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**REDACTED – FOR PUBLIC INSPECTION**

January 7, 2015

***VIA ELECTRONIC FILING***

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

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

Dear Ms. Dortch:

Pursuant to the *Second Amended Modified Joint Protective Order*<sup>1</sup> (“*Modified Joint Protective Order*”) in the above-captioned proceeding, Netflix hereby submits a public, redacted version of its January 7, 2015 Reply of Netflix, Inc. (“Reply”). The “{{ }}” symbols denote where Highly Confidential Information has been redacted.<sup>2</sup> Netflix has determined that this Reply contains no Confidential Information pursuant to the *Modified Joint Protective Order*. A

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<sup>1</sup> Applications of AT&T, Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 14-90, *Second Amended Modified Joint Protective Order*, DA 14-1640 (Nov. 12, 2014) (“*Modified Joint Protective Order*”).

<sup>2</sup> The Highly Confidential Information used in this Reply was provided by outside counsel acknowledged in this proceeding pursuant to the *Modified Joint Protective Order*, and has not been reviewed by Netflix’s in-house counsel.

Ms. Marlene Dortch  
January 7, 2015  
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Highly Confidential version of this filing is being simultaneously filed with the Commission and will be made available pursuant to the terms of the *Modified Joint Protective Order*.

Please contact me with any questions.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'M. C. Erickson', written over a horizontal line.

Markham C. Erickson  
*Counsel for Netflix, Inc.*

Enclosure

**REDACTED – FOR PUBLIC INSPECTION**

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554**

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

**REPLY OF NETFLIX, INC.**

Christopher Libertelli  
Corie Wright  
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January 7, 2015

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Before the  
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	)	
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<b>DIRECTV</b>	)	
	)	
For Consent To Assign or Transfer Control	)	
of Licenses and Authorizations	)	
	)	

**REPLY OF NETFLIX, INC.**

**I. INTRODUCTION AND SUMMARY**

Netflix replies to the Joint Opposition to Petitions to Deny and Condition and Reply to Comments (“Opposition”)<sup>1</sup> filed by AT&T and DIRECTV (collectively, the “Applicants”) in the above-captioned proceeding. The Applications of AT&T and DIRECTV<sup>2</sup> raise concerns regarding the proposed transaction’s negative effects, particularly through the combined entity’s increased incentive and ability to harm OVDs. As Netflix demonstrated in its Comments, AT&T has today the ability to harm consumers and the public by foreclosing its own subscribers’ access to OVDs and by seeking monopolistic rents at the point its network interconnects with the public

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<sup>1</sup> Joint Opposition of AT&T Inc. and DIRECTV to Petitions to Deny and Condition and Reply to Comments, MB Docket No. 14-90 (filed Oct. 16, 2014) (“Opposition”).

<sup>2</sup> Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations, Description of Transaction, Public Interest Showing, and Related Demonstrations, MB Docket No. 14-90 (filed Jun. 11, 2014) (“Application”).

Internet.<sup>3</sup> Were it to combine with DIRECTV, the combined entity's incentive and ability to do so would be greater.<sup>4</sup>

In their Opposition, Applicants do not assuage those concerns. Instead they misdirect the blame for the degradation of Netflix's services to Netflix.<sup>5</sup> AT&T's own internal documents tell a different story—one in which Netflix had little choice but to pay AT&T or be degraded.

**II. THE MERGER WILL INCREASE AT&T'S INCENTIVE TO HARM CONSUMER CHOICE AND COMPETITION IN THE ONLINE VIDEO MARKETPLACE**

AT&T argues that: (i) it always has embraced OVD providers as an important selling point for broadband to its own customers and (ii) that its transaction with DIRECTV will not alter that dynamic. Neither is true. As demonstrated below, AT&T already has harmed Netflix by demanding access fees for Netflix content to reach AT&T's subscribers. More fundamentally, this transaction would change the nature of AT&T's business and alter the combined entity's incentives: significantly increasing its number of broadband subscribers and transforming the company from primarily a telephony and wireless provider to a large, vertically integrated Multichannel Video Programming Distributor ("MVPD") and high-speed broadband provider.

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<sup>3</sup> Netflix Comments, MB Docket No. 14-90 (filed Sept. 16, 2014) ("Netflix Comments").

