STATEMENT OF ROSS J. LIEBERMAN
SENIOR VICE PRESIDENT OF GOVERNMENT AFFAIRS
AMERICAN CABLE ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

HEARING ON
"THE AT&T/DIRECTV MERGER: THE IMPACT ON COMPETITION AND CONSUMERS IN THE VIDEO MARKET AND BEYOND"

JUNE 24, 2014

STATEMENT OF ROSS J. LIEBERMAN
SENIOR VICE PRESIDENT OF GOVERNMENT AFFAIRS
AMERICAN CABLE ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

HEARING ON
"THE AT&T/DIRECTV MERGER: THE IMPACT ON COMPETITION AND CONSUMERS IN THE VIDEO MARKET AND BEYOND"

JUNE 24, 2014

Chairman Klobuchar, Ranking Member Lee and Members of the Subcommittee, my name is Ross J. Lieberman, Senior Vice President of Government Affairs of the American Cable Association ("ACA"). Thank you for inviting me to speak about AT&T Inc.'s ("AT&T") acquisition of DIRECTV, the nation's second largest subscription television provider and owner and manager of popular video programming networks.

We are in the midst of considerable consolidation within both the multichannel video programming distributor ("MVPD") and video programming markets that will have major ramifications for consumers and competition. In 2011, Comcast, the nation's largest MVPD, acquired broadcast and cable programming giant NBCUniversal ("NBCU"). Comcast has now announced plans to grow its MVPD business even larger by acquiring Time Warner Cable ("TWC"), the nation's second-largest cable MVPD, and to divest to and swap systems with Charter Communications to create another industry giant. For the past several years, in a series of deals large television station groups in the broadcast industry have also been merging. Recent reports also indicate that large programmers are looking to get even larger by acquiring mid-sized programmers, like AMC Networks, whose AMC channel is home of the popular "Walking Dead" series, and Scripps Networks, the company behind HGTV and the Food Network. Now AT&T is acquiring DIRECTV. The cumulative impact of these transactions will transform the industry, the competitive marketplace and the consumer experience and should be cause for concern.

Congress, federal and state antitrust authorities and regulators, and local governments each have a critical role in analyzing the pending deals and addressing harms they create, either through divestitures and behavioral remedies or outright denial. In this regard, ACA is pleased that this Subcommittee, which has oversight over antitrust and competition policy, is holding this hearing. But more is needed. In addition to reviewing individual transactions, Congress should review existing rules and regulations to ensure that industrywide problems are addressed so the new market order does not harm consumers by hindering the ability of firms other than the merging parties to compete effectively.

As I discuss below, the proposed AT&T/DIRECTV transaction will increase the incentive of DIRECTV-affiliated programmers to charge higher prices to their rivals, including hundreds of small and medium-sized MVPDs. ACA believes that regulators reviewing the transaction should adopt conditions to head off this potential harm. The deal also highlights existing problems in the video marketplace, such as significant price discrimination in the programming contracts of the large programmers and broadcasters, as well as rules and regulations that do not apply in a

competitively and technologically neutral manner. Congress and the Federal Communications Commission ("FCC") need to ensure that consumers who reside in markets served by smaller MVPDs will not lose any competitive options or see their prices increase as the consolidation wave continues.

I. Introduction to the American Cable Association

In the U.S., nearly 100 million households purchase subscription TV. More than 80 million households subscribe to broadband. While big companies like Comcast, DIRECTV, DISH Network, TWC, AT&T, Verizon, and Charter serve most of the market, there are nearly 850 small and medium-sized MVPDs that provide the "triple play" of video, broadband Internet access, and voice services in local markets in all 50 states to nearly 7 million video subscribers. These are ACA's members. In some instances, these operators provide these same services in markets the big companies have ignored. In other instances, they provide competition to the big operators. ACA members are rarely household names on the national scene. But they are highly valued in the communities they serve. Their local ownership and local focus provides a unique alignment of their incentives to build robust networks and offer valuable programming with the interests and needs of the local communities they serve.

