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September 16, 2014

By ECFS

Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street S.W.
Washington, DC 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**

Dear Ms. Dortch:

In accordance with the *Joint Protective Order*,¹ Netflix, Inc. submits the attached redacted version of its Comments. The “[]” symbols denote where Confidential Information has been redacted, and the “{ }” symbols denote where Highly Confidential Information has been redacted. The Confidential and Highly Confidential versions of this filing are being simultaneously filed with the Commission and will be made available to requesting parties pursuant to the terms of the *Joint Protective Order*.

Please contact me with any questions.

Respectfully submitted,



Markham C. Erickson
Counsel for Netflix, Inc.

¹ Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 14-90, *Joint Protective Order*, DA 14-804 (June 11, 2014).

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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

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

COMMENTS

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September 16, 2014

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Table Of Contents

EXECUTIVE SUMMARY iii

I. INTRODUCTION.....1

II. RELEVANT MARKETS2

A. National High-Speed Broadband Distribution Of Edge Provider Content.....2

B. Video Programming Distribution.....3

1. Product Market: High-Speed Distribution Of Edge Provider Content.....3

2. Geographic Market: National.....8

III. THE MERGED ENTITY WILL HAVE AN INCREASED INCENTIVE TO HARM EDGE PROVIDERS AND DIMINISH COMPETITION IN THE VIDEO MARKETPLACE11

A. Applicants Have The Incentive To Protect Both Their Linear Video Services And Affiliated OVDs From Competition And Are Developing OTT Services To Compete With OVDs While Protecting Their Bundling Strategy11

B. The Best Indication Of AT&T’s Incentives Is Its Conduct13

IV. THE COMBINED ENTITY WILL HAVE THE ABILITY TO HARM OVDs.....14

A. AT&T Has The Ability To Harm OVDs Through Its Interconnection Practices14

1. AT&T Is One Of Four Terminating Access Networks Can Congest Routes Into Their Networks And Extract Terminating Access Fees From Edge Providers.....15

2. An OVD’s Ability To Manage Congestion At Interconnection Points Is Critical To Delivering Its Service To Its Customers.....17

3. Large Terminating Access Networks Can Extract Terminating Access Fees Because They Pose A Significant Threat To OVDs With Fixed Costs For Content.....20

B. AT&T Has Already Leveraged Its Control Over Interconnection Points To Harm OVDs.....23

C. The Combined Entity Will Also Be Able To Use Data Caps To Advantage Its Own Video Product Over OVDs25

D. The Behavior Of The Combined Entity Will Not Be Disciplined By Competition In The Broadband Market28

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1.	Applicants Face No Meaningful Competition That Would Discipline Their Behavior.....	28
2.	High Switching Costs Prevent Consumers From Changing ISPs.....	29
V.	THE COMMISSION MUST CONDITION APPROVAL OF THIS TRANSACTION	33
A.	Applicants' Proposed Conditions Are Insufficient To Protect Consumers	33
B.	To Adequately Protect Consumers, The Commission Must Apply Broader Conditions To This Transaction.....	33
VI.	CONCLUSION	34

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EXECUTIVE SUMMARY

AT&T, Inc. and DIRECTV (together, the “Applicants”) seek the Commission’s authority to merge the nation’s second largest multichannel video programming distributor (“MVPD”) with one of the nation’s largest broadband Internet access providers (the “Transaction”). The Commission should properly condition the Transaction to avoid the significant public interest harms created by the combination.

Applicants make clear that the benefits from this Transaction flow directly from their ability to bundle broadband and video services to provide the combined entity with the incentive and ability to rollout next-generation wireless and wired broadband and to protect their video services from Internet edge-based content providers, such as online video distributors (“OVDs”). That may well be, however, this same bundling also increases the combined entity’s incentive and ability to harm content providers that Applicants view as a threat to their business model.

This Transaction is proposed at a critical time for consumers. OVDs such as Netflix have re-imagined the way in which a consumer accesses and enjoys video content—enabling her to access through an intuitive user interface a rich library of content at times and locations of her choosing. In response to OVD innovation, users increasingly demand more Internet-delivered video that they have paid high-speed broadband providers to access. In turn, broadband providers can attract new subscribers and sell existing customers more robust Internet speeds. As a result of this virtuous circle, consumers increasingly have access to more independent sources of video content.

Applicants’ own documents make clear that they see OVDs as a threat to their core video business. AT&T already has acted to diminish that threat by using its market power and control over interconnection pathways to degrade its own customers’ access to Netflix content until Netflix paid AT&T a terminating access fee. OVDs are particularly vulnerable to congestion and degradation of their services, owing to the myriad video providers available to consumers, the low costs of switching OVDs, and the sensitivity to congestion of video streaming traffic.

Applicants lack constraints on their ability to harm OVDs. The Commission has yet to address the practice of anticompetitive terminating access fees, and the future of its open Internet rules remains unclear. Consumers generally lack the competitive choices in broadband services necessary to allow them to avoid these unsettling network practices. OVDs have no alternative route to reach those consumers, except through AT&T’s network. Moreover, if the Applicants’ expected subscriber growth proves correct, OVDs will have little choice but to pay the combined entity terminating access fees. By raising their rivals’ costs, the combined entity will face far fewer competitive constraints for its video business from OVDs.

This likely harm can be avoided with appropriate, clear, and long-term conditions. Those conditions must be designed to ensure that the combined entity cannot abuse its control over Internet traffic, whether over its mobile or fixed networks, or whether over the last mile or at interconnection points, to harm OVDs.

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COMMENTS

I. INTRODUCTION

Netflix, Inc. (“Netflix”) files these comments regarding the proposed transaction (“the Transaction”) between AT&T, Inc. and DIRECTV (the “Applicants”) to raise concerns about the combined entity’s ability to harm OVDs. The Commission already has determined that vertically integrated multichannel video programming distributors (“MVPDs”) have the incentive and the ability to discriminate against online video distributors (“OVDs”). AT&T already has exercised its control over Internet traffic at interconnection points to its network to harm OVDs like Netflix. Approving the Transaction in its current form would heighten that public interest harm by making DIRECTV’s and AT&T’s services vertically integrated nationwide.

Netflix is the world’s leading Internet television provider with over 50 million members in more than 40 countries enjoying more than one billion hours of TV shows and movies per month, including Netflix’s original series. For a low monthly price, Netflix members can watch as much as they want, anytime, anywhere, on nearly any Internet-connected screen.

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Since launching our streaming service in 2007, Netflix has increased in popularity both domestically and internationally. The service is available on a broad array of consumer electronic devices, including Internet-connected TVs and set-top boxes, game consoles, computers, tablets, and mobile phones. As Netflix's service has grown, our content has evolved from an eclectic offering of older movies and TV shows to award winning original productions, such as *House of Cards* and *Orange is the New Black*. Likewise, as technology has improved, including the continued advancing speeds of cable broadband, our service has begun to offer its members new and innovative features, including higher resolution 4K content—a resolution that is unavailable through traditional MVPD services.

The ability of edge providers like Netflix to innovate, grow, and offer consumers new and exciting ways to enjoy online content depends on their ability to access high-speed broadband capable of distributing rich media and interactive content, such as high-quality video. Applicants claim that the Transaction would be a net positive for edge providers, but if approved without appropriate conditions, the Transaction likely will result in expanding an existing harm to OVDs.

II. RELEVANT MARKETS

A. National High-Speed Broadband Distribution Of Edge Provider Content

Applicants' expert identifies five relevant product markets for this transaction, but fails to discuss a key market affected by this transaction:¹ the national market for high-speed broadband distribution of edge provider content. The Department of Justice ("DOJ") recognized and relied upon this market definition in the *AT&T-MediaOne* transaction, which was approved by the DOJ

¹ Applications of AT&T Inc. and DIRECT for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 14-90, Declaration of Professor Michael Katz at 14-34 (filed June 11, 2014) ("Katz Declaration").