<sup>4</sup> *See id.* at 13 ("Post-transaction, the combined entity will be able to offer video services across the entire nation, and would have an increased incentive to harm OVDs wherever it operates, including in the remaining portions of AT&T's network. This new incentive will affect AT&T's existing 6 million DSL subscribers, as well as any new subscribers in the 13 million additional households that could receive its new fixed wireless local loop service.") (citations omitted).

<sup>5</sup> Opposition at 42-45.

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The addition of DIRECTV’s video services to millions of AT&T’s broadband customers also would greatly increase the combined firm’s incentive to degrade third-party video services in favor of its new investment in DIRECTV’s video content.<sup>6</sup> AT&T currently offers its U-Verse video offering to some, but far from all, of its broadband subscribers. The remainder of AT&T’s broadband subscribers must get their video services elsewhere, either through another MVPD or through a combination of OVDs. If combined with DIRECTV, however, AT&T would have a direct and powerful incentive to favor its combined entity’s video offerings to protect its \$48 billion investment—either by foreclosing OVDs from access to those customers or at least by seeking anticompetitive rents from them.

### III. AT&T HAS THE POWER TO FORECLOSE EDGE PROVIDERS

AT&T does not dispute that it has the technical ability to block or degrade OVD services. Instead, AT&T continues to claim only that it has no incentive to do so. Yet, AT&T already has done so. AT&T has used its control over the exchange of traffic at interconnection points to degrade Netflix’s traffic by congesting the interconnection ports needed to permit the traffic to reach AT&T’s subscribers. This congestion degraded the quality of requested Netflix movies and TV shows, harming Netflix’s service. The congestion was alleviated only after Netflix agreed to pay AT&T a terminating access fee to put an end to the harm to their mutual subscribers.

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<sup>6</sup> Applicants cite AT&T’s recent \$500 million joint venture with the Chernin Group to “acquire, invest in and launch over-the-top video services,” as an example of AT&T’s support of OTT video. *Id.* at 36 n.115. It does nothing of the sort. Instead, it provides further incentive for AT&T to favor affiliated OTT services over those provided by third parties.

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AT&T maintains that it does not have the incentive to degrade OVDs' connections because the “the only way a ‘degradation by congestion’ strategy could possibly work would be if AT&T congested or blocked *all* of its interconnection points”—thus undermining its broadband service.<sup>7</sup> AT&T does not need to block or degrade all of the routes into its network, however, to degrade an OVD's traffic. It need only degrade the transit routes actually available to and used by the particular OVD, leaving many other routes available for other traffic. Moreover, these routes into AT&T can be, and were, congested without undermining AT&T's broadband service generally, because OVD services are “particularly vulnerable to congestion”—unlike “emails, online shopping, and basic Web browsing.”<sup>8</sup>

Even if an alternative settlement-free route were available to an OVD, those routes remain settlement-free based only on the terms of the given agreement with AT&T and only for the finite period governed by the particular agreement.<sup>9</sup> In the case of AT&T, not even the largest transit providers in the world were able to secure sufficient settlement-free capacity from AT&T to deliver the content that AT&T's own subscribers were demanding. As a result, the number of routes that AT&T could congest to target an OVD for degradation is fairly modest—

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<sup>7</sup> *Id.* at 42 (emphasis in original).

<sup>8</sup> Netflix Comments at 17; *see also id.* (“Higher quality streaming video requires a reliable high-speed bit rate to avoid rebuffering and the ‘pixilation, freeze frames, audio garbling, etc., [which] effectively destroys a video watching experience for the end user.’”) (quoting William Norton, *The 21st Century Internet Peering Ecosystem*, DrPeeringInternational, available at <http://drpeering.net/core/ch I 0.2-The-21st-Century-Internet-Peering-Ecosystem.htm>).

<sup>9</sup> Netflix's outside counsel is continuing to review the material submitted by AT&T to determine how much leeway AT&T has in manipulating its settlement-free routes and pressuring its settlement-free interconnection peers.

meaning that most of AT&T’s routes to the Internet will remain completely unaffected by the degradation of routes available to an OVD.

