



En-Touch Systems, Inc.

En-Touch Systems, Inc.
11011 Richmond Avenue Ste. 400
Houston, TX 77042

June 30, 2015

VIA ECFS

The Honorable Thomas Wheeler
Chairman
Federal Communications Commission
455 12th Street, SW
Washington, DC 20544

Re: Ex Parte Submission, Applications of AT&T Inc. and DirecTV To Transfer Control of FCC Licenses And Other Authorizations, MB Docket No. 14-90

Dear Chairman Wheeler:

I am writing this letter to bring to your attention the troubling situation my company, enTouch Systems, Inc., a Houston-area quad-play provider, is currently facing in its carriage negotiations with Root Sports Southwest, a regional sports network (RSN) jointly owned by AT&T and DirecTV. Due to the fact that my company provides robust head-to-head video competition to both AT&T U-verse and DirecTV and the fact that the RSN has granted a most favored nation (MFN) clause to another MVPD in the market, the RSN is now demanding discriminatory and above fair market value rates from enTouch and its customers. I encourage you to take account of the circumstances surrounding my company's difficulties in reaching a fair deal with AT&T/DirecTV's RSN as you determine whether the AT&T/DirecTV transaction should be approved, and what conditions should be adopted to mitigate the expected harms to consumers and competition.

enTouch Systems was founded in 1995 to provide residential and business customers in the Houston metropolitan area with an alternative choice for bundles of local and long distance voice, digital cable television, broadband Internet access and alarm monitoring services. Today, these services, which include a first-to-market one Gigabit broadband service,¹ are provided by enTouch over a state-of-the-art fiber-to-the home (FTTH) network that cost the company tens of millions of dollars to deploy. Although we face fierce competition from AT&T U-verse in about 66 percent of our market and from DirecTV across our entire market, more than 26,000 customers (out of 45,000 total homes passed) have elected to choose enTouch over other providers.

In 2012, having deployed its FTTH network, it was vital for enTouch to attract customers, particularly from other multichannel video programming distributors (MVPDs) that also offer broadband Internet access service. This meant offering a competitive video service that included the Houston RSN which airs Houston Astros baseball and Houston Rockets basketball games. At the time, the network was owned by Comcast and called Comcast SportsNet (CSN) Houston. Very few MVPDs, including DirecTV and AT&T, were willing to pay the exorbitant rates demanded by Comcast, but as a small provider seeking to provide a competitive service in the market, we felt we had no choice but to carry the network at the rate demanded. Within a few years, unable to secure carriage with other MVPDs, CSN Houston declared bankruptcy. It was acquired recently by AT&T and DirecTV in a joint venture,

¹ See Joe Martin, *Local Internet service provider becomes fastest in Houston*, HOUSTON BUSINESS JOURNAL (July 7, 2014), available at <http://www.bizjournals.com/houston/blog/nuts-and-bolts/2014/07/local-internet-service-provider-becomes-fastest-in.html>.

www.EnTouch.net
phone: 281.225.1000
fax: 281.225.0589

renamed Root Sports Southwest, and the AT&T U-verse and DirecTV distribution services both entered into agreements to carry the network.

enTouch's current contract with Root Sports Southwest expires at the end of September, and we have been negotiating a renewal for the last couple of months. Despite our best efforts to reach an amicable deal, in our last discussions, the RSN continues to demand a price that we believe to be both discriminatory and above fair market value. The fee demands are excessive considering the RSN's low average viewership in the market relative to that of other RSNs in other markets, the fact that AT&T/DirecTV recently acquired the RSN from its former owner on the cheap and the fact that the Astros and Rockets have lowered their fees for airing their games. Given these facts, one would think that the RSN would agree to rates significantly lower than those previously offered by Comcast and rejected by most MVPDs in the market, including AT&T and DirecTV themselves. That, however, is not the case. I believe there are two primary reasons why Root Sports Southwest is demanding these discriminatory and above fair market value fees from enTouch and maybe others.

First, enTouch has been very successful in the market against AT&T U-verse and DirecTV since we launched our service. To their dismay, we have been able to convince many of their customers to become enTouch customers. Before acquiring Root Sports Southwest, AT&T and DirecTV's only means of stemming customer losses to enTouch was by offering an equally good or better quality MVPD service and offering service at an equal or lower price. However, with the acquisition of Root Sports Southwest, AT&T and DirecTV have a new means of undermining the competitive threat from enTouch. These companies can deny access to "must have" affiliated programming or, in the alternative, charge higher prices for it. We believe that AT&T, DirecTV, and Root Sports Southwest's current negotiating tactics stem directly from their recognition that they will benefit financially from denying enTouch access to Root Sports Southwest because each MVPD will sign up unhappy enTouch customers desiring a video service that includes Root Sports Southwest. However, they also recognize that Root Sports Southwest benefits from entering into a carriage deal with enTouch because of the affiliate fee revenue such a deal generates. To reconcile these competing interests, AT&T and DirecTV can maximize their joint economic interests by simply charging head-to-head rivals, like enTouch, higher prices than non-rivals. The higher prices they charge rivals offset the lost profits they would have achieved had the programming not been sold at all. We believe this party accounts for the high prices demanded of us.