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and the Commission only after a substantial divestiture and other conditions addressing the competitive concerns raised by the transaction.²

Applicants claim that the Transaction will benefit OVDs because it would result in a dramatic expansion of AT&T's broadband offerings—both in quality and geography.³ AT&T's and DIRECTV's claim, however, is undermined by their failure to acknowledge how the transaction will affect the national market for high-speed broadband distribution of edge provider content. The Transaction will expand the incentives and abilities of the Applicants to leverage AT&T's existing presence in this market to harm OVDs, such as Netflix.

B. Video Programming Distribution

1. Product Market: High-Speed Distribution Of Edge Provider Content

The product market definitions proffered by Applicants sidestep a key issue: that high-speed broadband Internet access to American households is a *necessary* input for the distribution of edge provider content.⁴ Consumers rely upon their broadband Internet access service

² Final Judgment, *United States v. AT&T*, No. 1:00-cv-01176 (D.D.C. Sept. 27, 2000) (“*AT&T-MediaOne Final Judgment*”).

³ Applications of AT&T Inc. and DIRECT for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 14-90, at 40-41 (filed June 11, 2014) (“*Application*”).

⁴ Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, *Fifteenth Report*, 28 FCC Rcd. 10496, 10619 ¶ 249, 10620 ¶ 254 (2013) (“*Fifteenth Video Competition Report*”). The Department of Justice has challenged transactions that threatened to give one entity control over crucial inputs. *See* Complaint, *United States v. WorldCom, Inc. and Sprint Corp.*, No. 1:00-cv-00368, at 13 (June 26, 2000) (“*DOJ WorldCom/Sprint Complaint*”) (bringing action to enjoin WorldCom, Inc.’s acquisition of Sprint Corporation because it would give the combined entity an even greater “commanding position” in the control of backbone networks for which “[t]here are no substitutes for this connectivity sufficiently close to defeat a small but significant nontransitory price increase”). The Commission has similarly conditioned its approval of transactions that allowed an entity to withhold a “critical input.” *See, e.g.*, Applications of AT&T Inc. and BellSouth Corp. for Transfer of Control, *Memorandum Opinion and Order*, 22 FCC Rcd. 5662 (2007); *SBC-AT&T*

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providers (“BIAS providers”) like AT&T to provide them access to all points of the Internet. For consumers to enjoy online video and other content, edge providers, like Netflix, need sufficient broadband access to respond to consumer requests for their content.⁵ As the Commission has recognized, “OVDs require [high-speed] Internet capacity to transmit their programming, and consumers need sufficient broadband to access OVDs’ content.”⁶

Edge providers cannot distribute media-rich content without full access to broadband customers, and high-speed BIAS providers have a terminating access monopoly: if an edge provider wants to reach a high-speed BIAS provider’s subscribers, it must have access to the BIAS provider’s network. The Commission recently analyzed this phenomenon in the Open Internet proceeding, and the D.C. Circuit affirmed the Commission’s analysis.⁷ In the Commission’s words, “broadband providers have the ability to act as gatekeepers,” because a subscriber’s BIAS provider “is typically an edge provider’s *only* option for reaching a particular

Order, 20 FCC Rcd. at 18292-93 ¶ 3; Verizon Commc’ns Inc. and MCI, Inc., Applications for Approval of Transfer of Control, *Memorandum Opinion and Order*, 20 FCC Rcd. 18433 (2005).

⁵ See, e.g., Competitive Impact Statement, *United States v. Comcast Corp., General Electric Co. and NBC Universal, Inc.*, No. 1:00-cv-00106, at 11 (D.D.C. Jan. 18, 2011) (“Unlike MVPDs, OVDs do not own distribution facilities and are dependent upon ISPs for the delivery of their content to viewers.”); *Fifteenth Video Competition Report*, 28 FCC Rcd. at 10620 ¶ 254 (“Access to high-speed data pipelines capable of delivering a high-quality video signal is critical for OVD entrants.”).

⁶ *Fifteenth Video Competition Report*, 28 FCC Rcd. at 10620 ¶ 254.

⁷ See *Verizon v. FCC*, 740 F.3d 623, 646 (2014) (citing *Preserving the Open Internet, Report and Order*, 25 FCC Rcd. 17905, 17919 ¶ 24 n.66 (2010), *aff’d in part, vacated and remanded in part sub nom. Verizon v. FCC*, 740 F.3d 623 (D.C. Cir. 2014) (“*Preserving the Open Internet Order*”)) (“The Commission also convincingly detailed how broadband providers’ position in the market gives them the economic power to restrict edge-provider traffic and charge for the services they furnish edge providers.”).

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end user,” and the provider is “capable of blocking, degrading, or favoring any Internet traffic that flows to or from a particular subscriber.”⁸

Applicants recognize the existence of this market when they note that “[i]ncreasing download speeds are making it possible for Internet access services . . . to serve as video-delivery platforms,”⁹ and that “[m]any consumers now expect broadband access to OTT video as a complement to MVPD service.”¹⁰ Such network capabilities and consumer expectations feature prominently in the Application’s post-Transaction consumer benefits.

a. Distribution Of High-Quality Online Video Content Over DSL Is Still Important For Many OVD Subscribers Today

Consumers increasingly expect their broadband services to provide significantly greater capabilities than are currently on offer through traditional digital subscriber line (“DSL”) options.¹¹ The Chairman recently agreed, noting that a “25 Mbps connection is fast becoming ‘table stakes’ in 21st century communications.”¹² Indeed, consumers have been voting with their feet, moving in large numbers from traditional DSL to Fiber-to-the-Node (“FTTN”), Fiber-to-the-Home (“FTTH”), or cable services that offer superior services.¹³

⁸ *Preserving the Open Internet Order*, 25 FCC Rcd. at 17919 ¶ 24, 17935 ¶ 50 (emphasis added).

⁹ Katz Declaration at 34.

¹⁰ Application at 22-23.

¹¹ Petition to Deny of Netflix, Inc., MB Docket No. 14-57, at 16 (filed Aug. 27, 2014). All references to Netflix’s Petition to Deny and associated Declarations are to the public, redacted versions.

¹² Prepared Remarks of Tom Wheeler, Chairman, FCC, The Facts and Future of Broadband Competition (Sept. 4, 2014) http://transition.fcc.gov/Daily_Releases/Daily_Business/2014/db0904/DOC-329161A1.pdf.

¹³ Press Release, Leichtman Research Group, About 385,000 Add Broadband in the Second Quarter of 2014 (Aug. 15, 2014), *available at* <http://www.leichtmanresearch.com/press/081514release.html> (reporting that the top cable companies accounted for 99 percent of net

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Nevertheless, DSL today is still important for many consumers. Netflix is committed to providing the best quality achievable for consumers that subscribe to DSL because of economic constraints or lack of alternatives. Some consumers, particularly those on a budget, are willing to accept lower quality video over the Internet in order to cut costs. Some of AT&T's lower price DSL services, for example, are capable of downstream speeds sufficient to support VHS or even DVD quality video.¹⁴ While those DSL services do not consistently support high-quality, HD or better video services, OVDs, like Netflix, have worked very hard to create streaming-video applications that provide the best possible service in these challenging broadband conditions.¹⁵

b. Mobile Services, If Untethered From Restrictive Data Caps, May Represent A Separate National Market

In general, mobile broadband services are not substitutes for fixed wireless and wireline services for the distribution of long-form content. While modern LTE and LTE-A services offer significant download speeds, currently applicable use and data-cap restrictions severely limit the use of those services for viewing of long-form video programming. Moreover, mobile devices are rarely connected (or even connectable) to Internet-connected TVs, where consumers are increasingly enjoying OVD content.

Absent such restrictive data caps, mobile services could become a complementary national market for the distribution of video content in the future. Applicants indicate, for

broadband additions for the quarter versus the top telephone companies: AT&T and Verizon added 627,000 U-verse and FiOS customers, and lost 636,000 DSL subscribers).

¹⁴ Netflix recommends at least 3 Mbps for DVD quality video, and 1.5 Mbps for VHS quality for subscribers. Netflix, Internet Connection Speed Recommendations, <https://help.netflix.com/en/node/306> (last visited Sept. 13, 2014).