The small and medium-sized operators of ACA – which include cable operators, rural telephone companies, and municipally-owned service providers –, serve a number of important functions in the U.S. communications market and in society at large. ACA members:

> <u>Provide broadband in rural areas</u>. As the National Broadband Plan noted in 2010, providing rural broadband is one of the great infrastructure challenges of the 21st century. Despite the high costs of building networks in more sparsely populated areas, ACA members have been building out broadband in rural areas for years. Most of them do so without any government funding, saving taxpayers billions in support for government-funded broadband networks.
>
> <u>Provide competition and choice in urban areas</u>. Some of ACA's biggest members, like WOW!, RCN, Wave Broadband, and Grande Communications, are competitive providers of cable, broadband, and voice services in urban areas. These companies entered markets that are dominated by large cable companies and incumbent telephone companies, bringing choice and price competition in the process. Today, ACA members provide choice to more than five million residences in the U.S.
>
> <u>Provide services to community institutions and business in underserved areas</u>. ACA members make available high-speed Internet access, private data networks and multiline voice products to tens of thousands of community institutions in small cities and rural areas. Nearly one million small businesses in rural areas have access to these advanced communications products from ACA members.

II. AT&T, DIRECTV, and the Competitive Landscape

AT&T and DIRECTV are both participants in the MVPD industry, which distributes video programming to consumers. DIRECTV also participates in the related video programming market, which provides this programming to these distributors.

AT&T is the fifth-largest MVPD. It is an IPTV MVPD operating under the U-verse brand, with about 5.7 million MVPD subscribers. U-verse video is available to between 24.5 million

and 33 million TV homes in 142 markets across 22 states. Some small and medium-sized cable operators compete head-to-head against AT&T's U-verse service. The degree of competitive overlap of smaller cable operators with U-verse varies. However, where there is overlap, robust competition exists.

DIRECTV is the second-largest MVPD with approximately 20 million video subscribers in the U.S. It provides satellite MVPD service in all 50 states to nearly all 116 million TV homes. Small and medium-sized cable operators compete against DIRECTV whose service area either completely or nearly completely overlaps with all smaller operators. There is also robust competition between smaller cable operators and DIRECTV for video customers, notwithstanding the fact that most of these cable operators make available a "triple play" service and DIRECTV primarily offers only a standalone video service. DIRECTV and the other direct broadcast satellite provider ("DBS"), DISH Network, offer video service comparable to the video service of cable MVPDs at competitive prices, and existing double- and triple-play customers of smaller cable operators are willing to discontinue just their video service with a triple-play provider in order to switch to DIRECTV or DISH Network. Smaller cable operators report that offering the triple-play service is not attractive enough on its own to prevent DIRECTV and DISH from luring customers away. Price, content, and customer service still matter a lot in the MVPD market, and DIRECTV's offering of the NFL Sunday Ticket makes its service particularly attractive to a large subset of valuable customers. Even senior executives at DIRECTV seem to agree that video service offered as part of a triple play is a competitor, according to recent remarks made prior to AT&T's announced acquisition.[1]

In the video programming industry, DIRECTV owns or manages three regional sports networks (RSNs): Root Sports Pittsburgh, Root Sports Rocky Mountain, and Root Sports Northwest. It also has interests in some national programming networks, including the MLB Network and the Game Show Network. Most small and medium-sized cable operators purchase some DIRECTV-affiliated programming. ACA is aware of at least 120 smaller cable operators carrying one or more Root Sports regional sports networks. Additionally, there are more than 600 small and medium-sized MVPDs that carry the Game Show Network through this networks' agreements with their buying group, the National Cable Television Cooperative ("NCTC"). Moreover, many individual smaller MVPDs have individual contracts with the MLB network. As a vertically integrated MVPD, DIRECTV has an incentive and ability to disadvantage its MVPD rivals in the sale of this programming by charging higher prices. The harm to its rivals, which includes hundreds of smaller operators currently carrying its programming, and ultimately to consumers, is particularly significant with regard to its RSNs – its most popular programming.

III. The Proposed Transaction Will Increase DIRECTV-Affiliated Programmers' Incentive to Charge Higher Prices to AT&T/DIRECTV's Rivals

ACA's members are concerned with the combination of AT&T's distribution assets with DIRECTV's distribution assets because it will incentivize DIRECTV-affiliated programmers to charge higher rates to the merged firm's rivals above and beyond existing incentives. This conclusion is based upon economic theory and evidence relied upon by the FCC in analyzing previous transactions involving MVPDs that have interests in programming. In these reviews, the FCC found that companies that own programming have an incentive to disadvantage their rivals in the sale of their affiliated programming *in proportion to their per-video-subscriber profits*.

---

[1] *See* "AT&T/DIRECTV: Regulatory and Business Takeaways from AT&T's Merger Application," Bernstein Research, at Exhibit 3 (June 19, 2014).

