

LEGAL ANALYSIS

This white paper addresses the Wireless Telecommunications Bureau's recent letter concerning Data Free TV, which allows AT&T Mobility customers to stream DIRECTV over AT&T's cellular network without implicating their monthly data allowances.¹ In the two months since Data Free TV was launched, nearly three million AT&T mobile customers have availed themselves of this feature, and their usage of the DIRECTV App has skyrocketed. The popularity of this service is no surprise. Consumers want more control over where, when, and how they watch video. To that end, Data Free TV lets consumers stream content on their mobile devices without worrying about using up their data allowances. By making mobile streaming more consumer-friendly, Data Free TV will help disrupt entrenched video delivery models and challenge cable TV incumbents, which account for the majority of pay TV subscriptions and more than 85% of the Internet connections that the Commission considers "broadband."²

Despite these unambiguous consumer benefits, the Bureau Letter expresses "serious concerns" that Data Free TV "may obstruct competition" in the video marketplace.³ That logic is exactly backwards. Cable companies, not AT&T or DIRECTV, dominate the video marketplace, and this phenomenally popular service *increases* competition by helping to challenge cable dominance. Nor can this service be attacked on "net neutrality" grounds because, as discussed below, it is nondiscriminatory in every respect.

In addition, the Bureau lacks any unilateral authority to attack this program. Delegated authority does not extend to any matter "present[ing] new or novel questions of law or policy

¹ Letter from Jon Wilkins, Chief, FCC, to Robert W. Quinn, Jr., Senior Exec. Vice President, AT&T, at 2 (Nov. 9, 2016) ("Bureau Letter").

² 2016 Broadband Progress Report, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability*, GN Docket No. 15-191, FCC No. 16-6, ¶ 27 n.82 (Jan. 29, 2016).

³ Bureau Letter at 1.

which cannot be resolved under outstanding Commission precedents and guidelines.”⁴ Here, any Bureau order targeting Data Free TV would chart a radical new legal and policy path. Indeed, it would contradict decades of authority entitling telecommunications carriers to provide inputs to their affiliated entities so long as they offer to sell the same inputs to unaffiliated entities on nondiscriminatory terms—as AT&T does here.

BACKGROUND

In early January 2014, AT&T Mobility launched its sponsored data program, open to customers “across a variety of industries such as healthcare, retail, media and entertainment and financial services”⁵ Like other carriers’ sponsored-data programs, this program closely resembles free shipping for online commerce or 800-number toll-free dialing. Just as Holiday Inn covers toll charges when customers dial 1-800-HOLIDAY, participants in AT&T Sponsored Data cover data charges for the customers who consume their content on AT&T’s mobile network.

Since September 2016, DIRECTV has participated in this program so that customers of DIRECTV and AT&T Mobility can stream DIRECTV content over AT&T’s mobile broadband network without having that content count against their data allowances.⁶ During those two months, nearly three million DIRECTV customers have used the service to supplement their satellite-delivered TV service by streaming DIRECTV linear content on AT&T’s network without charge—anytime, anywhere, over any mobile device. AT&T is now poised to offer another attractive streaming service, this time to those who do not want to subscribe to a

⁴ 47 C.F.R. § 0.331.

⁵ Press Release, “AT&T Introduces Sponsored Data for Mobile Data Subscribers and Businesses” (Jan. 6, 2014), <http://www.att.com/gen/press-room?pid=25183&cdvn=news&newsarticleid=37366&mapcode=>.

⁶ Data allowances “appropriately align incentives to encourage efficient use of networks” and avoid “forc[ing] lighter end users of the network to subsidize heavier end users.” *Preserving the Open Internet*, Report & Order, 25 FCC Rcd 17905, ¶ 72 (2010) (“*Open Internet Order*”).

satellite-delivered TV service. DIRECTV NOW, which will be launched this quarter, will enable customers to stream DIRECTV channels on any device, from a smartphone to a 55-inch TV, for as little as \$35 a month—and with no data charges for AT&T mobile customers, no annual contract or credit check, no installation charges, and no need for a set top box.