¹⁵ Netflix uses an adaptive streaming technology, to dynamically adjust the video quality based on the available bandwidth. Lower available bandwidth results in lower quality.

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example, that “US 4G LTE network providers typically offer average download speeds of 4 to 12Mbps today,” but that those speeds likely will increase while the cost per megabyte for delivering data over LTE networks is expected to drop over the coming years.¹⁶ If this comes to fruition, Applicants believe that “providing video services over a wireless network becomes feasible.”¹⁷

Applicants admit that {{

that {{
result has {{
}}¹⁸ AT&T speculates
}}¹⁹ and as a

}}.²⁰

In addition, Applicants contend that the Transaction will allow them to “develop new offerings providing enhanced access to video on . . . mobile devices”²¹ and deploy bundles of “mobile broadband and DIRECTV’s video service” to better attract consumers “who watch

¹⁶ Katz Declaration ¶ 24.

¹⁷ Katz Declaration ¶ 24; {{

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¹⁸ Katz Declaration ¶ 51.

¹⁹ {{

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²⁰ {{

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²¹ Applications of AT&T Inc. and DIRECT for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 14-90, Starkey Declaration ¶ 32 (filed June 11, 2014) (“Starkey Declaration”).

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video on mobile devices.”²² That market could be significant. AT&T has estimated that {{ }} of people use smartphones to view video of some kind while commuting or traveling.²³ While most of that video consumption is likely non-streaming video or video streaming through WiFi networks,²⁴ a complementary market for OVD content streamed through mobile broadband may be significant.

In the near term, however, mobile services are increasingly relevant for the distribution of short-form video (*i.e.*, video clips up to 5 minutes in length). Google reports, for example, that 40 percent of its global watch time on YouTube comes from mobile devices.²⁵ Short-form video consumption also has increased following the introduction of Vine and Instagram.²⁶

2. Geographic Market: National

The consumer market for broadband access may be local, but the market for content distribution over broadband is national. In this respect, the combined entity’s increased scale would directly impact edge providers that require *national distribution*.

In addition to established edge providers such as Netflix, Amazon Prime Video, Google, Apple, and Electronic Arts, there are a number of nascent edge providers such as Vimeo and

²² Starkey Declaration ¶ 30.

²³ {{ }}.

²⁴ {{ }}.

²⁵ YouTube, Statistics, <https://www.youtube.com/yt/press/statistics.html> (last visited Sept. 13, 2014).

²⁶ Mark O’Neill, *Vine Continues Growth Despite Challenge from Instagram* (Jan. 15, 2014), <http://smallbiztrends.com/2014/01/vines-growth-slowed-instagram-video.html>; Fernando Espejel, *Mobile First: Watch This! The Rise of Short-Form Video for the Mobile Channel* (Dec. 2013), <http://www.targetmarketingmag.com/article/the-rise-short-form-video-mobile-channel/1>; Ryan Tate, *Twitter Can’t Control Rapid Growth of Its Vine* (June 20, 2013), <http://www.wired.com/2013/06/twitter-vine-growth/>.

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Veoh that have entered the market and are trying to get a toehold in the video marketplace. All of these edge providers—whether established providers or fledgling entrants—require national distribution (anywhere that Internet access is available) at sufficient speeds to compete with incumbent services and invest in new and innovative offerings.²⁷

In evaluating prior transactions, the Commission has considered similar issues in which merely examining competitive effects in local markets failed to capture the transaction's competitive implications in more broadly defined geographic markets. For example, the Commission evaluated issues similar to those presented by the Transaction in its analysis in *AT&T-MediaOne*.²⁸

In *AT&T-MediaOne*, the DOJ's competitive concerns focused solely on the increased market power that AT&T would be able to exercise post-merger in a national market for broadband content distribution, and over those firms whose services required broadband-level speeds, such as the delivery of high-quality streaming video to consumers.²⁹ In particular, the DOJ's complaint emphasized that AT&T would have increased market power over broadband

²⁷ See *Fifteenth Video Competition Report*, 28 FCC Rcd. at 10607 ¶ 220 (“[A]n OVD’s geographic market generally covers all regions capable of receiving high-speed Internet service.”).

²⁸ Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc. to AT&T Corp., *Memorandum and Order*, 15 FCC Rcd. 9816, 9821 ¶ 11 (2000) (“*AT&T-MediaOne Order*”). In *AT&T-MediaOne*, AT&T—a large cable system operator—sought to acquire MediaOne, another large cable operator. AT&T was one of three cable owners (along with Comcast and Cox) of Excite@Home, then the largest residential broadband service provider in the country. Excite@Home had exclusive rights to provide residential broadband services over the systems of its three cable owners. At the time, AT&T owned a majority of the voting interest in Excite@Home. MediaOne owned a roughly one-third interest in RoadRunner, then the second largest residential broadband service provider after Excite@Home. Like Excite@Home, RoadRunner had exclusive rights to provide broadband over the systems of its two cable parents, MediaOne and Time Warner.

²⁹ Complaint, *United States v. AT&T*, No. 1:00-cv-01176, at 8 ¶ 22 (D.D.C. May 25, 2000) (“*AT&T-MediaOne Complaint*”).

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content providers “with national distribution in mind, largely to maximize the potential number of consumers they will reach.”³⁰

Today, edge providers—such as OVDs—require national distribution of their content. The revenue that can be earned by an OVD depends upon the number of consumers that it can access. Whether an OVD is subscription-based or ad-supported, most of its revenue opportunities are proportional to the increased number of consumers who access its online video content.³¹ OVDs require national distribution to maximize the potential number of consumers they can reach, thereby maximizing their revenue opportunities.

While DIRECTV does not currently provide broadband services, Applicants claim that the Transaction will directly result in a dramatic expansion of AT&T’s broadband service offerings, including deploying its gigabit broadband product to 2 million additional customer locations and making its proposed high-speed fixed wireless service available to an additional 13 million people in 48 states. To the extent Applicants’ proposed merger benefits come to fruition, those benefits are not unqualified: an edge provider that requires national distribution would face increased pressure to deal with the combined company. In other words, the Transaction would give the combined company a significantly larger scale in provisioning broadband connections on which edge providers rely. Therefore, focusing on AT&T’s existing local markets significantly underestimates the expansive national reach the combined company would have

³⁰ *AT&T-MediaOne Complaint* at 9 ¶ 23.

³¹ Petition to Deny of Netflix Inc., MB Docket No. 14-57, Declaration of David S. Evans ¶ 127 (filed Aug. 27, 2014) (“Evans Decl.”).

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and fails to take into account the Transaction's potential anticompetitive effects in the market for the national high-speed broadband distribution of edge provider content.³²

III. THE MERGED ENTITY WILL HAVE AN INCREASED INCENTIVE TO HARM EDGE PROVIDERS AND DIMINISH COMPETITION IN THE VIDEO MARKETPLACE

A. Applicants Have The Incentive To Protect Both Their Linear Video Services And Affiliated OVDs From Competition And Are Developing OTT Services To Compete With OVDs While Protecting Their Bundling Strategy

Both the Commission and the DOJ have acknowledged that “[o]nline content, applications, and services available from edge providers over broadband increasingly offer actual or potential competitive alternatives to broadband providers’ own . . . video services.”³³ The Commission has further noted that vertically integrated MVPDs “have incentives to interfere with the operation of third-party Internet-based services that compete with the providers’ revenue-generating . . . pay-television services.”³⁴

BIAS providers also have an incentive to raise revenues by extracting terminating access fees from edge providers. The Commission has observed that BIAS providers “may have incentives to increase revenues by charging edge providers, who already pay for their own connections to the Internet, for access or prioritized access to end users” even though “broadband

³² In the Commission’s consideration of the AT&T-MediaOne merger, it approved the transaction only because the applicants committed to ensuring that unaffiliated ISPs would be able to access the merged firm’s cable network, and the DOJ-imposed conditions, including divestiture of AT&T’s interest in RoadRunner, mitigated the combined firm’s “ability and the incentive to discriminate against unaffiliated content providers.” *AT&T-MediaOne Order*, 15 FCC Rcd. at 9871 ¶ 123. Here, however, there is no such divestiture, competition, or assurance. The concerns that led the DOJ to analyze the AT&T-MediaOne merger’s effect on competition in the market for the national high-speed broadband distribution of edge provider content are heightened in this Transaction.