**A. Netflix Could Not Avoid Congestion On AT&T’s Network**

AT&T denies that it allowed routes carrying Netflix traffic to congest and instead argues that the degradation of Netflix’s traffic was “the avoidable result of [Netflix’s] own routing decisions.”<sup>10</sup> AT&T argues that Netflix could have avoided the congestion by “using a different mix of backbone providers.”<sup>11</sup> Both claims are false and are refuted by AT&T’s own documents.

AT&T’s documents show that it was well aware that Netflix was doing exactly what AT&T now says it should have done—*i.e.*, “using a different mix of backbone providers”<sup>12</sup> to deliver its video services to AT&T’s broadband customers. {{

}}<sup>13</sup> {{

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<sup>10</sup> Opposition at 42.

<sup>11</sup> *Id.* at 43

<sup>12</sup> *Id.*

<sup>13</sup> {{

}}

}}<sup>14</sup> Netflix’s

attempts to reach its customers on AT&T’s network through various providers and AT&T’s deliberate decision to degrade Netflix traffic are clear. Netflix used some of the largest and most capable transit providers in the world to reach AT&T’s network. AT&T allowed each of these connections to congest in order to force Netflix to pay an access fee.

AT&T asserts that Netflix’s efforts to deliver its content by using some of the largest and most capable transit providers in the world were inadequate. AT&T’s Senior Vice-President of Technology Planning and Engineering stated in his Declaration that Netflix has caused network congestion by using only six AT&T peers: “Cogent, Level 3, NTT, TeliaSonera, Tata and XO” and that “there are many other transit providers that peer with AT&T from which Netflix could also have purchased access to AT&T’s network.”<sup>15</sup> Though it does not name them publicly, AT&T states that it has “peering arrangements with 23 partners.”<sup>16</sup> In reality, the competitive options for transit services to high-bandwidth customers in the United States include only the six identified by Mr. Mair—Cogent, Level 3, Tata, TeliaSonera, XO, and NTT.<sup>17</sup>

Netflix used all of the settlement-free routes into AT&T’s network that were reasonably available. Netflix cannot force any entity with a settlement-free agreement with AT&T to provide it with transit into AT&T’s network; it can only request bids to provide those services

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<sup>14</sup> {{

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<sup>15</sup> Declaration of Scot Mair, MB Docket No. 14-90, ¶ 23 (June 11, 2014) (attached to Opposition) (“Mair Declaration”).

<sup>16</sup> Opposition at 40.

<sup>17</sup> Letter from Robert Cooper, Counsel to Cogent, to Marlene Dortch, FCC, MB Docket No. 14-57, at 6 (filed Nov. 18, 2014).

and see who responds. Netflix also must evaluate those bids in terms of their competitiveness not only on price, but on their ability to provide the required services—transit not only into AT&T’s network, but to many other networks as well. Netflix utilized six of the largest and most capable transit providers to bring its traffic to AT&T’s network.

Quibbling over the exact number of routes available into AT&T’s network misses the larger point: AT&T alone sets the terms and conditions for settlement-free access and does so in a way that ensures that no content provider of any scale can meet those criteria. {{

}}<sup>18</sup> Even if Netflix was aware of all 23 of AT&T’s peering partners, AT&T reserves for itself, through its Peering Policy, the ability to change the settlement-free status of their transit routes unilaterally: “AT&T reserves the right to terminate peering . . . with peers who do not meet” its prescribed peering ratio of “[n]o more than a 2.00:1 ratio of traffic into AT&T” and a “reasonably low peak-to-average ratio.”<sup>19</sup>

Because AT&T’s subscribers consume content asymmetrically—i.e., they download much more content than they upload—AT&T’s peers are naturally “out of balance” with AT&T’s desired ratio. Internal AT&T documents note that {{

}}<sup>20</sup> These metrics demonstrate that AT&T has established a policy

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<sup>18</sup> See *infra* note 23 and accompanying text.

<sup>19</sup> AT&T, AT&T Global IP Network Settlement-Free Peering Policy (October 2012), <http://www.corp.att.com/peering> (last visited Jan. 7, 2015).

<sup>20</sup> {{

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that lets it arbitrarily declare a peer out-of-ratio and terminate the agreement or demand new fees when competitive marketplace dynamics suit it.