In other words, if the profit margin per video subscriber of a vertically integrated MVPD rises, so does its incentive to harm its rivals by either withholding its programming permanently or temporarily during negotiation impasses, or simply by forcing them to pay higher prices for this programming.[2]

AT&T and DIRECTV assert their proposed deal creates efficiencies, and to the extent this is true, many of these efficiencies will increase the profit per video subscriber of both U-verse and DIRECTV. As AT&T notes in its filing, the most significant cost savings from the proposed deal will come from the merged firm's ability to negotiate better programming deals. These cost savings will be fully realized as DIRECTV's existing programming contracts expire and are renegotiated. By adding AT&T's 5.7 million MVPD subscribers to DIRECTV's 20 million MVPD subscribers, the merged entity will become a "must have" distribution outlet for programmers, enabling it to command larger volume discounts than either firm is currently able to obtain. As AT&T notes, the deal also creates other costs savings, most of which appear to be realized in the near term.[3] These cost savings in the aggregate will materially lower the cost of doing business for both the U-verse and DIRECTV service, and the U-verse and DIRECTV services will be more profitable per subscriber combined than as stand-alone entities.

Accordingly, the increased profitability per video subscriber that is realized by the proposed AT&T/DIRECTV merger will increase DIRECTV-affiliated programmers' incentive to charge higher prices to the merged firm's rivals, and the harm will be particularly significant with regard to its RSNs. If AT&T/DIRECTV acts on this incentive, the deal will harm DIRECTV's rivals in markets where its programming is available, and ultimately their customers as well.

IV. Regulators Should Adopt a Remedy to Eliminate the Ability of DIRECTV-Affiliated Programmers to Charge Higher Prices to AT&T/DIRECTV Rivals

While the Communications Act directly deals with vertically integrated cable operators, it does not have a provision preventing AT&T/DIRECTV from disadvantaging its rivals through the prices charged for affiliated programming. The existing program access rules prevent only cable operators and cable-affiliated programmers from engaging in unfair acts and practices, including imposing on other MVPDs discriminatory prices, terms, and conditions. These rules do not apply to programmers affiliated with DBS providers, like DIRECTV, or to non-cable MVPDs, like AT&T. Despite this fact, up until recently, rival MVPDs that reached an impasse in their negotiations with DIRECTV for its RSNs had a right to take DIRECTV to arbitration pursuant to a voluntary commitment with the FCC agreed to by DIRECTV when Liberty Media acquired DIRECTV. However, this condition, which was in place for more than six years, expired on February 27, 2014.

---

[2] For a complete discussion on the bargaining theory framework for analyzing the competitive effects of vertical integration, *see* "Vertical Mergers in the Video Programming and Distribution Industry: The Case of Comcast-NBCU," Professor William P. Rogerson (2012), available at: http://faculty.wcas.northwestern.edu/~wpr603/Comcast-NBCU.pdf.

[3] According to AT&T's public interest statement, the proposed deal will allow AT&T and DIRECTV to consolidate broadcast centers, combine the distribution assets of AT&T's IP network and DIRECTV's satellite network, and to reduce costs associated with the operation of DIRECTV's and AT&T's super-hubs. It also will allow the merger of installation and service operations, and allow AT&T and DIRECTV to save money with respect to their customer call center operations, IT systems, and other general administrative and headquarters functions and services.

ACA believes regulators should impose a condition on AT&T/DIRECTV that prevents DIRECTV-affiliated programmers from disadvantaging the merged firm's rivals in the prices it charges. However, it would not be adequate to adopt similar arbitration conditions to those previously imposed on DIRECTV or the more recent version imposed on Comcast-NBCU. Those arbitration conditions, although well-intended, have a number of defects and problems limiting their effectiveness, particularly for small and medium-sized MVPDs. In particular, arbitration, even with one-way fee shifting, remains too expensive for individual small and medium-sized MVPDs to utilize. Smaller MVPDs also cannot precisely predict the results of an arbitrator's calculation of fair market value because they do not have precise information on the key factors that an arbitrator would likely use to make its determination, which is a problem exacerbated by the fact that much of this information is known by the programmer. Further, the manner in which a bargaining agent appointed by individual MVPDs could potentially avail itself of the arbitration conditions was poorly articulated and incompletely described in the FCC's Comcast-NBCU Order. ACA hopes to work closely with both the Subcommittee and the FCC throughout the year to explain the problems with arbitration conditions previously crafted by the agency and explore ways to fix them.

