



Written Testimony of

Matthew F. Wood
Policy Director
Free Press

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regarding

**“The AT&T/DIRECTV Merger: The Impact on Competition and
Consumers in the Video Market and Beyond”**

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INTRODUCTION

Chairman Klobuchar, Ranking Member Lee, and esteemed members of the Subcommittee, it is a pleasure to be called here again. Thank you inviting me to testify on “The AT&T/DIRECTV Merger: The Impact on Competition and Consumers in the Video Market and Beyond.”

Free Press is a nationwide, nonpartisan and non-profit organization with more than 750,000 members in the United States and around the world. We work for public interest media and technology policies intended to strengthen our democracy by improving the communications channels that people use for free expression, educational achievement, and economic activity.

We advocate for diverse ownership, and focus especially on promoting open, universal and affordable Internet access and communications platforms. We keep a watchful eye on consolidation and concentration in the telecommunications and media sectors. We’ve had quite an eye-ful lately. This merger is but one of many already proposed this year or rumored to be in the works in the near future.

Combined, these transactions would remake the nation’s communications landscape. But make no mistake: already, that landscape is far from a level playing field. It is full of almost insurmountable barriers to entry, with precipitously high prices and rapidly declining choices. The mega-deals under consideration this year would work seismic shifts in a marketplace already too difficult for consumers to navigate.

The AT&T/DIRECTV combination in particular would result in highly concentrated pay-TV markets everywhere that AT&T offers video service today, as it tries to take over (and take out) one of the largest multichannel video providers in the country. AT&T suggests it would experience savings on its own video acquisition costs as a result, though most analysts believe AT&T is vastly overstating the extent of those savings. More important than the overstatement, however, AT&T nowhere commits that customers of the combined company would share these savings in the form of lower retail prices.

Instead, AT&T implausibly claims that customers would benefit from improved service and more robust competition in the form of better service “bundles.” It also repeats its past promise to provide broadband to more customers and regions, recycling the claims it has made in attempts to gain approval for several mergers before this one. AT&T never pauses to explain adequately whether it fulfilled those earlier promises, or if it did, how its new assurances do anything to enlarge its prior commitments. And it conveniently ignores the wasted opportunity for our nation, and the kind of real and game-changing broadband upgrades it could build with the nearly \$70 billion on the table for this merger.

In sum, there is no good explanation for this merger between the nation’s second largest multichannel video provider in DIRECTV, and its largest phone, largest telco pay-TV, second largest wired broadband and second largest wireless provider all under one roof at AT&T. There is nothing to this transaction but more concentration, less competition, and the same old string of promises used to sell such bad deals to the public.

Deal After Deal, the AT&T Merger Playbook Remains the Same

As it does invariably each and every time it goes on a shopping spree, AT&T comes before you today bearing promises. It also comes here hoping to find you in possession of a high degree of credulity and a very short memory.

How else to explain AT&T's counterintuitive claim that eliminating competitors is the recipe for more competition? Or to explain the fact that it has made this same claim before, yet trots out the disproven hypothesis once again?

How else to explain the fact that AT&T suggests merger-specific benefits that, in fact, either have nothing to do with this merger or provide no discernible benefits to its current and would-be customers? Or that it has made the very same promises before, about expanded broadband deployment in exchange for giant acquisitions, in conjunction with deals stretching back over the past decade?

AT&T may think that this esteemed Subcommittee is gullible, just as it may think that the antitrust agencies and the Federal Communications Commission have already forgotten the last time they heard such claims in connection with an AT&T transaction, just three short years ago. But I hold a different belief.

I believe that when Members of this Subcommittee hear someone say the only way to promote competition is to kill it, each of you understand just how hollow that claim really is. I believe that when you hear someone say we need less video competition in order to get more broadband deployment, it leaves you rightly wondering why that would be the case.

Finally, I believe that when you see the same company appear before you time and again, each time promising that more broadband is just around the corner – that it is always just one more merger approval away – you wonder if you haven't heard before the exact same promises about rural broadband coverage, speeds, and capacity. You know enough to look under the hood of such claims, knowing that you should never trust a used car based on the fancy new paint job alone. That's especially true on a deal like this, with so many miles on its retread claims.

I. THE DEAL WOULD RESULT IN HIGHLY CONCENTRATED VIDEO MARKETS

The proposed combination of AT&T and DIRECTV plainly is a horizontal merger, in an already concentrated multichannel video market. Joining these two companies together would present a textbook violation of the Department of Justice's and Federal Trade Commission's Horizontal Merger Guidelines.¹ The outcome would be what antitrust authorities describe as a "highly concentrated" pay-TV market in 64 separate television markets, where nearly all of AT&T's video subscribers reside, with a presumption of enhanced market power that encourages firms to "raise price, reduce output, diminish innovation or otherwise harm customers."²

¹ U.S. Department of Justice and Federal Trade Commission, "Horizontal Merger Guidelines," Aug. 19, 2010, <http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf> (hereinafter, *Merger Guidelines*).

² *Id.* at 2.

Is there any real benefit from this outcome, in exchange for concentration numbers and prices going through the roof? AT&T and DIRECTV have professed confidence about gaining regulatory approval for this transaction. Their confidence may be misplaced as antitrust authorities and the FCC dig deeper into the deal and its nonexistent public interest benefits.

Herfindahl-Hirschman Index Analysis Explained

When assessing combinations between competitors, the *Merger Guidelines* use the well known Herfindahl-Hirschman Index (or “HHI”).³ Regulators use this tool to evaluate whether the transaction is likely to be anticompetitive. The HHI is a measure of market concentration that factors in the number of firms in a given industry and their respective market shares, calculating the final index number by squaring and then summing the companies’ respective market shares.