**B. AT&T Intentionally Allowed Its Network To Congest**

AT&T blames Netflix for congestion on its network due to AT&T’s and Netflix’s mutual customers requesting Netflix’s services through AT&T’s broadband Internet access service: “it was Cogent, together with Netflix, that caused the congestion in Cogent’s peering links with AT&T.”<sup>21</sup> Yet neither Netflix nor its partners send a single bit of data to AT&T’s network that is not specifically requested by AT&T’s own broadband subscribers. Instead, it was AT&T that congested its interconnection points.

AT&T’s internal documents show that the company made a specific choice to stop augmenting capacity on settlement-free routes in order to force traffic onto paid ones. AT&T has designed a network around the principle that consumers download far more content than they upload. But it is AT&T policy that {{

}}<sup>22</sup> Not surprisingly, {{ of AT&T’s peers qualified for additional capacity under this policy, and so {{

}}<sup>23</sup> With consumers seeking more content every month, by April 2014, the utilization across the top 10 settlement-free peers, which carried {{ of

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<sup>21</sup> Mair Declaration ¶ 40.

<sup>22</sup> {{  
}}

<sup>23</sup> {{  
}}

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AT&T’s traffic, was as high as {{ }}.<sup>24</sup> Utilization across all 23 settlement-free peers was {{ }}.<sup>25</sup>

Given this extremely high level of congestion {{ }}, the Applicants’ suggestion that congestion on its network would have eased if only OVD providers had made other peering arrangements is specious. If AT&T were truly willing to accept Netflix traffic on a settlement-free basis, there was no valid technical or business reason for it not to offer a settlement-free interconnection agreement to Netflix or simply to augment the capacity that Netflix was using. Instead, AT&T pursued a policy designed to restrict the settlement-free capacity available, during a time when AT&T’s own consumers were seeking more content from Netflix, and as AT&T was selling high-speed data plans to consumers with the promise of a better online video experience.

Given this confluence of events, Netflix had little choice but to pay AT&T, directly or indirectly, or allow its subscribers to continue suffering degradation on AT&T’s network.<sup>26</sup> While Netflix was increasingly concerned about the performance of its services, AT&T’s internal documents show that, not only was it aware that its strategy was harming its customers, it made the deliberate decision to allow such harm to continue to pursue its larger strategy of extracting a terminating access fee from Netflix.<sup>27</sup>

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<sup>24</sup> {{  
}}

<sup>25</sup> {{ }}

<sup>26</sup> Opposition at 43 n.145.

<sup>27</sup> {{

Despite the clear evidence, AT&T maintains that such a strategy of intentional congestion would be neither practical nor in its own interests.<sup>28</sup> For example, AT&T argues that “to win and retain broadband customers, the combined company must continue to offer them high-quality access to the OTT options they want . . . any provider that fails to facilitate OTT offerings would suffer a competitive disadvantage in the marketplace.”<sup>29</sup> AT&T’s own documents contradict this assertion and demonstrate that AT&T had the ability to degrade Netflix’s traffic with impunity despite the harm to its own customers. {{

}}<sup>30</sup> Indeed, in order to force either Netflix or its agents to pay a toll in the form of a terminating access fee, AT&T was perfectly willing to degrade its own customers’ broadband experience.

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<sup>28</sup> Mair Declaration ¶ 5.

<sup>29</sup> Opposition at 34-35.

<sup>30</sup> {{

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<sup>31</sup> {{

}}

**IV. CONCLUSION**

This Transaction would result in significant harm to consumer choice and the nascent market for OVD and OTT content. The Applicants have not shown otherwise. AT&T has previously been willing to degrade the connections of its own broadband customers to force OVDs to pay it a terminating access fee. The combined entity would have only increased incentive to harm online video distributors like Netflix.

\* \* \*

Respectfully submitted,

/s/  
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January 7, 2015

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CERTIFICATE OF SERVICE

I hereby certify that on January 7, 2015, I caused true and correct copies of the foregoing to be served by electronic mail upon the following counsel:

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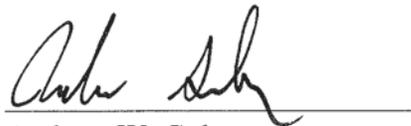
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