T sells video primarily to drive broadband penetration. AT&T's competitors are companies that also are bundling their video with broadband: cable companies and overbuilders. AT&T pays little competitive attention to DIRECTV and DISH, because those companies, which are technologically limited to providing stand-alone video, are providing a very differentiated offering.

DIRECTV's perspective is the mirror image of AT&T's. As its documents show, DIRECTV targets stand-alone video customers and focuses on differentiating its video offering from its principal video competitors: DISH and cable companies. While AT&T targets bundlers, DIRECTV puts little emphasis on its synthetic bundle offerings and focuses on its successful video service.

Section III discusses DIRECTV's national pricing strategy. **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

II.
The Evidence Confirms That
<u>AT&T and DIRECTV Are Not Close Competitors</u>

A. AT&T Competes Directly with Cable and Overbuilders To Sell Bundles

1. AT&T and DIRECTV Offer Fundamentally Different Products

Competition between AT&T and DIRECTV is limited, first of all, because of obvious differentiation: the two companies employ different technologies with different strengths and weaknesses. AT&T's wireline network, like cable networks, is most efficient for serving high-density areas and requires relatively limited customer equipment. The satellite delivery used by DBS providers such as DIRECTV and DISH, requires installation of a satellite dish antenna on the customer's residence and is constrained in many urban areas by line-of-sight and multi-dwelling unit issues.

More important, AT&T's wireline technology is designed to deliver a high-speed broadband connection to consumers that is competitive with cable; satellite technology cannot do that.[1]

As a result, while DIRECTV's business focus is almost entirely on the sale of stand-alone MVPD service, AT&T's U-verse business is built on broadband Internet service, and bundling that with MVPD and other services. The Commission last year highlighted the important role of bundles in differentiating DBS competitors from wireline MVPDs:

> The major cable and telephone MVPDs focus their marketing on bundles. Their emphasis usually is that bundles offer better prices for consumers, relative to individual service offerings. In contrast, the two DBS MVPDs focus their marketing on video services, in part, because the satellite technology they use for delivering video programming limits their ability to provide non-video (*i.e.*, Internet access and telephone) services.[2]

As the AT&T executive in charge of its Home Solutions business[3] stated in her Declaration in support of the Public Interest Statement, U-verse is primarily a broadband business.[4] Company documents confirm the primacy of broadband in the U-verse competitive strategy.[5]

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1 There also are limits on DIRECTV's ability to provide Video On-Demand services that consumers desire. AT&T and other broadband providers offer Video On-Demand service via a high-speed Internet Protocol connection, but only about **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** of DIRECTV subscribers have an Internet-connected set-top box, severely limiting Video On-Demand options for subscribers whose set-top boxes are not connected to the Internet.

2 *Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming*, Fifteenth Report, 28 FCC Rcd 10,496, 10,538 ¶ 93 (2013) ("Fifteenth Report").

3 Home Solutions is AT&T's wireline consumer organization and includes home telephone, customer information services, and AT&T's suite of U-verse services (broadband, video, and voice).

4 Declaration of Lori M. Lee, Senior Executive Vice President–Home Solutions, AT&T Inc. ¶ 7 (June 10, 2014) ("Lee Decl.").

Selling U-verse video makes economic sense because it enables AT&T to compete with cable in selling video/broadband bundles. Broadband Internet access is the **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** part of AT&T U-verse. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] Chairman Wheeler recently commented on the same correlation, stating:

> Those seeking to deploy new competitive broadband networks tell us that it's hard to provide new high-speed Internet access without also being able to offer a competitive video package as well.[8]

The imperative to expand broadband sales and the ability to use MVPD service as a tool to do so mean that the sale of bundles containing video and broadband is the central focus of

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5 ATT-FCC-00552010, *Outline for Friday Capital Meeting Kickoff* at 1 (June 11, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] ATT-FCC-00642367, *U-verse Evolution, Coker Speaking Notes* at 1 (May 23, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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6 ATT-FCC-01445197, *U-verse by Product* at 3 (reflecting data as of 1Q 2014).

7 ATT-FCC-00414403, *AT&T Video Strategy* at 10 (Apr. 3, 2013).

8 Tom Wheeler, *Tech Transitions, Video, and the Future*, Official FCC Blog (Oct. 28, 2014), *available at* http://www.fcc.gov/blog/tech-transitions-video-and-future.

AT&T's competitive energy in nearly all facets of the U-verse business. There are only about 138,000 stand-alone U-verse video subscribers nationwide.[9] AT&T has approximately 12.1 million U-verse broadband subscribers, and 6.1 million U-verse video subscribers, more than 97 percent of whom purchase the service as part of a bundle.[10] AT&T focuses its marketing efforts on broadband-based bundles: **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[9] Lee Decl. ¶ 12.

[10] Press Release, AT&T, *AT&T Reports 2 Million Wireless Net Adds, Record-Low Third-Quarter Postpaid Churn and Solid U-verse Subscriber Gains in Third-Quarter Results* (Oct. 22, 2014), *available at* http://about.att.com/story/att_third_quarter_earnings_2014.html.

[11] Lee Decl. ¶ 16.

[12] ATT-FCC-00736957, *2012 Bundles Strategy* at 6 **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** *see also* ATT-FCC-00414403, *AT&T Video Strategy* at 10 (Apr. 3, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[13] *See* ATT-FCC-01424436, *Wireline TV SOV Summary Report* at 19 (Feb. 10, 2014).