AT&T Mobility offers the same sponsored data service at the same unit cost to all unaffiliated content providers, regardless of their size or the amount of data they choose to sponsor. Thus, if a university wants to sponsor an online course, or a short documentary filmmaker wants to encourage viewing of his new film, or ESPN seeks to sponsor viewing of a sporting event, they can all pay the same sponsored rate that DIRECTV pays AT&T Mobility. That sponsored-data rate, moreover, is an extremely attractive wholesale rate. It is currently as low as the market-based rates AT&T Mobility offers to major wireless resellers who commit to significant purchase volumes. As such, it is generally well below the effective rates that retail customers pay per unit of actual consumption. These lower effective rates generate additional data usage, and the resulting combination of increased output at lower per-unit prices is the very criterion of increased consumer welfare.⁷

Although the Bureau letter suggests otherwise, AT&T Mobility incurs major costs in providing Data Free TV. Not only does it forgo the higher rates its retail customers would otherwise pay for their data usage, but it also incurs substantial new network costs by encouraging them to stream far more video than they otherwise would. AT&T Mobility will need to respond to those new usage demands by accelerating capital-intensive investments to expand its network capacity.

⁷ See, e.g., *McWane, Inc. v. FTC*, 783 F.3d 814, 841 (11th Cir. 2015); *MCI Commc'ns Corp. v. AT&T Co.*, 708 F.2d 1081, 1113 (7th Cir. 1983).

Given the growing popularity of video and music streaming, it is no surprise that AT&T is not the only provider of sponsored data. For example, in January 2016, Verizon introduced FreeBee Data, a program that, among other things, allows any content provider to pay for zero-rating of particular content, such as promotional videos.⁸ Shortly thereafter, in March 2016, Verizon began using FreeBee Data to zero-rate Verizon's previously launched Go90 streaming service, which offers Verizon's original video content, including dozens of original shows and sports events such as NBA games.⁹ Cable incumbents themselves now offer zero-rated video services of their own. For example, last year Comcast launched Stream TV, an IP-based streaming video service that does not count against Comcast's usage allowances for home broadband connections.¹⁰ In the words of one media analyst, such programs are "a win for everyone": (1) "customers naturally benefit from the promotion, since they're getting free data"; (2) the sponsored content providers "have seen an increase in usage"; and (3) other, *non*-sponsored content providers benefit because "the data [consumers] save from video streaming is allowing them to use their data more freely in other apps" ¹¹

⁸ Verizon, "Introducing FreeBee Data: The New Sponsored Data Service from Verizon" (Jan. 19, 2016), <http://www.verizon.com/about/news/introducing-freebee-data-new-sponsored-data-service-verizon>.

⁹ Verizon, "go90 FAQs," <http://www.verizonwireless.com/support/go90-faqs/>; Verizon, "Verizon and NBA Announce Major Content and Marketing Partnership" (Nov. 2, 2015), <http://www.nba.com/2015/news/11/04/verizon-nba-reach-new-marketing-agreement/>; Nathan McAlone, "One media giant is trying to beat Netflix by producing a whopping 52 original streaming shows by the end of the year" (Nov. 6, 2015), <http://www.businessinsider.com/verizons-go90-will-have-52-original-series-this-year-2015-11>.

¹⁰ See Jon Brodtkin, *Comcast Launches Streaming TV Service That Doesn't Count Against Data Caps*, Ars Technica (Nov. 19, 2015), <http://arstechnica.com/business/2015/11/comcast-launches-online-tv-service-that-doesnt-count-against-data-caps/>. Unlike AT&T, Comcast does not extend the same zero-rating treatment to unaffiliated video services. See, e.g., Jon Brodtkin, *Netflix Arrives on Comcast TV Boxes, Won't Be Exempt From Data Cap*, Ars Technica (Nov. 7, 2016), <http://arstechnica.com/information-technology/2016/11/netflix-arrives-on-comcast-tv-boxes-wont-be-exempt-from-data-cap/>. Comcast argues, however, that this Stream TV is a specialized IP service offered separately from broadband Internet access and is thus exempt from net neutrality rules.

¹¹ Adam Levy, "Look How Smart T-Mobile's Binge On Is," *The Motley Fool* (Jan. 27, 2016), <http://www.fool.com/investing/general/2016/01/27/look-how-smart-t-mobiles-bingeon-is.aspx>.