³³ *Preserving the Open Internet Order*, 25 FCC Rcd. at 17916 ¶ 22.

³⁴ *Id.*

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providers have not historically imposed such fees.”³⁵ Edge providers would not pay for improved service if they were satisfied with their existing service, which, as the Commission stated, creates “an incentive to degrade or decline to increase the quality of the service they provide to non-prioritized traffic.”³⁶

Applicants clearly view OVDs as a competitive threat. Indeed, {{

}}³⁷ Applicants estimate that competition with OVDs could cost DIRECTV {{ }} subscribers over the next five years,³⁸ and AT&T estimates that “only {{ }} percent of consumers in the 18-29 age range subscribe to a traditional MVPD television service,” and that “{{ }} of the consumers in this age groups will ‘cut the cord’ . . . within the next twelve months alone.”³⁹ This shift in viewership by young consumers has prompted DIRECTV to explore various options intended to compete directly with OVDs, including {{

³⁵ *Id.* at 17919 ¶ 24.

³⁶ *Id.* at 17922 ¶ 29.

³⁷ Katz Declaration ¶ 51.

³⁸ Application at 76.

³⁹ Applications of AT&T Inc. and DIRECT for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 14-90, Declaration of Lori M. Lee ¶ 44 (filed June 11, 2014).

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}}.⁴⁰ Applicants' economist states that, as a result, {{

}}⁴¹

Incorporating DIRECTV's video services into AT&T's entire footprint will naturally increase AT&T's incentive to protect its new investment by harming non-affiliated OVDs. AT&T already has an incentive to degrade or harm OVD services in areas in which it offers video services, but those services are available in a relatively small number of markets in which it also provides broadband access services. 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,⁴² as well as any new subscribers in the 13 million additional households that could receive its new fixed wireless local loop service.⁴³

B. The Best Indication Of AT&T's Incentives Is Its Conduct

The clearest indication of the combined entity's incentive to harm OVDs is that AT&T in fact has done so. As discussed below, AT&T has used its ability to control interconnection points into its network in order to raise the costs for OVDs. Applicants contend that, "[r]ather than attempting to discriminate against OTT video, traditional MVPDs are investing in their own

⁴⁰ Application at 76.

⁴¹ Katz Declaration ¶ 50.

⁴² AT&T, 2013 Annual Report, AT&T at 19 (2013), *available at* http://www.att.com/Investor/ATT_Annual/2013/downloads/ar2013_annual_report.pdf.

⁴³ Applications at 5, 44.

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OTT offerings and encouraging the continued growth of third-party OTT video.”⁴⁴ The fact that AT&T already has harmed Netflix, with no apparent repercussions to AT&T, undercuts the Applicant’s contention. As Netflix has previously explained in the context of the Comcast-TWC merger proceeding, what a broadband provider like AT&T “*did do* trumps speculation on what [it] *would do* according to economic theories based on various unsupported assumptions.”⁴⁵

IV. THE COMBINED ENTITY WILL HAVE THE ABILITY TO HARM OVDs

A. AT&T Has The Ability To Harm OVDs Through Its Interconnection Practices

In Netflix’s experience, AT&T is one of four BIAS providers with market power to extract terminating access fees at points of interconnection with edge providers. AT&T’s substantial broadband footprint (approximately 10 million subscribers) and its status as a Tier 1 network operator give it the ability to demand terminating access fees from edge providers such as Netflix. If the Transaction is approved, that leverage will increase significantly as AT&T expands its reach with its proposed, nationwide fixed wireless services and its expanded wireline services. That expanded ability to harm OVDs is particularly troubling, given that AT&T already has used its existing control over interconnection points into its network to cause ports carrying Netflix data to congest, negatively impacting the viewing experience of Netflix content for AT&T subscribers.

⁴⁴ Application at 79.

⁴⁵ Evans Decl. ¶ 25 (emphasis in original).

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1. **AT&T Is One Of Four Terminating Access Networks Can Congest Routes Into Their Networks And Extract Terminating Access Fees From Edge Providers**

Terminating access networks⁴⁶ carry traffic to and from end users who are wholly reliant on the networks for their access to the broader Internet. Each terminating access network enjoys a terminating access monopoly with respect to its end users. Just as “the terminating network possesses *terminating monopoly power* to the extent that no other network can complete calls to that number,”⁴⁷ these networks enjoy a terminating access monopoly because there is no way to deliver traffic requested by an ISP’s subscriber other than through an interconnection point with that ISP. In other words, there is only one way to get to AT&T’s customers—all traffic must make its way through the AT&T network.

Although every terminating access network is a terminating access monopoly, in Netflix’s experience to date, four terminating access networks have the requisite market power to leverage their terminating monopoly to foreclose edge providers or raise their costs to access the BIAS provider’s last-mile networks, and ultimately, consumers. Interconnection market power results from a combination of factors, of which the number of broadband Internet access

⁴⁶ See Petition to Deny of Netflix Inc., MB Docket No. 14-57, Declaration of Ken Florance ¶ 3 (filed Aug. 27, 2014) (“Florance Decl.”) (using the term “terminating access network” to mean “last mile residential ISPs such as Comcast and [TWC]. . . . [A] terminating access network is the final destination for delivery of content to consumers; the majority of commercial content does not originate from that kind of network or use that kind of network to reach other points on the Internet”); WILLIAM B. NORTON, *THE INTERNET PEERING PLAYBOOK: CONNECTING TO THE CORE OF THE INTERNET* 137 (2014 ed.) (“Access networks (also known as ‘eyeball networks’) are Internet Service Providers that sell Internet access to end-users. Access Networks include cable companies, telephone companies and wireless Internet providers. Since Internet users primarily download content, Access Network traffic is generally in-bound (toward the end-user.”).

⁴⁷ J. Scott Marcus, Presentation to ANACOM: Interconnection, Two-Sided Markets, and BERC’s Consultation on IP Interconnection in the Context of Net Neutrality 12 (Feb. 14, 2013), available at http://www.wik.org/uploads/media/NGN_2013_02_14_ANACOM.pdf (“*Marcus Presentation*”) (emphasis in the original).

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subscribers and the number of settlement-free connections with Tier 1 networks (which enable networks to degrade Netflix traffic without substantially degrading other traffic to and from the Internet) are critical.⁴⁸ With over 10 million broadband subscribers today, AT&T already has demonstrated that it has sufficient market power to impose terminating access fees. If the Applicants are correct that this Transaction will help them better compete in the broadband market, that number is likely to grow, and with it, the power to raise the costs of rival OVDs.

AT&T has rejected the premise that it is a terminating access monopoly. It claims there “are multiple paths to reach [a given ISP’s customers and that ISP] cannot impose a government authorized tariff.”⁴⁹ This mischaracterizes the relationship between a terminating access monopoly and the interconnecting transit provider, CDN, or peer. AT&T sets the terms of whether and how data enters its network. While Netflix may currently choose among several options for bringing data “to” AT&T’s network, *none* of those options allows those service providers or Netflix to avoid AT&T’s control over whether data is allowed “into” AT&T’s network. Because of the nature of peering and interconnection arrangements, AT&T has power to pressure transit providers, CDNs, and even fellow peers—including by congesting their ports, de-peering them, or even by cutting off the access of those other providers to AT&T’s network entirely. As discussed below, this threat is not theoretical: AT&T has used that power to harm OVDs already.

⁴⁸ See Evans Decl. ¶ 140 (“The ability of these very large ISPs to threaten to impose harms on OVDs increases dramatically as they increase in size.”).

⁴⁹ Letter from Robert C. Barber, General Attorney, AT&T, to Marlene H. Dortch, Secretary, Federal Communications Commission, GN Docket No. 14-28, Attachment at 8 (July 10, 2014).