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

2. Wireline Bundle Providers Are AT&T's Closest Competitors

[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

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14 *See, e.g.*, ATT-FCC-00058159, *The Bundle Times* (July 18, 2012) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

15 ATT-FCC-00285389, *Go-To-Market, 2013 U-verse Marketing Plan* at 2, 4 (undated).

16 ATT-FCC-00276293, *2013 BB, Bundles and Retention* at 3, 19-20 (Oct. 9, 2012).

17 *See, e.g.*, ATT-FCC-01423336, *Rack Rate Price Increase Comparison* (Jan. 8, 2014); ATT-FCC-01415360, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] ATT-FCC-01855833, *Competitive Metrics and Trends* at 8 (undated) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] ATT-FCC-00518182, *How Does Our Pricing Compare?* at 10 (undated) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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CONFIDENTIAL INFORMATION] ATT-FCC-01846009, *U-verse Marketing Status Report* at 4 (Apr. 29, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

[18] ATT-FCC-01423336, *Rack Rate Price Increase Comparison* at 2-4 (Jan. 8, 2014).

[19] *See id.* at 5. *Cf.* ATT-FCC-01415360, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**ATT-FCC-01616383, *1Q Top Competitor Moves* at 1 (2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[20] ATT-FCC-00136142, *Marketing 1Q14 Ops Review* at 15 (Feb. 13, 2014).

[21] *Id.*

[22] *Id.* at 16.

[23] ATT-FCC-01901200, *Home Solutions Marketing Operations Review* at 53-56 (July 30, 2013).

[24] *Id.*

[25] *See, e.g.*, ATT-FCC-00296893, *Home Solutions Marketing Quarterly Ops Review* (Apr. 19, 2012); ATT-FCC-02685653, *Home Solutions Marketing Operations Review* (Oct. 24, 2012); ATT-FCC-01755117, *May Ops Review* (May 30, 2013); ATT-FCC-01901200, *Home Solutions Marketing Operations Review* (July 30, 2013); ATT-FCC-00134865, *Home Solutions Marketing Operations Review* (Oct. 9, 2013).

[26] ATT-FCC-00047131, *Home Solutions Review* at 27 (Mar. 26, 2012).

[27] *Id.* at 28.

[28] *Id.*

[29] *Id.* at 26.

[30] ATT-FCC-01407502, *Local Market Roundtable Monthly Review*, at 4 (Aug. 2013).

[31] *Id.* at 6-12.

[32] ATT-FCC-00721918, *U-verse Competitive Analysis Connecticut* (Sept. 2012).

[33] *Id.*

[34] ATT-FCC-00712977, *Offers* at 4.

[35] ATT-FCC-00518182 at 2.

[36] *See id.*

[37] *See* ATT-FCC-00318633, *Speaker Notes* at 3. *See also* ATT-FCC-01309174, *AT&T Indirect Order Cancels POV* at 15 (undated) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** ATT-FCC-01629982, *U-verse Churn Deep Dive* at 10 (undated) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** *id.* at 22-23 **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[38] *See, e.g.*, ATT-FCC-00019444, *AT&T Ad Impact Report* (April 2012) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**ATT-FCC-01079845, *Home Solutions NPS Results* (April 13, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[39] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[40] ATT-FCC-01619077, *Local Market Roundtable* (Feb. 2014). *See also* ATT-FCC-00630425, *AT&T vs. the Competition Offer Comparison* (Oct. 17, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

3. AT&T Responds to Cable and Overbuilders, but Not DIRECTV

AT&T's pricing, promotions, and advertising respond to and target cable (and other wireline competitors), not DIRECTV. As AT&T's Home Solutions chief testified, "AT&T focuses on selling broadband and offering video as part of a bundle with broadband, whereas satellite video providers focus on video and do not have broadband capabilities. While we track satellite video pricing, we do not set U-verse pricing or launch promotions in response to promotions or rack rate changes by satellite providers."[41] AT&T's decisions regarding video or bundle pricing and other competitive strategies are not influenced by DIRECTV.

[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

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[41] Lee Decl. ¶ 39.

[42] ATT-FCC-01417288, *Comcast Contingency Plan* at 2-3 (Mar. 6, 2013).

[43] *Id.* at 8, 17. *See also* ATT-FCC-00569965, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[44] ATT-FCC-00271313, *Bundle Strategy Project Discussion* at 23 (June 12, 2012); *see also id.* at 12 **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[45] *See, e.g.*, ATT-FCC-01615646, *Pricing Approval Executive Summary* (Sept. 2013); ATT-FCC-01923711, *Pricing Approval Executive Summary* (Sept. 2013).

[46] **[BEGIN AT&T CONFIDENTIAL INFORMATION]** **[END AT&T CONFIDENTIAL INFORMATION]** *See, e.g.*, ATT-FCC-01615646, *Pricing Approval Executive Summary* at 1 (Sept. 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** ATT-FCC-01923711, *Pricing Approval Executive Summary* at 1 (Sept. 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[END AT&T HIGHLY CONFIDENTIAL INFORMATION] ATT-FCC-01923685, *Pricing Approval Executive Summary* (April 2012) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[47] ATT-FCC-01617126, *Pricing Approval Executive Summary* at 1 (undated).