DISCUSSION

The Bureau Letter suggests that Data Free TV is anticompetitive and thus violates the “Internet conduct standard” set forth in the *Open Internet Order*. First, it suggests that AT&T’s sponsored data arrangement with DIRECTV is inherently discriminatory because the two companies are affiliates. Specifically, the Letter claims that AT&T’s sponsored data program has a “notably different financial impact on unaffiliated providers” because, “while there is no cash ‘cost’ on a consolidated basis for AT&T to zero-rate its own affiliate’s mobile service (since DIRECTV’s cost of Sponsored Data is equal to AT&T Mobility’s Sponsored Data ‘revenue’), an unaffiliated provider’s Sponsored Data payment to AT&T Mobility is a true cash cost.”¹² Second, the letter alleges a predatory price squeeze on the theory that, “at foreseeable usage levels of zero-rated mobile video services, ... it is not difficult to calculate usage scenarios in which an unaffiliated provider’s Sponsored Data charges alone could render infeasible any third-party competitor’s attempt to compete with the \$35 per month retail price that AT&T has announced for DIRECTV Now.”¹³

Both claims are untenable. The discrimination claim is economically incoherent and contradicts decades of communications law precedent. The price squeeze claim is unexplained and completely unsubstantiated. Neither claim would survive judicial review even if adopted by the Commission, and both lie far outside the delegated authority of any Bureau.

I. DATA FREE TV IS NONDISCRIMINATORY AND COMPORTS WITH DECADES OF FCC PRECEDENT.

The Bureau Letter suggests that Data Free TV is somehow “anticompetitive” because DIRECTV makes its Sponsored Data payments to a corporate affiliate (AT&T Mobility),

¹² Bureau Letter at 2.

¹³ *Id.*

whereas “an unaffiliated provider’s Sponsored Data payment to AT&T Mobility is a true cash cost.”¹⁴ Under that reasoning, the Data Free TV program would have been pro-consumer the day before AT&T closed its merger with DIRECTV, but became “anticompetitive” the moment the merger closed and AT&T began incurring “no cash cost on a consolidated basis.”¹⁵ That position contradicts settled law, ignores the widely recognized economic benefits of vertical integration, and would lead to absurd and indefensible results.

For decades, both Congress and the Commission have entitled telecommunications carriers to provide services in adjacent markets so long as they offer any telecommunications input on nondiscriminatory terms to their competitors in those markets. For example, both Congress and the Commission have long entitled incumbent local telcos to offer long distance services—either themselves or through separate affiliates—so long as they provide “exchange access” services to long distance competitors on nondiscriminatory terms. As codified in Section 272(e)(3) of the Communications Act, those rules require a local telco to “charge [its long distance] affiliate ..., or impute to itself (if using the access for its provision of its own services), an amount for ... exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service.”¹⁶ In other words, Congress not only permitted but *required* the very arrangement that the Bureau Letter here describes as “anticompetitive,” in which unaffiliated rivals incur a “cash cost” (the price of access) that the telecommunications carrier and its own downstream affiliate do *not* incur “on a consolidated basis” (Bureau Letter at 2).

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ 47 U.S.C. § 272(e)(3); *see also* 47 U.S.C. § 274 (electronic publishing).

Indeed, for decades, the Commission has applied analogous rules in the precise context presented here, where telecommunications carriers provide inputs to their edge-services affiliates. Since the *Computer II* regime of the early 1980s, the Commission has allowed a telecommunications carrier to (1) vertically integrate with edge providers (then called “enhanced services” providers); (2) provide telecommunications inputs to those edge providers; and (3) charge any unaffiliated edge provider the same nondiscriminatory rates that it charges its affiliates for use of the same telecommunications inputs.¹⁷ These rules allowed any carrier, even a monopolist, to impose this “cash cost” on unaffiliated edge providers because it incurs real costs in providing telecommunications inputs, even though the carrier and its edge affiliate themselves incur, in the Bureau Letter’s words, “no cash cost on a consolidated basis.”¹⁸

Nothing in the *Open Internet Order* draws this regime into question. To the contrary, the *Open Internet Order* explicitly endorses that very regime.¹⁹ It is thus bewildering that the Bureau Letter would suggest that it is inherently problematic for AT&T Mobility to charge third parties for the telecommunications inputs it provides to its affiliate—particularly given that telco *monopolists* have been free to do that very thing for more than three decades, whereas AT&T Mobility is neither a monopolist nor even the leading U.S. mobile provider.