For example, DOJ considers markets with an HHI below 1,500 to be “unconcentrated.”⁴ This is equivalent to a market with roughly seven firms of equal size, and a merger in such a situation would cause few competitive concerns. Conversely, markets with HHIs above 2,500 are considered “highly concentrated.”⁵ This is equivalent to a market with four equal-sized firms (or one with just a couple of very large firms and a number of much smaller ones).

Mergers that take place in or that result in markets with this high level of concentration are concerning, as they usually enhance market power. Consider the AT&T/T-Mobile transaction that DOJ rightly moved to block at the end of August 2011: the post-merger HHI on the national level would have been 3,100, an increase of nearly 700 points from the pre-merger value.⁶

According to the *Merger Guidelines*, “[m]ergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed [] likely to enhance market power.”⁷ These guidelines are not “a rigid screen,”⁸ nor the end of the discussion; but DOJ looks skeptically on any deal that concentrates markets to this level and presents such a high likelihood of problematic dynamics arising from the transaction.

HHI Analysis Shows Clear Violations in Every Major AT&T Pay-TV Market

The AT&T-DIRECTV deal before you now fares poorly on the *Merger Guidelines* tests, to put it mildly. To understand how poorly, we define the geographic product market locally rather than nationally, as antitrust authorities typically do for horizontal pay-TV mergers, because customers can only buy the multichannel video services that are available at their physical locations.

³ See *id.* at 18; see also U.S. Department of Justice, “Herfindahl-Hirschman Index,” Merger Enforcement Public Documents, at <http://www.justice.gov/atr/public/guidelines/hhi.html> (last visited June 22, 2014).

⁴ See *Merger Guidelines* at 19.

⁵ See *id.*

⁶ *U.S. v. AT&T Inc.*, Case 1:11-cv-01560, Complaint, ¶ 25 (D.D.C. filed Aug. 31, 2011) (*AT&T/T-Mobile Complaint*).

⁷ *Merger Guidelines* at 19.

⁸ *Id.*

In many instances, antitrust authorities will look at the same geographic area that advertisers do – the so-called television Designated Market Area (or “DMA”). There are 210 such media markets in the United States, ranging from very large (the nearly 7.5 million TV homes in the New York City metro area) to very small (Glendive, Mont., and its 4,260 households).

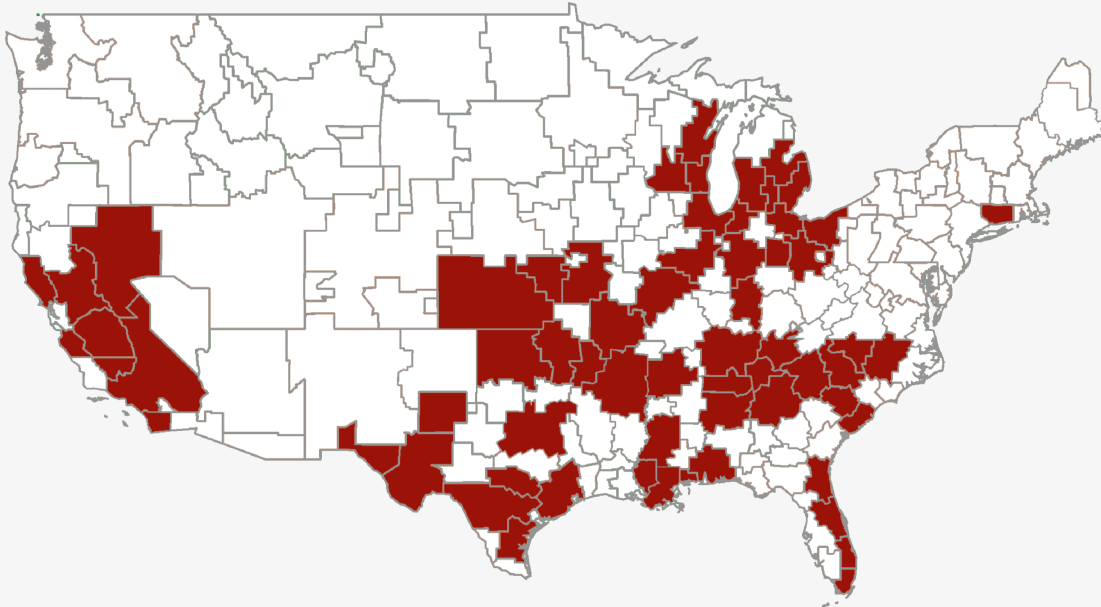
AT&T offers its U-verse pay-TV service in several dozen DMAs. About 99 percent of its television subscribers reside in 64 of the nation’s 210 DMAs. And in each and every one of these markets, AT&T’s takeover of DirecTV violates the *Merger Guidelines*.

In 61 DMAs, the deal would increase the market’s HHI value by more than 200 points and result in a highly concentrated market (meaning a total HHI over 2,500). That indicates this deal is “presumed to be likely to enhance market power,” and “likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives.”⁹

In the other three DMAs making up AT&T’s 64 main U-verse television markets, the deal would result in a post-merger HHI above 2,500 and increase the HHI between 100 and 200 points. This smaller increase doesn’t mean there’s nothing to worry about, as the *Merger Guidelines* say such transactions “potentially raise significant competitive concerns and often warrant scrutiny.”¹⁰

Half of the U.S. population resides in these 64 markets, though AT&T currently offers U-verse TV service to a portion of the homes in these areas, totaling about 20 percent of all U.S. homes.

The AT&T–DirecTV deal violates The Department of Justice Horizontal Merger Guidelines in 64 markets.



⁹ *Id.* at 2.

¹⁰ *Id.* at 19.