[48] ATT-FCC-01626679, *Pricing Approval Executive Summary* at 1 (undated).

[49] ATT-FCC-01612734, *Pricing Approval Executive Summary* at 2 (undated).

[50] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] *See*, *e.g.*, ATT-FCC-01612468, *Pricing Approval Executive Summary* (undated).

[51] ATT-FCC-02086749, *Special Offer* at 4 (undated).

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

[52] *See, e.g.*, AT&T, DIRECTV Packages - Get Satellite TV and HD TV Programming, *available at* http://www.att.com/shop/tv/directv.html#fbid=iSkh7IY8IZS (last visited Oct. 28, 2014).

[53] *See* ATT-FCC-00519064, *Wireline Evolution*, at 4 (undated) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** ATT-FCC-00303700, *Home Solutions Data & Voice Operations Review*, at 13 (Feb. 28, 2014) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[54] Lee Decl. ¶ 28 ("Earlier this year, Comcast began providing existing customers double their current broadband speeds for the same price, while also aggressively offering new customers broadband for prices similar to what AT&T was offering for a lower-speed service.")

[55] ATT-FCC-00519064, *Wireline Evolution*, at 4 (undated).

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

Overbuilders such as Google Fiber pose a relatively new, but increasingly serious, competitive threat to which AT&T has also responded. Overbuilders, like cable companies, offer integrated high-speed broadband and video bundles, and Google in particular has made significant inroads with consumers **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[57] ATT-FCC-02732585, *Home Solutions the Need for Speed* at 16 (Mar. 25, 2014); ATT-FCC-01407502, *Local Market Roundtable Monthly Review* at 18 (Aug. 2013).

[58] ATT-FCC-01409705, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[59] ATT-FCC-01616079, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** ATT-FCC-01593601, *Pricing Approval Executive Summary*, (May 2014) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[60] ATT-FCC-01409705, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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Google Fiber, even with Gigabit Internet, must bundle video and broadband service in order to be competitive.[62] In fact, Google executive Milo Medin has stated that video programming represents "the single biggest piece of [Google Fiber's] cost structure," and that, in some markets, Google Fiber "may be paying . . . double what incumbents are paying for the same programming."[63] Google Fiber's willingness to bear the exorbitant cost of video programming reinforces the bundle imperative.[64]

4. AT&T Views DIRECTV as a Distribution Channel To Help Sell Broadband Via the Synthetic Bundle, Rather Than as a Competitor

AT&T's willingness to sell DIRECTV video to customers within its own U-verse video footprint, as a means to capture incremental broadband sales, further illustrates the absence of significant rivalry between AT&T and DIRECTV with respect to video service.

AT&T and DIRECTV have partnered for years to offer customers a synthetic bundle of DIRECTV video and AT&T broadband, including in areas where AT&T offers U-verse video. The willingness to sell bundles of AT&T broadband and DIRECTV video even in areas where U-verse video/broadband bundles are available demonstrates that AT&T views video service primarily as a complement to broadband, rather than a competitively significant stand-alone

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61 ATT-FCC-01593601, *Pricing Approval Executive Summary* (May 2014).

62 Brian Fung, *Here's the Single Biggest Thing Holding Google Fiber Back*, Washington Post (Oct. 6, 2014), *available at* http://www.washingtonpost.com/blogs/the-switch/wp/2014/10/06/video-is-holding-google-fiber-back/.

63 *Id.*

64 *See id.*

product.[65] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

B. DIRECTV Focuses Its Competitive Efforts on DISH and Cable, Not U-verse

DIRECTV's offering is closest to that of DISH, the only other national, video-only MVPD company. DIRECTV also competes closely with the cable companies, which are longtime rivals in video-only competition, the source of most new DIRECTV subscribers, and the only other target of DIRECTV's national advertising. Therefore, as reflected in the DIRECTV documents and marketplace behavior, DIRECTV sees DISH and cable as its primary competitors.

1. DIRECTV and AT&T Do Not Sell the Same Products

With only stand-alone video, DIRECTV must target customers interested in that service.[67] DIRECTV is able to sell stand-alone video to these customers (although fewer and

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65 ATT-FCC-01424774, *FW: DTV Broadband Opportunity* at 2 (May 20, 2013) **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

66 ATT-FCC-00561458, *Marketing, 1Q14 Ops Review* at 33 (Feb. 13, 2014).

fewer over time)[68] because DIRECTV offers exceptional picture quality, technology, and programming packages with a wide range of premium and sports content, including NFL Sunday Ticket.[69] DIRECTV's core target audience prefers the best of the best video experience, and DIRECTV delivers it.

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67 **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] *See* DTVFCC-03259882, *Bundles Marketing* at 9 (July 18, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**
[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] DTVFCC-04048615, *2014 6+6 Subscriber Forecast* (June 14, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] *See* DTVFCC-03259882, *Bundles Marketing* at 5 (July 18, 2014).