¹⁷ See, e.g., *Protecting and Promoting the Open Internet*, Report & Order on Remand, GN Docket No. 14-28, FCC No. 15-24, at ¶ 311 (Mar. 12, 2015) (“*Open Internet Order*”) (“[I]n *Computer II* and *Computer III* the Commission required telephone companies that provided ‘enhanced services’ over their own transmission facilities to separate out and offer on a common carrier basis the transmission component underlying their enhanced services.”); *id.* at ¶ 311 n.799 (citing *Computer Inquiry* orders). Broadly speaking, *Computer II* required a telco to provide enhanced services through a separate corporate affiliate, whereas *Computer III* eliminated that requirement in favor of accounting and other nonstructural safeguards.

¹⁸ Bureau Letter 2. Indeed, the *Computer Inquiry* rules applied mainly to monopolists: they were designed to prevent incumbent telcos from leveraging their local exchange monopolies to harm competition in adjacent markets for edge (“enhanced”) services.

¹⁹ *Open Internet Order* at ¶ 311.

The Bureau’s novel “discrimination” theory not only ignores this settled law, but also violates basic economic principles. It makes no economic sense to distinguish, as the Bureau Letter does, between costs that AT&T recovers in the form of “cash” transfers from unaffiliated third parties and those it recovers from the operations of its affiliates. Again, no matter who is using its mobile network for video streaming, AT&T incurs the very real costs of carrying increased cellular traffic, and it must recover those costs from somewhere. Consumers would be worse off if AT&T had to recover all those costs from its mobile consumers in the form of retail rates, which are almost always higher per unit of actual consumption than the wholesale rates paid by sponsored data participants.

Moreover, AT&T’s Data Free TV arrangement with DIRECTV is economically equivalent to bundled-discount arrangements that are not even remotely controversial.²⁰ For example, no one would perceive any “net neutrality” problem if an edge provider (such as DIRECTV) that is affiliated with an ISP (such as AT&T) reimbursed its customers for the extra increments of data they buy from the ISP to stream the provider’s content. It should make no policy difference if, instead, the edge provider pays the ISP directly for the same increments of data, particularly if (as here) it pays a lower wholesale rate than retail consumers would pay per unit of actual consumption and passes along much of the savings to those consumers. From a consumer’s perspective, either arrangement is simply a bundled discount.

²⁰ Bundling “is a ubiquitous phenomenon” and “yields widespread benefits for both firms and consumers.” Bruce Kobayashi, *Two Tales of Bundling: Implications for the Application of Antitrust Law to Bundled Discounts* (2001), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=796432; see, e.g., Dep’t of Justice and Fed. Trade Comm’n, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION, 103 (Apr. 2007) (“Tying and bundling are so ubiquitous that we forget they are there. Tying and bundling are, roughly speaking, what the modern firm does. It’s the rationale. It puts things together and offers them in packages to consumers.”) (internal quotation marks, ellipses, and brackets omitted).

Indeed, the Commission cited precisely such discount arrangements as a pro-competitive benefit of the AT&T/DirecTV merger. It there found that, “[a]s standalone companies, neither has the full set of assets necessary to compete against the dominant providers of video service,” but that “the newly combined entity will be a more effective multichannel video programming distributor (‘MVPD’) competitor, offering consumers greater choice at lower prices.”²¹ In particular, “the combined AT&T-DIRECTV will increase competition for bundles of video and broadband, which, in turn, will stimulate lower prices, not only for the Applicants’ bundles, but also for competitors’ bundled products—benefiting consumers and serving the public interest.”²² The Commission could not have given a more prescient description of Data Free TV.

Finally, the Bureau Letter’s implicit condemnation of vertical integration is so sweeping that it would doom many common business practices in the telecommunications sector. For example, local telephone companies provide access services to affiliates and non-affiliates alike, and a number of facilities-based mobile carriers have corporate affiliates that operate as wireless resellers and use the facilities-based carriers’ wholesale services as inputs into their own discounted wireless plans. No one suggests that such arrangements are somehow “anticompetitive” because a facilities-based carrier’s *unaffiliated* wholesale customers (e.g., TracFone) incur a “cash cost,” whereas *affiliated* wholesale customers make their payments within the same corporate family. But that is the untenable conclusion of the Bureau Letter’s economic logic.

²¹ Mem. Op. & Order, Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations, MB Docket No. 14-90, ¶ 3 (July 28, 2015) (“*AT&T-DirecTV Merger Order*”).

²² *Id.* ¶ 4.