For these 64 DMAs where AT&T offers its own pay-TV service already,¹¹ the DIRECTV deal would increase the HHI by an average of 450 points and result in an average HHI above 3,300.

Yet even that likely understates the true impact of this merger. In any given DMA, there may be multiple pay-TV providers that don't actually compete directly. For example, in the Dallas market (AT&T's home town) the major cable company is Time Warner Cable; but some areas in that DMA are served instead by Charter or Suddenlink. In general, many people today have access to at most one traditional cable company (like the three named just above); two satellite companies (DirecTV and DISH Network); and, for only a third of the country, the incumbent phone company's pay-TV service (*e.g.*, AT&T U-verse, Verizon FiOS, CenturyLink Prism TV).

Yet satellite providers offer service everywhere, in every geographic market in the United States, because they are not constrained by the need to run a wire to every house they serve. Although AT&T does not offer U-verse pay-TV service everywhere that AT&T offers telephone and Internet service, U-verse faces video competition from DirecTV everywhere that AT&T offers it. When the non-overlapping service areas of cable companies are taken into account, the deal could increase HHI by more than 1,000 points, resulting in a post-merger HHI of nearly 4,000.

For multichannel video consumers that live in these 64 DMAs, this is a recipe for terrible service and higher prices. It's also bad for the rest of the country, too, as AT&T, with its less than stellar reputation for customer service and innovation, will become a nationwide satellite TV provider. The Department of Justice rejected AT&T's bid for T-Mobile deal in part because it found a reduction in the number of "providers from four to three, likely will lead to lessened competition due to an enhanced risk of anticompetitive coordination."¹²

¹¹ Half of all U.S. TV households are located in these 64 DMAs. However, AT&T does not offer its pay-TV service to all the homes in these markets. U-verse TV is currently marketed to 27 million customer locations, or more than 20 percent of the U.S. The AT&T/DIRECTV merger would result in a highly concentrated market with HHI exceeding 2,500 in all 64 DMAs. In 61 of them, the merger-related change in HHI would exceed 200. Free Press analysis of SNL Kagan subscriber estimates indicates DMAs with HHI increase greater than 200 are (rank-name): 2–Los Angeles, CA, 3–Chicago, IL, 5–Dallas-Ft. Worth, TX, 6–San Francisco-Oakland-San Jose, CA, 9–Atlanta, GA, 10–Houston, TX, 11–Detroit, MI, 16–Miami-Ft. Lauderdale, FL, 18–Orlando-Daytona Beach-Melbourne, FL, 19–Cleveland-Akron (Canton), OH, 20–Sacramento-Stockton-Modesto, CA, 21–St. Louis, MO, 24–Raleigh-Durham (Fayetteville), NC, 25–Charlotte, NC, 26–Indianapolis, IN, 28–San Diego, CA, 29–Nashville, TN, 30–Hartford & New Haven, CT, 31–Kansas City, MO, 32–Columbus, OH, 34–Milwaukee, WI, 36–San Antonio, TX, 37–Greenville-Spartanburg, SC-Asheville, NC-Anderson, SC, 38–West Palm Beach-Ft. Pierce, FL, 39–Grand Rapids-Kalamazoo-Battle Creek, MI, 40–Austin, TX, 41–Oklahoma City, OK, 44–Birmingham (Anniston and Tuscaloosa), AL, 46–Greensboro-High Point-Winston Salem, NC, 48–Jacksonville, FL, 49–Louisville, KY, 50–Memphis, TN, 51–New Orleans, LA, 55–Fresno-Visalia, CA, 56–Little Rock-Pine Bluff, AR, 59–Mobile, AL-Pensacola (Ft. Walton Beach), FL, 60–Tulsa, OK, 61–Knoxville, TN, 64–Dayton, OH, 67–Wichita-Hutchinson, KS-Plus, 70–Green Bay-Appleton, WI, 75–Springfield, MO, 76–Toledo, OH, 77–Columbia, SC, 79–Huntsville-Decatur (Florence), AL, 83–Madison, WI, 91–El Paso, TX (Las Cruces, NM), 93–Baton Rouge, LA, 94–Jackson, MS, 95–Charleston, SC, 96–South Bend-Elkhart, IN, 101–Ft. Smith-Fayetteville-Springdale-Rogers, AR, 107–Reno, NV, 115–Lansing, MI, 125–Monterey-Salinas, CA, 127–Bakersfield, CA, 129–Corpus Christi, TX, 134–Topeka, KS, 143–Lubbock, TX, 150–Odessa-Midland, TX, 160–Biloxi-Gulfport, MS. DMAs where post-merger HHI would exceed 2,500 and the change in HHI would be between 100 and 200 are 68–Flint-Saginaw-Bay City, MI, 84–Champaign & Springfield-Decatur, IL, 87–Chattanooga, TN.

¹² *AT&T/T-Mobile Complaint*, ¶ 36.

The situation with AT&T/DIRECTV is the same: for almost a quarter of the country, this deal would reduce the number of pay-TV competitors from four to three. And the level of market concentration post-merger would be worse in this case than it was in the T-Mobile deal.

AT&T Overstates the Level of Video Competition That Would Survive This Merger

Against these damning HHI numbers, the AT&T/DIRECTV application and public interest showing¹³ filed earlier this month offers two main defenses. Neither is persuasive. The first revolves around video options that will remain to subscribers even if the merger takes place.

AT&T suggests that for standalone multichannel video customers, the market will retain “sufficient competitive options.”¹⁴ The first two subsections of AT&T’s argument on this point dwell on the wonders of bundled service (claims that I will discuss in the next section below), ignoring the impact of increased pay-TV market concentration and the premise that there supposedly would remain “sufficient” alternatives for standalone video customers.