68 DTVFCC-01773981, *2013 Bundles Waterfall* (Apr. 11, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**
[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] DTVFCC-00280950, *Revenue & Marketing: Profitable Growth - 2014 SAC Planning Review* at 4 (Nov. 13, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**
[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

69 *See, e.g.*, DTVFCC-01320321, *Top Marketing Claims* at 2, 5, 6 (May 15, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] DIRECTV, DIRECTV, Entertainment & Technology, *available at* http://www.directv.com/DTVAPP/content/directv/entertainment-technology?lpos=Header:3 (last visited Oct. 15, 2014) ("It doesn't matter how many TVs you have in your home. With Genie, the world's most advanced HD DVR, you and your family can enjoy a full HD DVR experience on every one of them, from a single HD DVR. Plus you can record any five shows at once and store hundreds of hours of HD programming…GenieGO, the perfect companion to Genie HD DVR, lets you watch your shows on your computer, tablet, or phone wherever life takes you.").

DIRECTV cannot offer its own broadband, which is AT&T's leading product and the centerpiece of AT&T's integrated bundle offering.[70] DIRECTV can offer only competitively-deficient synthetic bundles and promotes them only to sell video: **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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

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

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[70] It is impossible to offer robust broadband over DBS. *See 2014 Measuring Broadband America*, FCC's Office of Engineering and Technology and Consumer and Governmental Affairs Bureau, at 18 (June 18, 2014), *available at* http://data.fcc.gov/download/measuring-broadband-america/2014/2014-Fixed-Measuring-Broadband-America-Report.pdf (describing latency issues inherent in satellite broadband); *see also* DTVFCC-00878481, *Takeaways from the MoffettNathanson Broadband Policy Summit* at 10 (Dec. 17, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] Fifteenth Report, 28 FCC Rcd at 10,545 ¶ 112 ("DBS systems have the disadvantage of using one-way technology.").

[71] *See* Declaration of Paul Guyardo, Executive Vice President and Chief Revenue and Marketing Director, DIRECTV ¶ 44 (June 10, 2014) ("Guyardo Decl.") (stating DIRECTV does no comparative television advertising against cable bundles or against telcos).

[72] Lee Decl. ¶ 16; *see also* DTVFCC-03259882, *Bundles Marketing*, at 20 (July 18, 2014) (providing DIRECTV's estimate that 91 percent of U-verse marketing leads with bundles).

[73] *See* DTVFCC-03259882, *Bundles Marketing* at 9 (July 18, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] And the fact that AT&T has so few video-only customers indicates that there could be at most only a few DIRECTV subscribers who have switched from DIRECTV to AT&T stand-alone video.[77]

Consequently, DIRECTV focuses its competitive efforts on the more likely alternatives for DIRECTV customers—DISH and cable—as described below.

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74 *See* DTVFCC-00352506, *Competitive Digital Sports Landscape* at 3 (July 22, 2011) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] DIRECTV, Sports Overview, *available at* http://www.directv.com/sports/overview?ACM=false&lpos=Header:3 (last visited Oct. 15, 2014) ("DIRECTV is the undisputed leader in sports. No matter what teams you follow, no matter where you live, DIRECTV has you covered. Get everything from international soccer to college hoops to every out-of-market NFL game every Sunday—the list goes on.").

75 *See id*. at 3 (July 22, 2011)

76 DTVFCC-00933029, *U-verse Technical Overview* at 16 (Sept. 9, 2011).

77 *See* Lee Decl. ¶12 (noting that AT&T has only 138,000 total stand-alone video subscribers).

3. DIRECTV Focuses Its Competitive Efforts on DISH and Cable Rather Than AT&T

DIRECTV's documents, national marketing efforts, and local advertising all highlight how DIRECTV targets DISH and cable as close competitors, almost ignoring AT&T and other telcos.

a. DIRECTV vs. DISH

DIRECTV and DISH offer the same product (stand-alone video, without an integrated bundle) using the same technology (DBS) to similar customers (those who value premium video over an integrated bundle). DIRECTV responds directly to DISH competition. **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

Both the Commission and the DOJ recognized these facts in the *DIRECTV/Echostar* proceedings, concluding that these two DBS companies are uniquely close competitors. DOJ challenged the merger of DIRECTV (then owned by Hughes) and DISH (Echostar) based on the

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[78] DTVFCC-00479310, *DIRECTV vs. DISH Network: Competitive Overview* at 6 (Sept. 17, 2011).

[79] *Id.* at 15.

view that "DBS services…offer products that are closer to each other in character and pricing than either is to cable."[80] DOJ recognized that this close competition was reflected in how DIRECTV and DISH went to market:

> [DIRECTV and DISH] compete on a broad array of price and quality characteristics, including programming pricing, programming packages, acquisition of channels, retailer compensation, equipment pricing, installation pricing, local broadcast channels, and targeted promotions.[81]

Likewise, the Commission observed that the DBS providers "appear to be closer substitutes for each other than for services of cable systems or other MVPDs."[82]

The key facts recognized by the Commission and the DOJ in *DIRECTV/Echostar* remain true today. DIRECTV and DISH continue to compete vigorously to attract customers from cable, responding to each other's moves on the "broad array of price and quality characteristics" mentioned in the DOJ's *DIRECTV/Echostar* complaint:

Programming Pricing. Both DIRECTV and DISH use national pricing, offering the same promotional and rack rate prices to all customers regardless of location.[83] **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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80 *See U.S. v. Echostar Communications Corporation*, Complaint ¶ 39 (Oct. 31, 2002), *available at* http://www.justice.gov/atr/cases/f200400/200409.htm.

81 *Id.* at ¶ 42.