V. Congress and Policymakers Must Concurrently Address Regulatory Inconsistencies that Aggravate Existing Market Problems Facing MVPDs, Particularly Smaller MVPDs

Congress and regulators cannot limit their time and effort to looking just at deals like AT&T/DIRECTV and Comcast/TWC/Charter; they must provide enhanced oversight of the market as a whole, and update rules and regulations that work in the new market order. If all the pending MVPD deals are approved, the largest video distributors will grow even larger, creating an even greater disparity with the smallest providers with whom they compete. Moreover, the programming market is likely to respond to large video distributors getting larger by getting larger themselves, which will give these programmers even greater bargaining leverage over the smallest cable operators. Smaller cable operators need Congress to review the existing rules and regulations that govern the market to ensure that industrywide problems, which cannot effectively be dealt with through a merger review, are also addressed. This will ensure consumers that receive service from companies not growing larger through acquisition can continue to benefit from a competitive market. Given the mounting problems in the market even before the Comcast/TWC/Charter and AT&T/DIRECTV deals were announced, the public can't wait years for Congress to act. Action must be taken soon before smaller MVPDs exit the market, because once a smaller MVPD exits a market, particularly in rural areas, it is unlikely that Wall Street or Main Street will fund its return, or that government programs will help.

Although not all the marketplace problems can be easily addressed, ACA specifically urges Congress and the FCC to take action to better ensure that smaller MVPDs are not unreasonably disadvantaged compared to other industry participants, and that rules applied to smaller MVPDs are applied in a competitively and technologically neutral manner. The following are some examples where oversight and action by Congress or the FCC are appropriate at the same time that regulators decide whether to approve the AT&T/DIRECTV and Comcast/TWC/Charter deals.

Promoting Competition by Ensuring that Price Discrimination in Programming Contracts is Not Harming Consumers and Competition

For the last decade, small and medium-sized operators have been outspoken about the rising cost of programming, particularly sports programming, and the increasing demands of

programmers to require their customers to receive and pay for unwanted programming. In the early years, smaller MVPDs were alone in their concerns, but now these concerns are shared by larger MVPDs as well. For most MVPDs, the single largest cost of providing video service is programming cost, and the relative cost of programming for smaller MVPDs is significantly higher than for larger MVPDs because of the discriminatory pricing practices of the large programmers. The spread between the largest and smallest is commonly thought to average about 30%. As ACA has noted in the past, this price discrimination is not justified based on the cost of delivering the service to the distributor. Given that most MVPDs have at least two large national DBS competitors, small and medium-sized MVPDs are often at a substantial competitive disadvantage against their larger competitors, who typically have many more subscribers, often tens of millions of more subscribers, because the most significant cost of providing a comparable video service is so very different. This problem is most pronounced for recent entrants in the market.

Given these marketplace realities, small and medium-sized cable operators are not surprised by AT&T's interest in acquiring DIRECTV. With nearly 6 million subscribers, AT&T finds itself in competition against Time Warner Cable with 11 million subscribers, DISH Network with 14 million subscribers, DIRECTV with 20 million subscribers, and Comcast today with 22 million subscribers. After trying to compete in the MVPD market for years, AT&T learned that it is hard when its programming costs are so much higher than its competitors – allegedly at least 20% higher than DIRECTV's – and likely even greater compared to Comcast. They also understand their current competitive standing would get even worse if regulators approve the Comcast/TWC/Charter deals. With respect to addressing their programming cost issue, this deal solves that problem.

While AT&T can buy its way out of its programming cost problems by purchasing a large MVPD like DIRECTV, small and medium-sized operators, who do not have the deep pockets of AT&T, are not so fortunate. They are increasingly struggling to stay profitable, no less survive, and consumers in their service territory are paying the price. Critics of the AT&T/DIRECTV merger have raised concerns about the decrease in the number of competitors for video service from four to three in AT&T U-verse territories. In many rural areas where there are only three providers of video service, rising programming prices are now driving some smaller MVPDs to exit the market altogether, leaving consumers with only two providers, a marketplace that is far less competitive than what consumers in AT&T U-verse territories will face. Unfortunately, decreasing levels of competition in these areas, which occur on a slow but steady basis, rarely generate the same levels of concerns from policymakers in Washington, but they should because they are often leading indicators of problems soon to face the market as whole.

ACA recently reported to the FCC that between 2008 and 2013, small and medium-sized cable operators closed a total of 1,078 small and rural cable systems, the vast majority of which reflect systems that have ceased providing video service in their communities. At the time of their closing, these systems served a total of approximately 50,000 subscribers. After these systems closed, consumers in these rural areas saw a reduction in competition as their only choices for video service became DIRECTV and DISH Network. Given the rise in programming costs, we are likely to see even more system closings in the coming years. Moreover, we're also likely to see more small cable systems controlling costs by dropping programming, particularly independent programming.