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2. An OVD's Ability To Manage Congestion At Interconnection Points Is Critical To Delivering Its Service To Its Customers

OVDs are particularly vulnerable to congestion and therefore are under acute pressure to pay terminating access fees to alleviate congestion. Emails, online shopping, and basic Web browsing are highly tolerant of port congestion.⁵⁰ By contrast, “VoIP and streaming video [traffic] . . . are the most sensitive to performance degradation caused by interconnection congestion.”⁵¹ 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.”⁵²

Even mild congestion can impact consumer behavior. A 2012 study by the University of Massachusetts (Amherst) and Akamai Technologies found that viewers of streaming video content begin to abandon a video if it takes more than two seconds to start, with each incremental delay resulting in a 5.8 percent increase in the abandonment rate.⁵³ Although some of this abandonment is due to “video surfing,” a poor viewing experience makes a viewer less likely to revisit the same site within a week than a similar viewer who did not experience a failure.⁵⁴ This impact is magnified for users who watch video on “a better connected computer or device” such

⁵⁰ *Marcus Presentation* at 31.

⁵¹ Comments of Level 3 Communications, LLC, Protecting and Promoting the Open Internet; Preserving the Open Internet, GN Docket Nos. 14-28, 09-191, at 7 (filed Mar. 21, 2014).

⁵² William B. Norton, *The 21st Century Internet Peering Ecosystem*, DrPeeringInternational, available at <http://drpeering.net/core/ch10.2-The-21st-Century-Internet-Peering-Ecosystem.htm>.

⁵³ S. Shunmuga Krishnan and Ramesh K. Sitaraman, Proceedings of the 2012 ACM Conference on Internet Measurement, *Video Stream Quality Impacts Viewer Behavior: Inferring Causality Using Quasi-Experimental Designs*, Univ. Mass and Akamai Techs. at 1 (Nov. 14, 2012), available at https://people.cs.umass.edu/~ramesh/Site/HOME_files/imc208-krishnan.pdf.

⁵⁴ *Id.*

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as those on fixed broadband connections.⁵⁵ The study found that “the likelihood that a viewer on fiber abandoned earlier than a similar viewer on a mobile device exceeded the likelihood that the opposite happens by 38.25 [percent].”⁵⁶

This result makes sense. Mobile device users, familiar with dropped calls and poor reception, are aware that localized congestion is common. Consumers who purchase 10 Mbps broadband packages from fixed BIAS providers, however, expect to receive traffic at something approaching that level. If their viewing experience is inconsistent with that expectation, they are as likely as not to assume that the problem is with the video streaming service and move to a different application.

Much of this abandonment occurs in part because of the low switching costs associated with OVDs and the number of alternatives video distributors, some of which may have substantially overlapping libraries of content. Consumers can reach a growing field of streaming options in addition to Netflix, including Hulu, Verizon’s Redbox, Blockbuster, Google Play, Apple iTunes, and Crackle with a few mouse clicks or a few buttons on a remote. Consumers viewing online streaming services through their set-top boxes also can switch to VOD, TV Everywhere, or linear video options offered by the MVPD/BIAS provider.

Leaving a subscription-based OVD is vastly simpler than unsubscribing from a linear MVPD service. There is no customer premises equipment to return, no cancellation fee, and no phone call with a persistent customer service representative attempting to dissuade the consumer from abandoning the service. Netflix strives to be extremely straightforward as evidenced by its no-hassle online cancellation. A consumer who is dissatisfied with the quality of streaming

⁵⁵ *Id.* at 3.

⁵⁶ *Id.*

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video can unsubscribe from Netflix in three clicks, and she can gain access to another OVD just as quickly.

Given the sensitivity of online video traffic to congestion, the ubiquity of alternatives, and the ease of switching among them, OVDs must make substantial investments to ensure that requested video traffic can reach its members. At a cost of more than \$100 million in research, development, and deployment costs,⁵⁷ Netflix created Open Connect, a single-purpose CDN, to ensure that its members receive Netflix’s programming in high-quality video formats without rebuffering or other performance issues. Open Connect allows Netflix content to be stored at interconnection exchange points or any location a terminating access network requests and uses a “proactive caching” method to conduct daily content updates during periods when networks are least used, such as early in the morning, to avoid congesting the network.⁵⁸

Globally, Netflix delivers its traffic without exchange of payment to 99 percent of terminating access networks. In the United States alone, Netflix exchanges traffic on a settlement-free basis with [[]] networks. Further, if an ISP has an individual market area serving a population of at least 100,000 subscribers, Netflix will install Open Connect appliances at that location at no charge to the BIAS provider.⁵⁹ By placing popular Netflix content closer to those BIAS provider’s subscribers who are seeking access to it (either through embedded cache servers or by interconnecting at public Internet exchange points) Netflix can help terminating access networks avoid creating unnecessary traffic “up the chain”—either over the middle-mile

⁵⁷ Florance Decl. ¶ 42.

⁵⁸ Netflix OpenConnect: Appliance Deployment Guide, Netflix, at 7 (Apr. 2014), *available at* <http://oc.nflxvideo.net/docs/OpenConnect-Deployment-Guide.pdf>.

⁵⁹ Netflix Open Connect Content Delivery Network: Open Connect FAQ, Netflix (May 6, 2012), *available at* <http://ip.fi/~kajtzu/openconnect%20site%20dump.pdf>.

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or at the BIAS provider's interconnection points. Notably, however, none of the U.S.'s four major BIAS providers has agreed to partner with Open Connect without payment.

3. Large Terminating Access Networks Can Extract Terminating Access Fees Because They Pose A Significant Threat To OVDs With Fixed Costs For Content

OVDs' content licensing arrangements with production companies, studios, and TV networks generally involve some combination of fixed and variable fees.⁶⁰ Regardless of how those fees are structured, the investments are substantial. For example, Amazon Prime's streaming content costs rose from [[] in 2011 to an estimated [[] in 2012.⁶¹ With an annual subscription fee of \$99, Amazon must retain approximately [[] subscribers just to cover its annual content costs and even more if those subscribers also impose shipping costs for physical goods. As Amazon invests more in acquiring content from premium cable programmers like HBO and invests in new original series, its streaming content costs are expected to [[]⁶² Netflix too faces significant content costs, which accounted for 68.1 percent of its total operating expenses in 2013.⁶³ To acquire film and television content from studios, networks and production companies, Netflix enters into contracts for periods of 6 months to five years.⁶⁴ It typically pays a fixed fee to license content.⁶⁵ Further, Netflix's increasing investments in original content represent long-

⁶⁰ Evans Decl. ¶ 123.

⁶¹ [[]].

⁶² [[]]

⁶³ Evans Decl. ¶ 130, Table 5.

⁶⁴ Evans Decl. ¶ 129.

⁶⁵ *Id.*

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term bets that original programming will attract new viewers and convince existing ones to stay.⁶⁶

To recover those content costs, OVDs must achieve and maintain a “critical mass” to operate profitably.⁶⁷ A healthy subscriber base ensures that OVDs can perpetuate their own virtuous circle between viewers and content. Revenue from viewers enables OVDs to invest in acquiring or creating new content, which in turn attracts new viewers.⁶⁸ The reverse is also true: a decline in viewers limits an OVD’s ability to acquire content and less content results in fewer viewers.⁶⁹ An OVD’s profits, therefore, depend on its ability to attract a sufficient number of viewers to cover its costs.

For OVDs with long-term fixed-costs for content, large terminating access networks pose a significant threat to profitability because they can foreclose access to such a large portion of the OVD’s subscribers.⁷⁰ This threat of foreclosure gives large BIAS providers the ability to extract terminating access fees from OVDs. And the larger the BIAS provider, the more bargaining power it has over an OVD in negotiating such access fees because failure to reach an agreement

⁶⁶ Netflix, Annual Report (Form 10-K), at 26 (Feb. 3, 2014) (stating that although original content still represents less than 10 percent of Netflix’s global content expense, it is substantially increasing its investment in original content this year and will continue to do so in the future), available at <http://files.shareholder.com/downloads/NFLX/3468506201x0xS1065280-14-6/1065280/filing.pdf>.