82 *Echostar Communications Corporation*, *General Motors Corporation, and Hughes Electronics Corporation, Transferors, and Echostar Communications Corporation, Transferee* Hearing Designation Order, 17 FCC Rcd 20,599, 20,608 ¶ 34 (2002).

83 *See* Section III (describing DIRECTV's national pricing approach); DTVFCC-01511839, *2010 Announced Video Price Increases thru 1/29/10* at 2 (Feb. 2, 2010) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] and "if you want…the best channels at the best price…you need DIRECTV."[85]

Programming Acquisition and Packaging. DIRECTV and DISH attempt to differentiate their programming offerings based on the channels offered in each package. For example, according to one DIRECTV advertisement:

> DISH claims they offer the same TV for less, but pay attention to what channels you're really getting with them. They don't include 25 of the most watched channels in their America's Top 120+ package, including NFL Network, Animal Planet, MLB Network, Nick Jr., and more.[86]

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[84] DTVFCC-00479310, *DIRECTV vs. DISH Network: Competitive Overview* at 4 (Sept. 17, 2011). As one DISH television ad states, "DISH Network and DIRECTV look the same to me," but "after all the offers end, DIRECTV costs more than $60 a month…a similar package with DISH Network, over $20 less." DISH, *Side by Side Commercial*, *available at* https://www.youtube.com/watch?v=4uNMl-TIpWY (last visited Oct. 23, 2014).

[85] DTVFCC-01327503, *DISH vs. DIRECTV* at 26 (Feb. 1, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DIRECTV, Compare DIRECTV with DISH, *available at* http://www.directv.com/DTVAPP/content/directv/directv-vs-dish-network (last visited Oct. 15, 2014) (comparing DIRECTV and DISH on various metrics). *See also* DTVFCC-00479310, *DIRECTV vs. DISH Network: Competitive Overview* at 4, 13, 18 (Sept. 17, 2011) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

[86] DTVFCC-02942805, *5 Reasons to Switch to DIRECTV (vs. DISH)* at 3-5 (Aug. 5, 2013); DIRECTV, DIRECTV vs. DISH, *available at* http://www.directv.com/DTVAPP/content/directv/directv-vs-dish-network (last visited October 21, 2014) (stating that DIRECTV offers "20 more of your favorite channels on average than the comparable DISH packages" and "more full-time HD channels than Dish, and more sports").

DISH's website makes similar claims:

> DISH BEATS DIRECTV…DISH offers the most national HD channels—over 200! DIRECTV only offers 170… With DIRECTV you could pay up to $30 to rent a movie. When you switch to DISH [y]ou'll get 15 movie channels with Blockbuster Home including EPIX, STARZ Cinema, Sony Movie Channel and FXM, plus access to thousands of movies streamed to your TV, computer or iPad. You'll also get HBO, Cinemax, SHOWTIME and STARZ free for 3 months.[87]

Retailer Compensation. **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

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[87] DISH, Compare DIRECTV, *available at* http://www.dish.com/why-dish/compare-directv/ (last visited Oct. 21, 2014); DTVFCC-01327503, *DISH vs. DIRECTV* (Feb. 1, 2014) at 3-12 **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] DTVFCC-00479310, *DIRECTV vs. DISH Network: Competitive Overview* at 4, 13, 18 (Sept. 17, 2011) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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[88] *See* DTVFCC-03027227 (Apr. 16, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

[89] *See* DTVFCC-01718720, *DIRECTV Monthly Operations* at 13 (Apr. 29, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

Equipment Pricing. The companies' websites also highlight their aggressive competition in equipment pricing and performance. Both companies currently offer free upgrades to their HD DVR technologies, and each company claims its product is superior to the other's.[90]

Installation Pricing. DIRECTV and DISH today routinely offer free installation to new customers.[91] DIRECTV's current offer includes free "standard professional installation in up to four rooms" for most new customers.[92] Not to be beaten, DISH currently advertises, "Free installation. Get TV installed in up to 6 rooms FREE—DIRECTV charges extra for that."[93]

Local Broadcast Channels. In *DIRECTV/Echostar*, DOJ noted that, as a result of competition from DISH, DIRECTV had "embarked on an aggressive strategy to offer local

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90 *See* DIRECTV, DIRECTV vs. DISH, *available at* http://www.directv.com/DTVAPP/content/directv/directv-vs-dish-network (last visited October 21, 2014) ("See how Genie stacks up against DISH's Hopper"; emphasizing seven attributes on which the Genie HD DVR outperforms DISH's Hopper; and advertising a "Free Genie HD DVR Upgrade"); DISH, The Hopper is the Best DVR of Them All, *available at* http://www.dish.com/why-dish/compare-whole-home/?WT.svl=watch-button (last visited Oct. 28, 2014) ("DIRECTV Genie...The Hopper from DISH is a thousand times better than you."). **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] DTVFCC-00479310, *DIRECTV vs. DISH Network: Competitive Overview* (Sept. 17, 2011) (same).

91 *See, e.g.*, DIRECTV, Help Center, *available at* https://support.directv.com/app/answers/detail/a_id/1489/~/what-is-the-difference-between-standard-and-custom-installation%3F (last visited Oct. 21, 2014) (stating that "most new customers . . . . get FREE standard professional installation"); DISH, Compare DIRECTV, *available at* http://www.dish.com/why-dish/compare-directv/ (last visited Oct. 21, 2014) (advertising "free installation").