When it gets back to the task at hand, AT&T is largely at a loss to name standalone video alternatives other than the cable and satellite options recited in Free Press’s HHI analysis above. AT&T cites video competition from nascent entrants such as Google Fiber – while noting that Google has only “entered one AT&T U-verse DMA (Kansas City, Kansas/Missouri), and has stated that it will enter a second (Austin, Texas) this year.”¹⁵ It also asserts that AT&T faces “additional competition in a substantial portion of [its] footprint from other competitors that offer video and broadband bundles,” suggesting that such overbuilders “are present in approximately half of the U-verse DMAs” but failing to provide data on just how substantial the number of homes passed and served by such alternatives may be.¹⁶

Finally, as a last alternative for video consumers, AT&T cites over-the-top (or “OTT”) video distributors. This argument conveniently ignore the fact that OTT video alternatives can only be accessed over a wired or wireless broadband connection available from a shrinking number of facilities-based broadband providers such as AT&T.

Thus, the presence of OTT options is cold comfort against concerns about AT&T’s market power. This is so despite AT&T’s commitment to abide by the FCC’s Open Internet rules, recently struck down by the D.C. Circuit Court of Appeals, for a mere three years after closing this transaction.¹⁷ The 2010 rules were full of loopholes, including an utter lack of protections against discrimination on mobile wireless platforms such as AT&T Wireless. Recent negotiations between large ISPs and OTT distributors such Netflix also have shown just how much leverage broadband providers can exercise against over-the-top alternatives even while purporting to make way for them.

¹³ *Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations*, Description of Transaction, Public Interest Showing, and Related Demonstrations, MB Docket No. 14-90 (filed June 11, 2014) (hereinafter, the “*Application*”).

¹⁴ *Id.* at 68.

¹⁵ *Id.*, Declaration of Lori M. Lee, ¶ 31.

¹⁶ *Id.*, Declaration of Lori M. Lee, ¶ 38.

¹⁷ *Application* at 51.

The FCC currently proposes to adopt successor Open Internet rules that could permit “substantial room for individualized bargaining and discrimination in terms.”¹⁸ Enter AT&T, promising in a declaration from its Chief Strategy Officer attached to this Application that the combined company could “partner” and, perhaps, individually negotiate, “more effectively with content providers to follow consumer demand for OTT video.”¹⁹ And if AT&T truly were committed to providing open pathways for third-party OTT video, it is not clear what that would have to do with the “nationwide base of video customers”²⁰ it wants to capture from DIRECTV.

In any event, with respect to facilities-based pay-TV competition, the availability of OTT video may incentivize cord-cutting behavior by a growing number of consumers who no longer wish to pay for both a pay-TV and a home broadband subscription; but that number is still small compared to the number of pay-TV subscribers. That is why the cord-cutting phenomenon cannot completely alleviate concerns about increased concentration in the pay-TV market that would result here from combining the second and fifth largest multichannel video providers, with the market-by-market concentration outcomes and enhanced market power illustrated above.

AT&T’s “Integrated Bundle” Product Market Definition Does Not Alleviate Concerns

AT&T spends more time by far not on illustrating the competitive video alternatives it supposes would remain after the transaction, but on trying to define its way out of this competition problem altogether. In essence, it argues throughout the Application that AT&T and DIRECTV do not truly compete today for video customers because DIRECTV offers a standalone video product while AT&T focuses on bundling video with broadband and wireless service.²¹

In typical AT&T fashion, the company’s hired economics expert refers to concerns about video market concentration as “naïve,”²² dismissing them as AT&T once attempted to brush aside similar concerns with its claims that T-Mobile was not a particularly close competitor either.

Whatever the merits of AT&T’s attempted sleight-of-hand to make the deal’s pay-TV market concentration issues disappear, this line of argument undervalues the utility of what the Application refers to as “synthetic” bundles: those combining DIRECTV satellite video service and “a variety of third-party broadband and/or voice services” from providers including AT&T.²³ The main problem for AT&T in suggesting that a bundle must be assembled and integrated for the customer by a single-source provider, which must own all of the facilities used to offer the bundled products, is the way in which it seems to bundle AT&T and DIRECTV service today.

Why have these combined products, offered to subscribers without the need for combining the two companies outright, not worked “to make significant inroads against the integrated bundle

¹⁸ *Verizon v. FCC*, 740 F.3d 623, 652 (D.C. Cir. 2014).

¹⁹ *Application*, Declaration of John T. Stankey, ¶ 9.

²⁰ *Id.*

²¹ *See, e.g., Application* at 1.

²² *See Application*, Declaration of Michael L. Katz, at 7.

²³ *Application* at 3.

offerings of entrenched cable companies”²⁴ A large part of the reason may be AT&T’s unwillingness to wholesale a competitive broadband product to DIRECTV at a reasonable and competitive price. Were AT&T to do so, or if the FCC had policies in place promoting such resale opportunities, then the “synthetic” bundles that the Application critiques might do just as well as the integrated bundles that this merger promises.

DIRECTV’s Chief Revenue and Marketing Officer notes in his declaration that “AT&T prices [its own] broadband and voice components substantially lower when paired with U-verse video versus paired with DIRECTV. For example, the current introductory price for 6 Mbps broadband when paired with U-verse video is \$14.95 versus \$34.95 when paired with DIRECTV.”²⁵ He concludes that the total price to consumers of an integrated AT&T bundle is substantially less than the price of signing up with DIRECTV for a “synthetic” bundle.²⁶

Could that possibly have anything to do with the fact that the so-called synthetic bundle isn’t such a hot commodity? One might think an unexplained – and frankly indefensible – markup of 133 percent would be enough to explain to both companies’ executives why their joint marketing endeavors are not crushing the cable competition. The higher price, coupled with a hefty \$34.95 price tag for a relatively slow 6 Mbps, might be enough to keep anyone away from DIRECTV’s synthetic, broadband-like service package.