⁶⁷ Evans Decl. ¶ 125.

⁶⁸ *Id.* ¶ 126.

⁶⁹ *Id.*

⁷⁰ OVDs that pay variable content fees based on viewership would face less of a threat to their profitability than OVDs that pay entirely fixed fees. OVDs with variable fee structures would reduce some of their costs as revenue fell, thereby reducing the amount of lost profit. The OVDs, however, would likely either lose out on future content deals or have to make fixed-price commitments since content providers would recognize that the fees they could expect would be smaller. *Id.* ¶ 134.

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with a terminating access network that accounts for a very large portion of an OVD's customers could have a devastating effect on the finances of the OVD.⁷¹ In contrast, a small terminating access network cannot charge an OVD for direct interconnection because failure to reach an agreement with a network that accounts for a very small portion of an OVD's customers would not be financially detrimental.⁷² Additionally, a small terminating access network does not have the same ability to manipulate its interconnection points to create artificial congestion.⁷³ Moreover, because small ISPs tend to pay for transit of all data coming into and out of their networks, they are naturally incentivized to work with Netflix to cut down on traffic being sent over those paid-transit links.

This difference becomes apparent by comparing the terminating access networks that partner with Open Connect for free with those that demand a payment. Most terminating access networks partner with Open Connect for free because doing so improves a subscriber's viewing experience, which in turn makes broadband subscriptions more valuable to the subscriber. Also, Open Connect relieves potential congestion at interconnection points, which increases the overall value and performance of the terminating access network's broadband service. Unlike all other terminating access networks, the four largest terminating access networks have allowed settlement-free routes carrying Netflix's traffic to congest while agreeing to partner with Open Connect only upon receipt of payment. These networks "presumably made the business decision

⁷¹ *Id.* ¶ 136.

⁷² *Id.*

⁷³ As mentioned above, large access ISPs' market power depends on the size of their subscriber base and also on their ability to route traffic through many settlement-free and paid interconnection points. Smaller access terminating access networks have neither the subscriber base nor the plethora of routing options to exercise power in this way.

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that the present discounted value of benefits from degrading the quality of the Netflix video stream to [their] subscribers was greater than the present discounted value of the costs.”⁷⁴

B. AT&T Has Already Leveraged Its Control Over Interconnection Points To Harm OVDs

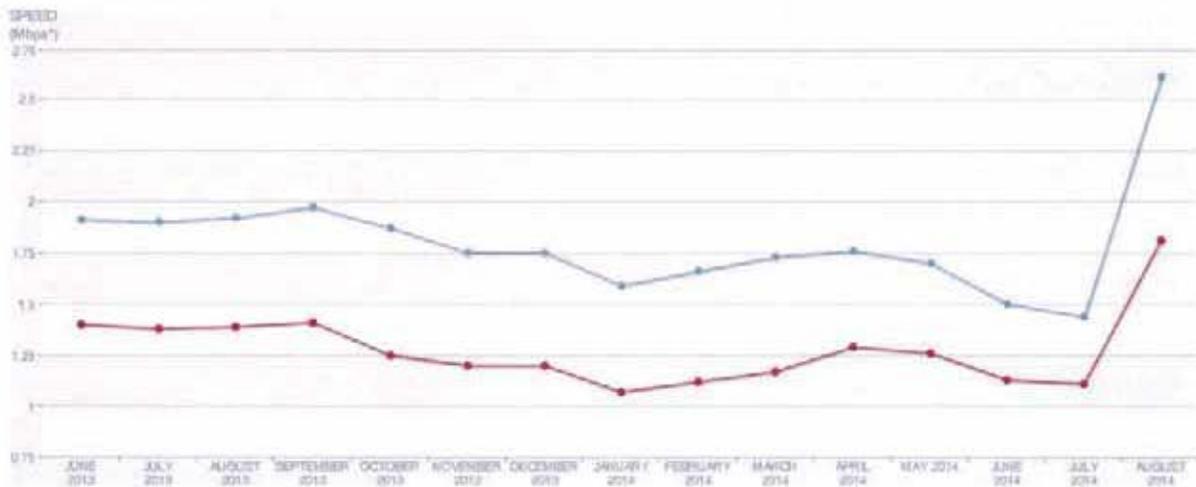
AT&T already has demonstrated that it can manipulate interconnection traffic in ways that harm OVDs. Specifically, beginning in September 2013, AT&T began allowing its interconnection points to become congested.

This degradation had a significant effect on the ability of AT&T’s DSL and U-verse customers to access Netflix content. As illustrated below, Netflix’s service to members using AT&T’s DSL (bottom line) and U-verse (top line) network declined to 1.0 Mbps and 1.5 Mbps, respectively, at their lowest points. Netflix recommends at least 3 Mbps for DVD quality video and 1.5 Mbps for VHS quality, meaning that AT&T’s subscribers were experiencing service at or below VHS quality, regardless the level of service those customers had purchased from AT&T. Moreover, while Netflix works hard to ensure that its service is resilient in the face of congestion, a drop in service below 1.5 Mbps likely caused many users to experience video interruptions.

⁷⁴ Evans Decl. ¶ 115.

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Figure 1: USA ISP Speed Index—AT&T DSL and U-verse (June 2013 – August 2014)⁷⁵



The fact that the congestion peaked in December and January is significant. December and January represent some of Netflix's busiest times because members spend more time at home over the holidays and therefore request more streaming video from Netflix and other OVDs.⁷⁶ While that congestion relaxed some over the next few months, AT&T's level of service to its own customers never returned to its previous, already-low level. It became clear that AT&T would continue to allow congestion across its network to negatively affect its subscribers' online video streaming experience. At the same time, Netflix realized that with nearly 10 million broadband subscribers AT&T's power to harm Netflix's service could increase Netflix's churn and undermine its profitability.

Faced with severe degradation of its streaming video service, Netflix agreed to pay AT&T to directly interconnect. {{

⁷⁵ Netflix, USA ISP Speed Index, <http://ispspeedindex.netflix.com/results/usa/graph> (last visited Sept. 13, 2014).

⁷⁶ Florance Decl. ¶ 53.

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}} As that agreement has begun to be implemented by AT&T, AT&T's subscribers were able to access Netflix content at bit rates approximately 63% (for DSL) and 85% (for U-verse) higher than at its lowest ebb. Netflix expects those numbers to continue to improve as AT&T continues allocating the permitted service level for Netflix content in more markets.

C. The Combined Entity Will Also Be Able To Use Data Caps To Advantage Its Own Video Product Over OVDs

Applicants' plan to bundle DIRECTV's OTT with AT&T's wired and wireless products gives it an ability to harm OVDs by exempting its own OTT services from the data caps but applying them to rival OVDs. Data caps are unpopular with consumers because they impose an extra cost on broadband use to access bandwidth-intensive content such as streaming video. For the same reason, the data caps are a tool to discourage subscribers from accessing unaffiliated, or unsubsidized, streaming video content. {{

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AT&T has historically applied data caps to both its wired and wireless broadband services—with more significant restrictions placed on its mobile services. Currently, AT&T imposes different data caps depending on the specific wired service provided:

Residential AT&T High Speed Internet service includes 150 gigabytes (GB) of data each billing period, and most residential AT&T U-verse High Speed Internet service (up to 45 Mbps) includes 250 Gigabytes (GB) of data each billing period. For U-verse with AT&T GigaPower Internet services, where available, "AT&T U-verse High Speed Internet 100" includes 500 gigabytes (GB) of data each billing period, "AT&T U-verse High Speed Internet 300" includes 1 terabyte (TB) of data each billing period, and "AT&T U-verse High Speed Internet 1 Gbps" includes 1

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terabyte (TB) of data each billing period. The data you send and receive each month contributes to your monthly data plan.⁷⁸

By contrast, AT&T sells mobile broadband as a purely metered service, charging \$100 a month for 10 GBs of mobile data and \$375 for a 50 GBs of mobile data.⁷⁹ Applicants state that their proposed fixed wireless service will be offered as a “home broadband” service rather than a mobile one, but they do not specify how restrictive its “usage allowance” will be.⁸⁰

It bears repeating that mobile broadband is generally not a substitute for wired broadband because of the significant usage and data restrictions placed on mobile broadband, and the tendency of users not to tether large video devices, such as televisions, to their mobile networks. But mobile broadband can be a complementary service to fixed broadband for the distribution of edge provider content, particularly when those data restrictions on the mobile service are eased. In addition, if AT&T exempts data caps for its own OTT services, mobile may become a more effective complimentary service for distributing AT&T-affiliated edge provider content. As noted above, AT&T has previously forecast that {{

and it has consequently determined that {{

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AT&T already has taken steps to employ usage allowances to syphon the consumer surplus that results from OVD video. AT&T specifically {{

⁷⁸ AT&T, Broadband Usage FAQs, <http://www.att.com/esupport/article.jsp?sid=KB409045#fbid=kEOftMulv2s> (last visited Sept. 13, 2014).