92 DIRECTV, Additional Details, *available at* http://www.directv.com/DTVAPP/content/directv-tv-deals-gm (last visited Oct. 21, 2014).

93 DISH, Compare DIRECTV, *available at* http://www.dish.com/why-dish/compare-directv/ (last visited Oct. 21, 2014).

broadcast channels via satellite, accounting for roughly 85 percent of U.S. households."[94] As a result of such continued competition, DIRECTV now "offers local channels in over 99 percent of U.S. households, available in HD in nearly all of these households."[95]

Targeted Promotions. **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

Just as their technical characteristics make DIRECTV and DISH particularly close competitors, those characteristics also differentiate the DBS companies from wireline providers. DBS service requires a satellite dish antenna on the home, **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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94 *U.S. v. Echostar Communications Corporation*, Complaint ¶ 49 (Oct. 31, 2002), *available at* http://www.justice.gov/atr/cases/f200400/200409.htm.

95 DIRECTV, Does DIRECTV Offer Local Channels?, *available at* https://support.directv.com/app/answers/detail/a_id/2420/related/1 (last visited Oct. 28, 2014).

96 *See supra notes* 84-88, 90-93 and accompanying text.

97 DTVFCC-01327503, *DISH vs. DIRECTV* at 12 (Feb. 1, 2014).

98 *See, e.g.*, DTVFCC-02104041, *good read on hulu* (June 15, 2013) (quoting news article from PandoDaily.com: "Today, when people think of DirecTV, they think of satellite TV (and thus, ugly rooftop satellite dishes)"); DTVFCC-00453192, *Comcast Ad* at 4 (Mar. 2014) ("Want even more reasons to choose Xfinity over Satellite? . . . You can ditch the ugly satellite dish…"); *cf.* Jennifer Levitz, *As Dishes Stack Up, Cities Start Trying To Put Them Away*, Wall St. J. (Apr. 25, 2012), *available at* http://online.wsj.com/news/articles/SB10001424052702304444604577340052254206654 ("Boston, Philadelphia and Chicago are among the cities that have recently passed or are drafting laws banning satellite dishes from the fronts of homes, unless a signal can't be obtained another way. . . . They look tacky, said Chicago Alderman Ray Suarez . . . 'It's just ugly,' said Boston City Councilman Sal LaMattina, waving down a dish-decked street in East Boston.").

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

Thus, as indicated in DIRECTV documents and verified by marketplace behavior, DIRECTV competes closely with DISH, whose offering is much more similar to DIRECTV's than those of wireline competitors.[100]

b. DIRECTV vs. Cable

DIRECTV considers cable MVPD providers its other closest competition. Historically, cable offered only stand-alone video. When DIRECTV entered in 1994, DIRECTV took share from cable by competing on video quality, offering better picture quality and many more channels.[101] Cable responded by more aggressively offering triple-play bundles. **[BEGIN**

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[99] *See, e.g.*, DTVFCC-02167247, *DIRECTV U.S.: NPS Analysis and Commentary* at 26 (Apr. 7, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-02553062, *DIRECTV Brand Analysis Report* at 12 (Feb.–Mar. 2012) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-00631585, *Product Concept Opportunities* at 14, 26 (June 12, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-00944349, *Comcast Ad* at 2 (June 22, 2011) (criticizing DIRECTV for "unreliable reception in bad weather").

[100] *See* DTVFCC-01327503, *DISH v. DIRECTV* at 12 (Feb. 1, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[101] *See, e.g., U.S. v. Echostar Communications Corporation*, Complaint ¶ 41 (Oct. 31, 2002), *available at* http://www.justice.gov/atr/cases/f200400/200409.htm ("[B]ecause most DBS customers switch from cable, much of the competition between Hughes and Echostar is to attract the customers switching from cable").

DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

[102] *See* DTVFCC-00280950, *Revenue & Marketing: Profitable Growth—2014 SAC Planning Review* at 4 (Nov. 13, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION] [END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[103] *See* DTVFCC-00595716, *December 2013 Migration Report* at 4 (Jan. 20, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION] [END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[104] *See* DTVFCC-03259882, *Bundles Marketing* at 5 (July 18, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION] [END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[105] DTVFCC-00595716, *December 2013 Migration Report* at 4 **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION] [END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[106] Cable companies traditionally were stand-alone video providers, until they began aggressively marketing bundles in the mid-2000s.

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] These historical customer purchasing patterns further evidence the competitive distance between DIRECTV and AT&T.[108]

c. DIRECTV Marketing Shows DISH and Cable To Be Its Closest Competitors

DIRECTV markets against DISH and cable, but not against U-verse or FiOS. The DIRECTV website[109] underscores the company's focus on DISH and cable:

The DIRECTV website does not make any comparisons or otherwise market against AT&T or other telcos.

DIRECTV regularly targets DISH in national marketing campaigns, including most recently the "Choice is Clear" series of ads highlighting DIRECTV advantages over DISH:

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107 *See* DTVFCC-03259882, *Bundles Marketing* at 5 (July 18, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

108 *FTC & DOJ*, *Horizontal Merger Guidelines* at § 2.2.2. (stating that customer "historical purchasing patterns and practices" may be "highly relevant" to merger analysis).

109 DIRECTV, Why DIRECTV?, *available at* http://www.directv.com/DTVAPP/content/directv/what_is_directv?lpos=Header:1 (last visited Oct. 15, 2014).