The only attempt to explain such high prices for synthetic bundles comes from AT&T’s economic expert again. As he opines, “economic theory also indicates that ‘because the merger will internalize complementarities, the merged company can be expected to offer a bundle superior to those that they offer through their existing joint marketing arrangement.’”²⁷ What does that mean, precisely? As soon as AT&T can control the whole service bundle, and capture all of the revenues from customers of the combined company, it may no longer impose such a ridiculously large markup on the broadband it bundles with DIRECTV. This deal may be good for AT&T’s bottom line, but it’s certainly not good for customers who’ll see fewer video choices when they could have gotten the same benefits from better competition policies.

These outcomes could be avoided were the FCC to promote resale by limiting how a facilities-based provider can frustrate the development of such arrangements. Resale markets naturally exist in competitive markets, and they “confer[] important public benefits in less competitive markets, including encouraging competitive pricing; discouraging unjust, unreasonable, and unreasonably discriminatory practices; reducing the need for regulatory intervention and concomitant market distortions; promoting innovation; improving carrier management and marketing; generating increased research and development; and positively affecting the growth of the market.”²⁸ The synthetic bundles that the Applicants critique could spring fully to life if AT&T would permit that to happen without the merger.

²⁴ *Id.*

²⁵ *Application*, Declaration of Paul Guyardo, ¶ 29.

²⁶ *Id.*

²⁷ *Application* at 32 n.90 (quoting Declaration of Michael L. Katz, ¶ 62).

²⁸ *Personal Communications Industry Association's Broadband Personal Communications Services Alliance's Petition for Forbearance For Broadband Personal Communications Services*, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 13 FCC Rcd 16857, ¶ 32 (1998).

II. EMPTY RHETORIC, BROKEN PROMISES, NOT PUBLIC INTEREST BENEFITS

The benefits of bundles could be replicated with effective resale policy, and without removing a competitor from the market. That means AT&T's claims about the integrated bundle benefits – even if those outcomes were real – should not be viewed as merger-specific benefits offsetting the likely harms from additional concentration. Such benefits could be obtained without removing a competitor from the market.

AT&T offers two other possibilities for merger-specific benefits: reduced programming acquisition costs for its video content, and increased broadband deployment both inside and outside of its wireline footprint. The first one is overstated, with no promise that these program cost savings will be passed along to AT&T customers. The second one really has nothing to do with this deal. It merely restates meager commitments that AT&T has put on the table in one form or another several times in the past decade – leading discerning merger reviewers to ask if AT&T already had planned these rollouts prior to this DIRECTV merger, and also whether the company should have hit these benchmarks already if it had delivered on earlier promises.

Program Cost Savings Uncertain, Overstated, and Unlikely to be Shared by Consumers

According to AT&T, spending so much money on a standalone satellite TV provider all makes sense because the deal would deliver the combined firm \$1.6 billion in cost savings. It attributes the bulk of such savings to reduced video programming acquisition costs, owing to the benefit of increased scale in negotiations with pay-TV channel owners.²⁹

AT&T may be overstating its cost savings in the first instance. Some analysts estimate these at just \$400 million a year.³⁰ Savings at that lower level wouldn't be close to sufficient to justify the deal.³¹ Even at a higher level than AT&T's public prediction of \$1.6 billion, the deal still may not make financial sense for AT&T.³² And while volume discounts for multichannel video providers undoubtedly are real, recent research from SNL Kagan suggests that rising costs for sports programming, broadcast retransmission consent, and the digital rights that bundled providers now seek to obtain all may be eroding the benefits of scale in the pay-TV distributor business.³³

²⁹ See *Application*, Declaration of Rick L. Moore, ¶¶ 9-10.

³⁰ See, e.g., Stephen Gandel, "AT&T's bid for DirecTV doesn't add up," *Fortune*, May 20, 2014, <http://fortune.com/2014/05/20/atts-bid-for-directv-doesnt-add-up/>; Peter Kafka and Amy Schatz, "AT&T Could Probably Buy DirecTV. But Why?" *Re/Code*, May 1, 2014, <http://recode.net/2014/05/01/att-could-probably-buy-directv-but-why/>.

³¹ See Kafka and Schatz, *supra* note 30 (quoting analyst Craig Moffett).

³² Jeffrey Goldfarb, "AT&T Will Struggle to Justify a Deal for DirecTV," *NY Times Dealbook*, May 14, 2014, <http://dealbook.nytimes.com/2014/05/14/att-will-struggle-to-justify-a-deal-for-directv/>.

³³ See Tony Lenoir, "MSOs log seasonal surge in programming costs in Q1," *SNL Kagan: Multichannel Trends*, June 11, 2014 (reporting that the programming costs of Comcast, the nation's largest multichannel video distributor by number of subscribers, had risen more than the costs incurred by smaller cable operators).

While AT&T's programming costs for U-verse video obviously would go down, AT&T is bringing far fewer subscribers to this deal than DIRECTV is. AT&T's programming costs could decrease by as much as 20 percent according to the company's June 2014 statements to the Securities and Exchange Commission; but that 20 percent applies only to AT&T's U-verse content costs, not the costs of acquiring programming for more than 20 million current DIRECTV subscribers in the United States.

In any event, the programming cost savings are relevant for AT&T's bottom line and its shareholders, but of course that alone is not enough to justify the deal. The key point for this Subcommittee, as for antitrust and communications regulators, is not whether the deal makes financial sense for AT&T but whether its customers will see any benefits from it. The answer is that AT&T makes no real commitment to pass any cost savings along to its subscribers, nor is it likely to do so in a more concentrated and commensurately less competitive pay-TV market.