Unless Congress or the FCC can find a way to put small operators on a fairer competitive playing field with their larger rivals, particularly with regard to the cost of programming, the loss of those operators and the unique competitive alternative they provide

will increase and start expanding into more populous areas. In particular, Congress and the FCC should examine and find ways to address programmers' discriminatory pricing practices, which are some of the biggest threats facing smaller operators and will grow more troublesome if the Comcast/TWC/Charter and AT&T/DIRECTV deals are approved.

Promoting Competition by Ensuring Buying Groups like the NCTC Have Access to the Program Access Rules as Congress Intended

Congress sought to ensure that smaller operators were protected from discriminatory and unfair behavior by cable operators and cable-affiliated programmers by extending "program access" protections to their buying groups. However, the regulations adopted by the FCC, particularly its definition of a "buying group," prevent the nation's largest programming buying group, the NCTC, from availing itself of the protections Congress intended. This means that more than 900 MVPDs, who obtain most of their national programming through this organization, are effectively denied the protection of the program access rules. Moreover, it puts smaller MVPDs at a competitive disadvantage with larger MVPDs who can avail themselves of the program access rules. For nearly two years, the FCC has been considering the adoption of new rules that would allow a buying group, like the NCTC, to file program access complaints and also contain safeguards to prevent programmers from evading the protections of the rules. It is vital that the FCC act now by updating its definition of a buying group, making clear programmers must treat buying groups comparably to other MVPDs, and not arbitrarily excluding certain buying group members from joining a master agreement signed by the buying group.

Promoting Competition by Ensuring FCC Regulatory Fees tied to MVPD-related work by the FCC's Media Bureau are Assessed on all MVPDs, including DBS Companies.

Congress requires the FCC to recover the costs of its activities from entities subject to its regulatory authority. Generally speaking, industry participants that receive direct benefits of a core bureau of the FCC are assessed fees that reflect those benefits. However, this is not the case with regard to the MVPD industry where the costs of the Media Bureau's MVPD-related activities are not assessed in a competitively neutral manner. Despite the extensive regulatory, policy, rulemaking and enforcement activities that Media Bureau employees engage in that concern and benefit all MVPDs, including DBS operators, DBS MVPDs, like DIRECTV, currently pay no (zero) fees to cover these costs. In contrast, cable operators pay a fee of $1.00 per subscriber.

Last year, the FCC recognized that IPTV providers like AT&T benefited from Media Bureau MVPD regulatory activities, and should therefore be included in the same fee category as cable operators. This brought regulatory fee parity between cable and non-cable MVPDs. The FCC is still considering whether DBS operators should also pay similar regulatory fees. According to the FCC's most recent regulatory fee rulemaking notice, the per-subscriber regulatory fees for cable operators and IPTV providers would drop from $1.00 to $0.68 if DBS were included in the relevant fee category. The notice asks whether it should expand this fee category to include DBS providers and whether it should change the name of the category to "MVPD" or "subscription television fees" or another appropriate name that would treat MVPD market participants more equally than they are today.

ACA strongly supports creation of such a fee category to include DBS, as has AT&T. The fact that DBS providers do not shoulder their fair share of the fee burden is more than simply a matter of equity. This disparity in fee assessment can have market-distorting effects.

As noted above, because DBS operators do not pay fees to cover the expenses of the FCC's Media Bureau regarding MVPD-related work, these costs are shifted entirely onto cable operators and IPTV providers that do pay the fees. Moreover, because cable operators typically pass through regulatory fees to customers, the DBS exemption has the effect of raising the cost of cable service for consumers. This is especially unfair to smaller operators serving smaller and rural markets, who are the least able to bear regulatory fee burdens and for whom the two DBS operators are the primary competition. The time has come to ensure that rules governing small and medium-sized MVPDs are applied to all MVPDs in a technologically and competitively neutral manner, and Congress or the FCC should address this problem immediately.

VI. Conclusion

As the consolidation wave in the MVPD and video programming industry continues, federal decision-makers must ensure that consumers and competition are protected. This means taking seriously their duty to review pending transactions under the antitrust laws and public interest standards and adopting appropriate remedies to address identified harms, specifically those raised in this testimony. It also means taking action on existing market problems threatening the important competitive choice that small and medium-sized operators provide. The AT&T/DIRECTV transaction and others highlight these problems. The choices that Congress makes to deal with these issues are profound. ACA looks forward to working closely with both Congress and the agencies in their review of the AT&T/DIRECTV deal, and in crafting rules that make the broader industry fairer to the independent cable community.