⁷⁹ AT&T, Mobile Share Value Plans with Unlimited Talk & Text, <http://www.att.com/shop/wireless/plans/mobileshare.html> (last visited Sept. 13, 2014).

⁸⁰ Application at 43.

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}}⁸² and leveraging its ability to {{

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Data caps can be a significant problem for those who rely on OVDs for a significant portion of their video entertainment, and a strict application of data caps can place a hard limit on a consumer's enjoyment of OVD content. This problem becomes particularly acute with next-generation services, such as 4K content, through which consumers easily can hit their data caps with normal data use and one long weekend binge watching *House of Cards* in 4K.⁸⁴ Even for consumers who use OVDs for more modest video consumption, data caps can introduce anxiety over the potential for extra charges and can cause consumers to ration their viewership of OVDs.⁸⁵

Post-transaction, the combined entity will have strong incentives to exempt its affiliated OTT content from its fixed and mobile services. This strategy would place rival OVDs at a significant disadvantage in seeking to reach the combined entity's broadband customers. AT&T

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⁸⁴ Leslie Horn, *You Can Burn Through Your Entire Broadband Data Cap in One Long Weekend*, Gizmodo (Feb. 18, 2014), <http://gizmodo.com/you-can-burn-through-your-entire-broadband-data-cap-in-1524579598>.

⁸⁵ See generally Marshini Chetty et al., 'You're Capped!' *Understanding the Effects of Bandwidth Caps on Broadband Use in the Home*, Microsoft Research and Georgia Inst. Tech (May 5, 2012), available at http://research.microsoft.com/pubs/162079/YourCapped_HomeBroadbandUseUnderCaps_CHI2012.pdf (finding consumer anxiety related to bandwidth caps was related to uncertainty about which applications consumed the most bandwidth and multiple users on a plan using up allotted data and caused users to limit their usage habits).

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already has set the precedent for this strategy when it began using its restrictive mobile data caps to persuade edge providers into paying to avoid them.⁸⁶

D. The Behavior Of The Combined Entity Will Not Be Disciplined By Competition In The Broadband Market

1. Applicants Face No Meaningful Competition That Would Discipline Their Behavior

The general lack of competitive options for broadband services and the high cost of switching make the combined entity's manipulation of OVD traffic practically costless for Applicants. Applicants contend that stand-alone high-speed broadband service is not competitive in the long term, arguing instead that only bundled broadband-video services have staying power in the market.⁸⁷ Assuming that Applicants are correct, there is unlikely to be significant competitive constraints in the future on the combined entity that would prevent it from harming OVDs to protect its own video offering.

Unfortunately for consumers, the vertical integration of video and broadband by service providers creates an incentive to either foreclose OVDs from accessing their subscribers or to co-opt OVDs by forcing them to pay terminating access fees to access AT&T's network. If Applicants are correct that bundled services are the only way forward, consumers likely will be unable to avoid any AT&T action against OVDs by switching to a provider with a more permissive policy toward OVDs.

⁸⁶ AT&T, Press Release: AT&T Introduces Sponsored Data for Mobile Data Subscribers and Businesses (Jan. 6, 2014), <http://www.att.com/gen/pressroom?pid=25183&cdvn=news&newsarticleid=37366>.

⁸⁷ Application at 55-68.

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2. High Switching Costs Prevent Consumers From Changing ISPs

Even where there is an adequate alternative high-speed broadband service, the high costs of switching BIAS providers impose a substantial barrier between consumers and these alternatives. Based on the results from the Commission's 2010 *Broadband Decisions* survey, only 11.6 percent of respondents switched ISPs in the prior year, excluding those who changed ISPs because they moved.⁸⁸ Although a majority of respondents suggested that it would be easy or very easy to change broadband providers, the numbers went down substantially for subscribers who actually had contemplated changing providers. The survey suggests that "it is possible that those who have considered switching have looked into it more closely than those who have not—and as a result have found it to be a more involved process than those with less information."⁸⁹

To describe switching wireline broadband providers as an "involved process" is a generous characterization. Consumers face significant switching costs when changing BIAS providers, including "early termination fees; the inconvenience of ordering, installing, and set-

⁸⁸ Evans Decl. at ¶ 82 (citing FCC, *Broadband Decisions: What Drives Consumers to Switch—Or Stick with—Their Broadband Internet Provider*, 5-6 (Dec. 2010), available at https://apps.fcc.gov/edocs_public/attachmatch/DOC-303264A1.pdf ("*Broadband Decisions Survey*"). This figure is likely overstated given that many respondents claimed multiple "home" broadband providers, including mobile wireless. *Broadband Decisions Survey* at 4 n.4. The survey was conducted in conjunction with the FCC's report on broadband use and adoption in America. As explained in that report, respondents could pick more than one type of home broadband connection and 44 percent of respondents selected "Mobile broadband wireless connection for your computer or cell phone" as a home broadband connection, which do not offer speeds comparable to wired broadband services. John B. Horrigan, *Broadband Adoption and Use in America*, 14, Exhibit 2 (OBI Working Paper Series No. 1 Mar. 2010), available at https://apps.fcc.gov/edocs_public/attachmatch/DOC-296442A1.pdf. However, mobile wireless connections are immune from many of the switching costs associated with changing fixed wireline broadband subscribers, which are discussed below.

⁸⁹ *Broadband Decisions Survey* at 7.

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up, and associated deposits or fees; the possible difficulty returning the earlier broadband provider's equipment and the cost of replacing incompatible customer-owned equipment; the risk of temporarily losing service; the risk of problems learning how to use the new service; and the possible loss of a provider-specific email address or website.”⁹⁰ Switching costs factored heavily in the D.C. Circuit's agreement with the Commission that wireline BIAS providers act as “terminating monopolists” or “gatekeepers” with respect to edge providers:

[I]f end users could immediately respond to any given broadband provider's attempt to impose restrictions on edge providers by switching broadband providers, this gatekeeper power might well disappear. . . . For example, a broadband provider like Comcast would be unable to threaten Netflix that it would slow Netflix traffic if all Comcast subscribers would then immediately switch to a competing broadband provider. But we see no basis for questioning the Commission's conclusion that end users are unlikely to react in this fashion.⁹¹

AT&T and DIRECTV both have imposed barriers to canceling and switching by locking consumers into long term contracts for certain services, and subject consumers to potentially significant early termination fees if they seek to switch providers.⁹² Equipment also must be

⁹⁰ *Preserving the Open Internet Order*, 25 FCC Rcd. at 17924-25 ¶ 34.

⁹¹ *Verizon v. FCC*, 740 F.3d 623, 646 (D.C. Cir. 2014). The Commission declined to extend the *Open Internet* rules to dial-up Internet access “because telephone service has historically provided the easy ability to switch among competing dial-up Internet access services.” *Preserving the Open Internet Order*, 25 FCC Rcd. at 17935 ¶ 51.