> Want more or less? Your choice is clear. Any way you look at it, DIRECTV beats DISH hands down. Here are the facts plain and simple: if you want the ultimate HD DVR experience, the best channels at the best price, more full-time HD channels than Dish, and more sports, you need DIRECTV.[110]

[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

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[110] DIRECTV, Compare DIRECTV with DISH, *available at* http://www.directv.com/DTVAPP/content/directv/directv-vs-dish-network (last visited Oct. 15, 2014) (comparing DIRECTV and DISH on various metrics).

[111] *See* DTVFCC-01330586, *NFL Sunday Ticket 2012 Marketing Plan* at 5 (Apr. 4, 2012). *See also* DTVFCC-01370602, **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DISH, Compare DIRECTV, *available at* http://www.dish.com/why-dish/compare-directv/ ("DISH BEATS DIRECTV. DISH simply gives you more for less—get a free Hopper upgrade, free installation in up to 6 rooms, over 30 Premium Movie channels free for 3 months and so much more with packages starting at only $29.99/mo."); DTVFCC-00479310, *DIRECTV vs. DISH Network: Competitive Overview* at 15 (Sept. 17, 2011) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[112] DTVFCC-01327503, *DISH v. DIRECTV* at 25-26 (Feb. 1, 2014). *See also* DTVFCC-01965289, *Genie-GenieGO comparison chart* (Apr. 6, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-01330512, *Direct Sales Business Review* at 11 (Mar. 28, 2012) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

DIRECTV also advertises nationally against "cable."[113] Even though there are multiple cable providers, each with a different footprint, cable service is near-ubiquitous and consumers understand who "cable" is in advertising. The current "Get Rid of Cable" ads highlight cable's inferior customer service, higher price compared to value, content outages, and smaller content selection.[114] Like DISH, the major cable companies have targeted DIRECTV just as forcefully.[115]

Below are screen shots of representative national advertising campaigns reflecting DIRECTV's intense competition with DISH and cable.

113 *See, e.g.*, DIRECTV, DIRECTV vs. Cable, *available at* http://www.directv.com/DTVAPP/content/directv/directv-vs-cable-network (last visited Oct. 15, 2014) (stating that DIRECTV has "ranked higher than cable for 14 years in a row" in the American Customer Satisfaction Index; and "DIRECTV vs. cable: It's no contest.").

114 *See, e.g.*, *Compilation of DIRECTV "Get Rid of Cable" Commercials*, *available at* https://www.youtube.com/watch?v=NZ80SVOHKoo (last visited Oct. 26, 2014).

115 *See, e.g., Comcast ad, Blindsided* (2014), *available at* https://www.youtube.com/watch?v=udb6YJs_cn4 (last visited Oct. 21, 2014) ("If you sign up for DIRECTV's latest deal, prepare to be blindsided, because they'll double your rate before you know it."); DTVFCC-01330586, *NFL Sunday Ticket 2012 Marketing Plan* at 5 (Apr. 4, 2012) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-01370602, **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

DBS and Cable Advertising Campaigns (2012-14)[116]

DIRECTV v. Cable

"Don't be like this me. Get rid of cable and upgrade to DIRECTV."

DIRECTV v. DISH

"DISH claims that they offer the same channels for less... but the truth is, you just get less."

Cable (Comcast) v. DIRECTV

"If you sign up for DIRECTV's latest deal, prepare to be blindsided, because they'll double your rate before you know it."

DISH v. DIRECTV

"Look, my price is 15% lower than yours."

In contrast, DIRECTV does not target U-verse or other telco services on its website or in any of its marketing.[117] Despite the fact AT&T has introduced U-verse in dozens of new localities over the last few years, DIRECTV has not targeted U-verse in local advertising. These decisions were not made because telcos are regional providers; as evidenced by the fact

116 *See DIRECTV v. Cable*, *available at* https://www.youtube.com/watch?v=1R2_b6CN728 (last visited Oct. 23, 2014); DIRECTV v. DISH, *available at* https://www.youtube.com/watch?v=4IqhDisA2Ek (last visited Oct. 23, 2014); Cable (Comcast) v. DIRECTV, *available at* https://www.youtube.com/watch?v=9qbIFGLNiwI (last visited Oct. 23, 2014); DISH v. DIRECTV, *available at* https://www.youtube.com/watch?v=td25mb5xG5s (last visited Oct. 23, 2014).

117 *See* Guyardo Decl. ¶ 44 (stating DIRECTV runs no television campaigns against telcos).

DIRECTV has targeted Comcast, which offers video only in certain regions, as shown in the screen shot below.[118]

DIRECTV's documents, national marketing efforts, and local advertising show how DIRECTV responds competitively to DISH and cable, which it considers its close competitors, not the telcos.