The Application is replete with references to the “downward pressure” on price about which AT&T's predictions and econometric analyses speculate. Yet, AT&T can't quite bring itself to claim that all of this downward pressure will result in real price savings for consumers. The most definitive claim AT&T seems willing to put on paper appears on a single page in the Application, referencing the economic expert's opinion that “market forces will ensure that the company uses these reduced marginal costs to enhance consumer welfare, whether through reduced prices, improved offerings, new services and capabilities, or a combination of these.”³⁴

Note AT&T's care not to promise reduced prices. The best it can muster is a combination that may include lower prices along with bigger bundles and new services. And the claim that the combined company would face competition in the pay-TV and broadband markets, and thus “have incentives to pass through some” savings, is belied by almost two straight decades of pay-TV price increases across the industry³⁵ – even in markets deemed competitive and served by the largest pay-TV providers with, in theory, the largest volume discounts on their programming.³⁶

AT&T's Broadband Promises Are Underwhelming and All Too Familiar

As explained in detail in Part III below, real network investment would be a much better use of the billions that AT&T proposes to spend on this merger. Yet never shy about parading the same deployment promises in more than one deal, AT&T claims that this pay-TV merger would enable it to invest in broadband. In fact, the company insists the transaction at issue here is what will allow it “to expand and enhance its deployment of both wireline and fixed wireless broadband to at least 15 million customer locations across 48 states, with most of the locations in underserved rural areas.”³⁷

³⁴ *Application* at 33-34 & n.97 (citing Declaration of Michael L. Katz, ¶ 118).

³⁵ See S. Derek Turner, *Combatting the Cable Cabal: How to Fix America's Broken Video Market*, at 10 (May 2013).

³⁶ See Free Press, “Four Infographics Reveal Why the Comcast Merger Is Bad for You,” Mar. 26, 2014, <http://www.freepress.net/blog/2014/03/26/four-infographics-reveal-why-comcast-merger-bad-you>.

³⁷ *Application* at 1-2.

Expanding to 15 million customer locations may sound like a lot, until you unpack all of the nuances in this commitment and compare it to AT&T's eerily similar claims from past announcements.

AT&T is not planning to extend U-verse advanced DSL technology or more advanced wireline capabilities to all of those homes. To reach 15 million locations, AT&T says it will “provide [fiber-based] wireline broadband service to 2 million more customer locations” but “fixed wireless local loop (‘WLL’) technology” for the remaining “13 million largely rural customer locations” in that total.³⁸

Translation: AT&T's broadband solution for rural America is the same expensive, capped, fixed 4G wireless services that it currently offers in areas where it refuses to upgrade its wired networks. This “commitment” doesn't even come close to offering real broadband at future-proofed speeds to these 13 million homes.

Moreover, both the wireless and wireline rollouts likely would have happened without this merger. When AT&T announced its “Project Velocity IP” initiative in November 2012, the company indicated that its 4G LTE network was “expected to cover 300 million people by year-end 2014.”³⁹ AT&T is always careful to change the denominator in its promises so that it is difficult to make apples-to-apples comparisons between this 300 million under Project VIP and the lucky 13 million “new” locations that would get fixed WLL service as a result of this merger. AT&T asserts without further explanation that its DIRECTV commitment goes beyond its Project VIP plans,⁴⁰ but the math is anything but clear on the surface of the Application. It is also hard to square with AT&T announcements last month that the company's Wireless Home Phone & Internet service is already available nationwide, in a blog posted just days after the DIRECTV merger was announced but (obviously) long before it has been approved.⁴¹

The suggestion that AT&T must first buy out a competitor before it can afford to improve its broadband coverage, in a plainly horizontal merger that results in a highly concentrated market, is mindful of nothing so much as AT&T's most recent failed takeover of this sort.

In 2011, while trying to persuade regulators of the benefits from its attempted buyout of T-Mobile, AT&T continually recited the preposterous claim that it could not afford to deploy LTE to 97 percent of the country without first spending some \$39 billion on its rival. Just how preposterous that claim was became apparent to the public, however, only when AT&T's attorneys failed to redact this cost that AT&T claimed it could not afford without first acquiring T-Mobile: \$3.8 billion.⁴²

³⁸ *Id.* at 5.

³⁹ See AT&T, Press Release, “AT&T to Invest \$14 Billion to Significantly Expand Wireless and Wireline Broadband Networks, Support Future IP Data Growth and New Services,” Nov. 7, 2012, <http://www.att.com/gen/press-room?pid=23506&cdvn=news&newsarticleid=35661&mapcode>.

⁴⁰ See *Application* at 50.

⁴¹ See AT&T Consumer Blog, “AT&T Wireless Home Phone & Internet Goes Nationwide, and So Can You,” May 22, 2014, <http://blogs.att.net/consumerblog/story/a7795364>.

⁴² See Letter from Richard L. Rosen, Counsel for AT&T, to Marlene H. Dortch, Esq., Secretary, Federal Communications Commission, WT Docket No. 11-65, at 1-2 (filed Aug. 8, 2011) (redacted for public inspection).

Then as now, it is hard to accept the claim that AT&T can only justify spending on broadband deployment if the government first approves an anticompetitive merger – with a price tag five to ten times higher than the pure investment figure that supposedly makes AT&T blanch.