⁹² AT&T, U-verse TV Support, Bundle Service, Early Termination Fee, <http://www.att.com/esupport/article.jsp?sid=KB413367&cv=813#fbid=kEOftMuIv2s> (last visited Sept. 13, 2014); DIRECTV, Help Center, Will I Be Charged a Fee If I Cancel My Service, https://support.directv.com/app/answers/detail/a_id/940/~/-will-i-be-charged-a-fee-if-i-cancel-my-service%3F (last visited Sept. 13, 2014); *see also* AT&T, Terms of Service, <http://www.att.com/u-verse/att-terms-of-service.jsp> (last visited Sept. 13, 2014); DIRECTV, Equipment Lease Agreement, http://www.directv.com/DTVAPP/content/legal/equipment_lease_addendum (last visited Sept. 13, 2014) (“If you do not maintain your base level of programming for the full term, we will charge you an early cancellation fee. The maximum fee is \$480 for new customers, \$480 for

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returned within a short period of time to avoid additional significant fees.⁹³ Moreover, AT&T and DIRECTV do not permit their customers to cancel their service online.⁹⁴

For consumers, initiating a new service can prove just as daunting as canceling an existing service, if not more so. In the Commission's survey, the top three reasons cited for staying with the current provider involved the cost of switching to a new service rather than the cost of leaving an old one: installation fees, hassles associated with installation, and deposits for new service.⁹⁵ Finally, consumers are reluctant to change an existing bundle of services, some of which may not be offered by the alternative broadband provider.⁹⁶ The potential of switching away from AT&T is made more daunting by the fact that in 67 percent of AT&T's U-verse service area, the main options for switching are the two largest cable ISPs—Comcast and TWC⁹⁷—who are also the two held in the lowest regard by their own customers.⁹⁸

existing customers with DVR, HD and/or HD DVR Receivers, or \$240 for existing customers with only standard Receivers.”).

⁹³ See AT&T, Terms of Service, <http://www.att.com/u-verse/att-terms-of-service.jsp> (last visited Sept. 13, 2014) (indicating that consumers will be charged the value of any equipment not returned within 21 days); DIRECTV, Equipment Lease Agreement, http://www.directv.com/DTVAPP/content/legal/equipment_lease_addendum (last visited Sept. 13, 2014) (“If we haven’t received your leased equipment within 21 days of termination of your base level of programming, or if the equipment is returned in damaged condition, we will charge you \$45 for each standard DIRECTV Receiver, \$135 for each DVR, \$45 for each HD Receiver, \$135 for each HD DVR, \$135 for each Genie HD DVR and \$45 for each Genie Mini.”).

⁹⁴ See AT&T, U-verse TV Support: Cancel or Suspend AT&T U-verse Service, <http://www.att.com/esupport/article.jsp?sid=KB420540&cv=813#fbid=kEOftMuIv2s> (last visited Sept. 13, 2014) (“Canceling services can’t be completed online.”); DIRECTV, Help Center: Can I Cancel My DIRECTV Service Online?, https://support.directv.com/app/answers/detail/a_id/1953/related/1/session/L2F2LzEvdGltZS8xNDEwMTA1NzU2L3NpZC9RMzNFMIAXbQ%3D%3D (last visited Sept. 13, 2014).

⁹⁵ *Broadband Decisions Survey* at 8.

⁹⁶ *Id.*

⁹⁷ Application at 24.

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Switching costs also make it unclear whether consumers would behave differently if they had better information about the cause of degraded performance and the availability of superior alternatives. Consumers may not know why the degradation takes place or who is responsible—they just want it fixed.⁹⁹

The lack of real competition for broadband access and high switching costs means that AT&T essentially is unrestrained and unharmed when it elects to forgo routine upgrades that would reduce or eliminate congestion at interconnection points in order to harm OVDs. This, in turn, leaves OVDs largely powerless in the face of that indifference to the user experience. Applicants attempt to downplay this lack of constraint by saying that, “[r]ather than attempting to discriminate against OTT video, traditional MVPDs are investing in their own OTT offerings and encouraging the continued growth of third-party OTT video.”¹⁰⁰ Were this in fact the case, AT&T would promptly remedy congestion of OVD traffic at interconnection points, rather than allowing protracted bouts of congestion, as it did with Netflix.

⁹⁸ American Customer Satisfaction Index, ACSI Telecommunications and Information Report 2014, at 2 (May 20, 2014), *available at* <http://www.theacsi.org/news-and-resources/customer-satisfaction-reports/reports-2014/acsi-telecommunications-and-information-report-2014/acsi-telecommunications-and-information-report-2014-download>.

⁹⁹ *See* Statement by FCC Chairman Tom Wheeler on Broadband Consumers and Internet Congestion (June 13, 2014), *available at* https://apps.fcc.gov/edocs_public/attachmatch/DOC-327634A1.pdf (“In reading the emails I receive, I thought this one . . . pretty well sums up public concern: ‘. . . . Is Verizon abusing Net Neutrality and causing Netflix picture quality to be degraded by ‘throttling’ transmission speeds? Who is at fault here?’ Consumers pay their ISP and they pay content providers like Hulu, Netflix or Amazon. Then when they don’t get good service they wonder what is going on.”).

¹⁰⁰ Application at 79.

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V. THE COMMISSION MUST CONDITION APPROVAL OF THIS TRANSACTION

A. Applicants' Proposed Conditions Are Insufficient To Protect Consumers

Unless the Commission takes steps to prevent the combined entity from harming OVDs, this transaction will significantly undermine competition in the video marketplace. Applicants view OVDs as rivals and are seeking to create more robust bundles in part to defend against losses from cord-cutting and cord-shaving. Given AT&T's bottleneck control over various points in its broadband footprint, AT&T can raise the costs for rival OVDs, at the same time it is lowering them for its own affiliated video services, significantly limiting consumer choice and undermining video competition.

Applicants' modest three-year commitment to abide by the 2010 Open Internet rules is insufficient to protect against this harm. As an initial matter, the competitive harms posed by this Transaction will grow, not shrink, in the future if the purported benefits of this Transaction come to fruition. Applicants' Open Internet commitment will likely expire just as it becomes increasingly necessary. Moreover, as AT&T and others have already demonstrated, BIAS providers can engineer around the Open Internet commitments by imposing interconnection fees and restrictive data caps.

B. To Adequately Protect Consumers, The Commission Must Apply Broader Conditions To This Transaction

Because of the significant public interest harms associated with this Transaction, the Commission must condition any grant of this Transaction on measures designed to prevent harm by the merged entity to competing edge providers for as long as the threat created by this Transaction continues. The negative effects of this Transaction are not transient; rather, they are the result of vertical integration of DIRECTV's video and AT&T's broadband services. So long

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as those services are connected, the threat of anticompetitive effects from the threat of foreclosure of OVDs remains real and significant. Any remedy must remain in effect so long as this vertical integration between those video and broadband services remains—not for a term of years.

The remedy crafted by the Commission must also be robust enough to prevent the combined entity from undermining rival OVDs, in whatever possible form it may take.

Specifically, in addition to abiding by the 2010 Open Internet rules:

- the combined entity should be prohibited from charging a content provider a terminating access fee to interconnect;
- the combined entity’s wireless services (both fixed and mobile) should be required to abide by the open Internet protections established for wireline services; and
- the combined entity should be prohibited from excepting its own affiliated services from any data cap applicable to any of its services (whether fixed or mobile).

VI. CONCLUSION

Through this Transaction, AT&T and DIRECTV seek to create one of the largest and most vertically integrated terminating access networks in the country. With that vertical integration and proposed network expansion, the combined entity will have a significantly greater incentive and ability to harm rival OVDs. Netflix requests that the Commission impose conditions on any grant of this Transaction sufficient to mitigate this likely harm.

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Respectfully submitted,

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September 16, 2014

CERTIFICATE OF SERVICE

I, Andrew W. Guhr, hereby certify that on September 16, 2014, I caused true and correct copies of the foregoing Comments to be served by electronic mail to the following counsel of record:

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