Second, we have been told that Root Sports Southwest cannot offer us rates that take into account current marketplace considerations because the network must comply with an MFN in its contract with Comcast that was negotiated at a time when Comcast had a stake in the RSN. According to court documents, when Comcast acquired a stake in the RSN in 2010, Comcast agreed to pay an "artificially inflated price" in exchange for receiving an MFN.² Under the clause, if the RSN entered into an affiliation agreement with a subsequent distributor for a lower rate, Comcast would be entitled to reduce its base rates to equal the rate of the subsequent affiliation agreement. Although Comcast agreed to pay higher than market rates, as a stakeholder in the network, the artificially higher price was mostly costless – nothing more than a pocket-to-pocket transfer. The inflated price, combined with its MFN, made it likely that other MVPDs in the market would pay no less than the artificially high price paid by Comcast because the RSN would be unlikely to enter into a deal that would reduce the revenue it receives from Comcast. As a stakeholder, Comcast thus benefited financially from its rivals paying artificially higher

² *In re Houston Regional Sports Network, L.P.*, Memorandum Opinion and Order, Case No. 13-03325, at 3-4 (Bankr. S.D. Tex. May 22, 2014), available at http://www.gpo.gov/fdsys/pkg/USCOURTS-txsb-4_13-ap-03325/pdf/USCOURTS-txsb-4_13-ap-03325-0.pdf.

prices. This scheme permitted the RSN to charge Comcast's rivals above fair market value rates without being overtly discriminatory, thus lessening the chance of being subject to a program access complaint.

This "soak the competitor" philosophy exhibited by Comcast ultimately was not as successful as Comcast and other network stakeholders had hoped, but demonstrates the perverse incentives of vertically integrated operators and programmers. It also demonstrates that even failed attempts by vertically integrated entities to act on incentives to disadvantage rivals can harm competition and consumers. Specifically, some MVPDs, like enTouch, that carried the network for years now realize they and their customers were charged artificially higher rates for this programming. Other MVPDs, who refused to carry the network, ended up losing subscribers to MVPDs, like Comcast, that were carrying the network. Disappointingly, this philosophy has been retained by AT&T and DirecTV, who similarly claim now in our negotiations over Roots Sports Southwest that they can't give us a materially better rate for our subscribers because they can't afford to give that same rate to Comcast as required by the existing MFN. Even after Root Sports Southwest's contract expires with Comcast, we fear that AT&T and DirecTV will have the same incentives as Comcast to enter into a similar scheme of paying Roots Sports Southwest above fair market value rates and securing for themselves an MFN that establishes a price floor on carriage fees for other MVPDs that interferes with what should be otherwise be arm's length negotiations.

enTouch has considered filing a complaint under the program access rules, but does not believe that relief can be obtained due to flaws in the process. First, to the extent that the largest cable operator in the market is paying an artificially high rate due to an MFN clause, it may reflect that Roots Sports Southwest is engaging in a uniform pricing strategy, which would make filing a complaint about price discrimination ineffective. Second, even if there is no uniform pricing strategy, the rules do not permit enTouch to bring a complaint comparing itself to another similarly sized MVPD. enTouch would have to compare itself to a head-to-head competitor that carries the RSN, which today includes only AT&T, DirecTV, Comcast, and Consolidated. Since each of these companies serves many more customers than enTouch, it would be difficult, if not impossible, to demonstrate to the Commission whether enTouch is facing the type of discrimination that the program access rules prohibit.

We are concerned about the AT&T and DirecTV merger because once the two companies combine, they will be more profitable than either standing alone, giving them an increased incentive and ability to charge even higher prices for their jointly owned RSN programming than if they remained separate companies. For this reason, we urge the Commission not to approve the pending merger involving these companies unless conditions are imposed that mitigate this and other merger-specific harms. It is our understanding that the Commission is considering adopting two types of conditions, with improvements for smaller operators, that were previously adopted by the Commission to address the problems similar to those facing enTouch: a non-discriminatory access condition (enforced through the program access complaint process) to protect against discriminatory practices and a commercial arbitration remedy to protect against the imposition of above-fair market value pricing through a uniform price increases strategy. We also understand the Commission is considering a condition that would prevent AT&T and DirecTV from entering into an agreement with their RSNs that would interfere with a company like enTouch from entering into an agreement with third-party programmers at fair rates. We hope the Commission would adopt all of these conditions because these remedies, if adopted, would definitely benefit competition and consumers by tempering the anticompetitive activities of AT&T and DirecTV.

I note that enTouch isn't the first operator to face difficulties negotiating non-discriminatory and fair market value deals with cable-affiliated RSNs, and not even the first with Root Sports. Setting aside the very public difficulties that MVPDs have had securing carriage of RSNs in Los Angeles, there is irrefutable evidence that DirecTV's Root Sports Pittsburgh demanded rates above fair market value from

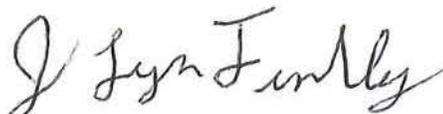
Hon. Thomas Wheeler
June 30, 2015
Page 4

the small cable operator Armstrong Utilities. Luckily, since DirecTV was subject to a non-discriminatory access condition and a baseball style arbitration remedy under the terms of the FCC's transfer of control of DirecTV from News Corp. to Liberty Media, Armstrong had the right to take DirecTV to arbitration for its unreasonable demands. It exercised its right, and after a long and costly battle that few if any other smaller operators today would endure, an arbitrator ruled against DirecTV – a decision that was affirmed by the FCC in 2014.

In closing, if AT&T and DirecTV, as joint owners of Root Sports Southwest are willing to treat enTouch unfairly in our negotiations while they are under scrutiny by the Commission in this proceeding, then I suspect they will treat other MVPDs in the same way in their future negotiations as they and other vertically-integrated programmers have done in the past. To protect consumers and competition, I hope the Commission will not approve the AT&T and DirecTV transaction unless there are sufficient conditions to address the problems that enTouch is facing in its current negotiations.

Thank you for your consideration.

Sincerely,

A handwritten signature in black ink that reads "J Lyn Findley". The signature is written in a cursive, flowing style.

J Lyn Findley
President and Chief Executive Officer