Before 2011, AT&T successfully closed a different merger while promising to deliver broadband to 100 percent of the housing units located within its wireline territory. In 2006, AT&T's commitments for its BellSouth acquisition detailed plans to serve 85 percent of AT&T's wireline footprint with wired broadband offerings, and the remaining 15 percent with satellite and wireless technologies.⁴³ AT&T today suggests the same kind of comprehensive coverage is possible with newer fiber and 4G technologies only if it is allowed to merge once more. Yet its track record on fulfilling such promises is spotty at best, with residents in its wireline service territory suggesting they were still waiting for AT&T to meet BellSouth merger commitments some six years after those promises were made.⁴⁴

What could AT&T do if it were serious about building a better broadband network? Plenty. It could start by taking the money it wants to throw at this deal and putting it to a better use. AT&T could pass all 15 million homes with gigabit fiber for fraction of the total deal value with DIRECTV. And if it invested the entire amount it in fiber, AT&T could do a great deal more.

III. WASTED OPPORTUNITIES TO BUILD A BETTER BROADBAND FUTURE

Immediately after AT&T announced its intent to purchase DIRECTV, my organization labeled this transaction the “most wasteful deal ever” – or at least the most wasteful since Comcast announced its plans to buy Time Warner Cable.⁴⁵ That may sound hyperbolic until you understand the wasted opportunity that this AT&T transaction represents for our country, especially when coupled with the other mega-mergers on tap as we speak.

Were AT&T serious about expanding broadband availability and opportunities throughout its entire service territory – and indeed, throughout the entire country – it would give up on its constant acquisition dreams and concentrate on real broadband expansion and improvements. It might set aside the merger mania mentality that some investors and analysts have adopted and forced on us. That attitude may benefit Wall Street, but it works to the detriment of Main Street.

AT&T Plans to Spend Nearly \$70 Billion Merely to Increase Revenues in the Near-Term

AT&T's announced purchase price for DIRECTV, the nation's largest satellite-TV company, was \$48.5 billion in cash and equity. Yet the total transaction value is much higher, standing at \$67.1 billion after factoring in \$18.6 billion in debt. For this sum, AT&T would get a satellite-

⁴³ See Letter from Robert W. Quinn, Jr., AT&T, to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 06-74, ¶ 1 (filed Dec. 28, 2006).

⁴⁴ See Gerry Smith, “Many Rural AT&T Customers Still Lack High-Speed Internet Despite Merger Promise,” *Huff Post Tech*, Nov. 18, 2012, http://www.huffingtonpost.com/2012/11/18/rural-att-customers-merger-internet_n_1914508.html.

⁴⁵ S. Derek Turner, “Why the AT&T-DirecTV Deal Is the Dumbest, Most Wasteful Deal Ever (at Least Since Comcast–Time Warner Cable),” May 19, 2014, <http://www.freepress.net/blog/2014/05/19/why-the-att-directv-deal-dumbest-most-wasteful-deal-ever>.

only company with declining profits and no real terrestrial assets. By Free Press’s estimates, with the amount of profit DIRECTV brings in each year at about \$2.9 billion, it would take AT&T more than two decades to pay for this merger.

Before the deal had even been finalized, critics were out in full force – and they were right to be. The *New York Times*’ Jeffrey Goldfarb wrote on May 14, 2014, that the deal “gives off a whiff of desperation.”⁴⁶ He noted the kinds of savings that AT&T would need to wring out of DIRECTV for the transaction to make sense, and argued that “AT&T has been eager to make a big acquisition – seemingly any purchase of a certain size, regardless of strategic rationale,” even if its return on investment for a merger were lower than its cost of capital.⁴⁷

Not surprisingly, these independent evaluators of the transaction tell a different story than the merger applicants’ employees and experts. The truth is that AT&T’s short-term interests are the only things served by this merger, and those benefits are directly tied to making consumers’ lives worse. For AT&T, this deal is all about revenue growth, which analysts at Moffett Nathanson rightly decried as a failure of strategy. “If simply buying cash flows is sufficient, AT&T could just as easily buy a pharmaceutical firm. Or a dog-racing track.”⁴⁸ Indeed, as Recon Analytics analyst Roger Entner noted, “[t]his deal is about getting more money from the same customers.”⁴⁹

What AT&T (and Comcast) Could Do Instead with \$70 Billion

AT&T prefers to grow profits quickly by killing competition, rather than grow its capacity. Buying DIRECTV could accomplish the former, reducing pay-TV choice for at least 20 percent of the U.S. population and spurring higher prices. That is why AT&T wants to make this deal.

What if it were serious about building better broadband for America, instead of reciting the same litany of evasive broadband promises catalogued in Part II of this testimony? It is when the cost of merging is taken into account, and the AT&T acquisition is set next to the planned Comcast acquisition of Time Warner Cable, that the lost opportunity becomes painfully apparent.

These takeovers are a perfect illustration what is wrong with America’s telecommunications market. Because for the total price of these two mega-deals, AT&T and Comcast could collectively deploy super-fast gigabit-fiber broadband service to every single home in America.

The \$67 billion AT&T plans to spend on a standalone satellite TV company is staggering, if one takes at face value the claims in the Application about DIRECTV’s declining performance and diminishing prospects. What if, instead of buying some short-term revenue growth, AT&T instead invested that money in its core broadband business? In that case, for the total amount

⁴⁶ Goldfarb, *supra* note 32.

⁴⁷ *Id.*

⁴⁸ See Brian Fung, “If AT&T buys DirectTV [sic], it could go head-to-head with Comcast-Time Warner Cable,” *Wash. Post* “*The Switch*,” May 1, 2014, <http://www.washingtonpost.com/blogs/the-switch/wp/2014/05/01/if-att-buys-directtv-it-could-go-head-to-head-with-comcast-time-warner-cable/>.

⁴⁹ See Roger Yu and Mike Snider, “Analysis: Why AT&T wants DirecTV,” *USA Today*, May 19, 2014, <http://www.usatoday.com/story/money/business/2014/05/13/att-directv-deal-analysis/9044491/>.

this merger would cost AT&T, the company could triple the size of its current fiber broadband footprint and sign up more video subscribers than DIRECTV currently serves.