III.
DIRECTV Pricing Confirms <u>It Does Not View AT&T as a Close Competitor</u>

A. DIRECTV Uses a National Pricing Strategy Because Its Closest Competitors Are "National" Providers

DIRECTV prices its service to customers on a national basis. No matter how pricing is defined—rack rates for promotional packages, discounts off rack rates, retention benefits, etc.—the approach is virtually identical regardless of geography. This national pricing strategy, facilitated by DIRECTV's national marketing efforts, reflects the fact that DIRECTV's main

[118] DIRECTV, *Compare the Competition*, *available at* http://usawireless.tv/directv/why-directv/directv-vs-cable-dish-network.html (last visited Oct. 23, 2014). *See also* DIRECTV, DIRECTV vs. Comcast Xfinity, *available at* http://www.directv.com/DTVAPP/content/directv/directv-vs-comcast-xfinity?ACM=false (last visited Oct. 23, 2014) ("Fed up with Comcast? You're not alone. In one year, more people chose DIRECTV than the top ten cable TV companies, combined").

competitors, DISH and cable, are present nationwide. It also highlights the competitive insignificance of U-verse for DIRECTV.

DIRECTV does not vary its pricing based on which competitors are present in particular areas. **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

DIRECTV's national pricing reflects its competitive focus on DISH and cable, which are DIRECTV's closest competitors and are present nationwide. **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] DIRECTV's prices are not different inside or outside the U-verse footprint.[120]

B. DIRECTV Prices Its Service to Customers on a National Basis

[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

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119 *See* DTVFCC-01336005, *Media Marketplace Update* at 30 (Dec. 9, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

120 *See infra* Section III.B.

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

For new and existing customers, DIRECTV sets national rack rate prices for its programming packages.[122] Likewise, when DIRECTV offers new customer discounts off programming package rack rates or other promotional benefits, those are uniform nationwide.[123] Beyond the rates for programming packages, other fees and charges also are set nationally.[124]

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[121] DTVFCC-01805143, *Content Strategy* at 10 (July 22, 2011).

[122] DIRECTV's 2014 rack rates for its programming packages are: Select - $49.99, Entertainment - $57.99, Choice - $66.99, Xtra - $73.99, Ultimate - $81.99, and Premier - $129.99. DTVFCC-00273105, *2014 Pricing Strategy*, at 13 (Oct. 3, 2013). Previous years' rack rates followed a similar distribution (with the exception of the Entertainment package which was added in 2012) and reflect an average annual price increase of 4.2 percent. *See* DTVFCC-00273082, *2014 Pricing and Packaging: Follow-up Discussion* at 7 (Dec. 2, 2013) **[BEGIN DIRECTV CONFIDENTIAL INFORMATION]** **[END DIRECTV CONFIDENTIAL INFORMATION]**

[123] **[BEGIN DIRECTV CONFIDENTIAL INFORMATION]** **[END DIRECTV CONFIDENTIAL INFORMATION]** *See generally*, DTVFCC-00279798, *DIRECTV Historical Offer Timeline* (Oct. 23, 2013) (providing comprehensive list of new customer offers).

[124] *See, e.g.*, DTVFCC-01751284, *Premiums Business Review 2014* at 9 (Nov. 13, 2013) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DIRECTV, Premium Channels, *available at* http://www.directv.com/premiums/overview?ACM=false&lpos=Header:3#! (last visited Oct. 28, 2014) (listing national prices for premium channels that can be added to any new customer's programming package); DIRECTV, DIRECTV Protection Plans, *available at* http://www.directv.com/technology/protection_plan?ACM=false&lpos=Header:3#! (last visited Oct. 28, 2014) (listing national prices for protection plans that can be added to any new customer's programming package).

These include premium programming add-ons such as HBO, Showtime, Starz, and NFL Sunday Ticket, PPV/On-Demand, Advanced Receiver Service (multi-room DVR access), and equipment lease fees. Additionally, any promotions for new subscribers are uniform nationwide.

When it comes to the retention credits that are offered to customers who, for example, threaten to disconnect DIRECTV service, DIRECTV also takes a uniform nationwide approach in assessing whether and how large a credit to offer, **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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[125] *See, e.g.*, DTVFCC-02715715, *Heart Cross Reference* 20140328 (Mar. 28, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** DTVFCC-02718351, *Apr 2014 Residential CVS* at 2 (Apr. 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[126] **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** See DTVFCC-00400152, *Churn Brainstorming* at 9 (Mar. 14, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[127] *See id.* at 8 **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] DIRECTV does not make available promotions, credits, or upgrades only to customers in certain geographic areas.

C. [BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

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[128] *See* DTVFCC-00273153, *RSN Fee Strategy* at 5 (Jan. 17, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]

[129] *See* DTVFCC-00273153, *RSN Fee Strategy* at 4 (Jan. 17, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[130] *See* DTVFCC-02597558, *2013 Pricing Notice* at 1 (Oct. 2013) **[BEGIN DIRECTV CONFIDENTIAL INFORMATION]** **[END DIRECTV CONFIDENTIAL INFORMATION]** This applies to less than 1 percent of DIRECTV subscribers.

[131] **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION] DTVFCC-00273153, *RSN Fee Strategy* at 3 (Jan. 17, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION] [END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

[132] **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION] [END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**

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[133] *See* DTVFCC-00288724, *Dish Attack Plan* (June 6, 2014) **[BEGIN DIRECTV HIGHLY CONFIDENTIAL INFORMATION]** **[END DIRECTV HIGHLY CONFIDENTIAL INFORMATION]**.

IV.
Conclusion

For the foregoing reasons, the Commission should conclude that, as the ordinary-course documents confirm, AT&T and DIRECTV are not close competitors. Rather, AT&T competes for customers who want broadband/video bundles, and DIRECTV competes for customers who are interested in a stand-alone video product.