According to a variety of sources, including AT&T's own experience⁵⁰ with its U-verse fiber service that is already available to about 31 million customer locations, the cost to wire the entire country with gigabit fiber would be approximately \$140 billion.⁵¹ Fiber deployments come in two parts: first passing and then connecting homes. Fiber is strung past all the houses in a neighborhood. Then, if a customer subscribes, the company connects the customer's house with service. The \$140 billion figure for the entire country is based on an average cost to pass a home with gigabit fiber of \$700.⁵² The subsequent cost to connect a subscriber is about \$800, and much less than that if they just sign up for Internet service instead of Internet plus video.

So for the \$67 billion-plus that it intends to spend here, AT&T could pass 71 million new homes with gigabit fiber, and connect 21 million new subscribers (assuming an industry-average 30 percent take-rate).

Some who would defend AT&T's spending might note that the deal's price tag includes \$18.6 billion in DIRECTV debt, and that all but \$14.55 billion of the remaining amount is made up of AT&T stock. But debt and stock have actual value, and that \$14.55 billion in cash alone would allow for some impressive deployments. Indeed, one estimate placed the cost for Verizon's FiOS project to pass more than 17 million homes with fiber broadband at \$15 billion.⁵³

Failures of Industry Imagination, Spurred by Failures of Statutory Implementation

This transaction makes no real sense in either the short term or the long haul. In contrast to the two decades it would take AT&T to earn its money back from buying DIRECTV, it would take AT&T at most 8 to 10 years to pay for a gigabit-fiber deployment that would serve as many or more video customers than DIRECTV has today. And if instead of that industry-average 30 percent take rate, AT&T were to experience astronomical, near 75 percent sign-up rates like Google is seeing for its fiber services in Kansas City,⁵⁴ then AT&T's making a real investment in broadband would pay for itself in far less time.

At its core this deal shows how unimaginative our country's telecom titans are. Comcast's takeover of Time Warner Cable comes with a total price tag of nearly \$70 billion (\$45 billion in equity plus \$25 billion debt). For that price, Comcast is getting almost 12 million TV/Internet

⁵⁰ See Project VIP Press Release, *supra* note 39.

⁵¹ See, e.g., Jay Yarow, "How Much It Would Cost Google To Become A National Cable Company Like Comcast," *Business Insider*, Dec. 7, 2012, <http://www.businessinsider.com/how-much-it-would-cost-google-to-build-a-cable-network-2012-12>.

⁵² See Dave Burstein, "Fiber Economics – Quick and Dirty," *Fast Net News*, Aug. 11, 2012, <http://fastnetnews.com/fiber-news/175-d/4835-fiber-economics-quick-and-dirty>.

⁵³ See Yarow, *supra* note 51.

⁵⁴ Phillip Dampier, "Uh Oh Time Warner Cable & AT&T: Google Fiber Winning 75% of Customers in Kansas City," *Stop the Cap*, May 6, 2014 (citing Bernstein Research analysis of Google's performance in Kansas City), <http://stopthecap.com/2014/05/06/uh-oh-time-warner-cable-att-google-fiber-winning-75-of-customers-in-kansas-city/>.

customers and infrastructure that reaches 30 million homes. But for \$70 billion, Comcast could deploy gigabit fiber past every single non-rural home in the U.S. and sign up far more customers than it would get from Time Warner Cable.

The \$137 billion price tag of the AT&T and Comcast deals is enormous, and comes within a whisker of the \$140 billion cost to connect every home in the U.S. to gigabit fiber. Moreover, that would be the cost for starting from scratch. AT&T and Comcast already have fiber-fed services that collectively cover 60 percent of the country.

Antitrust authorities, communications regulators, and this Subcommittee must ask why these companies are choosing consolidation over investment. The answer is Wall Street's short-term mindset, combined with lax antitrust enforcement and FCC abdication of its competition policies -- all of which have combined to favor wasteful capital allocation. If our telecom markets were effectively competitive, we'd see companies investing not in expensive buyouts and bailouts, but in better infrastructure to lure new customers.

This waste is a sign of market failure. It's the exact kind of market failure that should set off alarm bells in Washington. The purpose of the 1996 Telecom Act was to spur investment in robust, competitive and open networks that enable new industries and boost competition in existing ones. By now, we were supposed to see incumbents deploying outside of their home markets, much as AT&T promised every time it bought out another Baby Bell company in the last decade – before it switched its standard merger promise to “more wireless for everyone!”

The FCC and antitrust enforcers at one time had largely abandoned these plans to promote real competition,⁵⁵ and today we see the result. Incumbents generally refuse to build out to compete against each other, and in fact their stock prices are punished when they have the temerity to invest in new infrastructure. Plus with the current state of the FCC's Open Internet proposal, we've lost the legal protections that guaranteed these networks would remain open platforms for competition.

CONCLUSION

The AT&T/DIRECTV deal is another wasteful merger proposal in a season full of them. It would result in a highly concentrated pay-TV market, with no real and discernible offsetting benefits that are specific to this merger. And it would waste an opportunity to provide real broadband advances and next-generation fiber deployments in a much larger swath of the country than the relatively paltry commitments offered up here.

Our nation's antitrust authorities are sworn to prevent deals that lessen competition, and current FCC Chairman Tom Wheeler has stated that his mantra likewise is “competition, competition, competition.” These agencies have the power to block these wasteful and anticompetitive deals. Doing so would send the right message to the market giants: If you want growth, you should build it, not buy it.

⁵⁵ See generally S. Derek Turner, *Dismantling Digital Deregulation: Toward a National Broadband Strategy* (May 2009), http://www.freepress.net/sites/default/files/fp-legacy/Dismantling_Digital_Deregulation.pdf.