II. THE BUREAU'S PRICE SQUEEZE CONCERN IS BASELESS.

Almost in passing, the Bureau Letter asserts that AT&T may be engaged in a predatory price squeeze because (according to the Letter) “it is not difficult to calculate usage scenarios in which an unaffiliated provider’s Sponsored Data charges alone could render infeasible any third-party competitor’s attempt to compete with the [introductory] \$35 per month retail price that AT&T has announced for DIRECTV Now.”²³ That assertion is untenable.

As a threshold matter, we do not know, because the Letter does not say, what “usage scenarios” the Bureau has considered. Under settled law, the Commission may not simply tell a company under investigation that it has made backroom “calculat[i]ons” showing anticompetitive effects and expect the company to respond to that accusation without seeing the supposedly incriminating “calculations.”²⁴ Instead, the Communication must show its work. This very investigation illustrates why such transparency is essential. Among other material omissions, the Bureau’s analysis appears not to have considered (1) variation in channel packages and pricing for DIRECTV NOW bundles; (2) the substantial percentage of time the typical user streams video via Wi-Fi rather than cellular networks; or (3) the ability of any unaffiliated content provider to choose how much of its customers’ data usage it wishes to sponsor (it need not sponsor all such usage if it sponsors any).

In any event, there is nothing remotely anticompetitive about either AT&T’s sponsored data charges or DIRECTV’s retail rates and thus no basis for alleging a price squeeze. As noted, the sponsored data rate is as low as the competitive wholesale rates that major wireless resellers pay AT&T for network capacity today when they commit to large purchase volumes, even

²³ Bureau Letter at 2.

²⁴ See, e.g., *Am. Radio Relay League v. FCC*, 524 F.3d 227 (D.C. Cir. 2008).

though the sponsored data rate itself is not based on any volume commitments. The Bureau Letter identifies no reason to doubt the reasonableness of that rate, and there is none. Instead, the Letter suggests greater concern about the attractive *retail* rates for DIRECTV NOW, insinuating that those rates are so favorable to consumers that they must be predatory. Indeed, the letter's suggestion that some "third-party competitor[s]" might find it hard "to compete" with DIRECTV NOW's retail prices reads like a request that DIRECTV raise those rates, at its customers' expense, to give less efficient competitors a retail price umbrella.

That position is indefensible. Low retail prices are almost always beneficial to consumers. In the words of then-Judge Stephen Breyer, "a price cut that ends up with a price exceeding total cost ... is almost certainly moving price in the 'right' direction (towards the level that would be set in a competitive marketplace). The antitrust laws very rarely reject such beneficial 'birds in hand' for the sake of more speculative (future low-price) 'birds in the bush.'"²⁵

Competition law has thus always been careful to avoid condemning low prices unless the firm charging them has monopoly power, the prices fall below an appropriate measure of the firm's costs, *and* there is a dangerous probability that those below-cost prices will drive all competitors out of the market and then allow the monopolist to recoup its lost profits by charging monopoly-level prices.²⁶ That test is appropriately hard to meet because, as the Supreme Court explains, "predatory pricing . . . [is] rarely tried, and even more rarely successful."²⁷ Here, the Commission could not possibly satisfy any test for predatory pricing because neither AT&T nor DIRECTV has monopoly power today, they have no chance of obtaining it in the future, and

²⁵ *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983).

²⁶ *See, e.g., Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

²⁷ *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986).

they therefore lack either the incentive or ability to engage in below-cost pricing. The Bureau Letter does not contend otherwise.

In sum, because the Letter identifies no basis for challenging either AT&T's sponsored data rate or DIRECTV's retail rates, it articulates no economically coherent basis for alleging an anticompetitive price squeeze.

III. THE BUREAU LACKS DELEGATED AUTHORITY TO CHALLENGE DATA FREE TV.

The Bureau Letter does not suggest that the Bureau intends to take any unilateral action against Data Free TV under delegated authority. That is prudent because unilateral Bureau action in this context would be lawless and subject to certain and prompt reversal, whether by the Commission or a reviewing court.

The Bureau lacks delegated "authority to act [in matters] present[ing] new or novel questions of law or policy which cannot be resolved under outstanding Commission precedents and guidelines."²⁸ Again, all "outstanding Commission precedents and guidelines" relevant here, from the *Computer Inquiries* on, support only one conclusion: Data Free TV is lawful. As a result, any exercise of delegated authority *against* Data Free TV would not only plow radical new policy ground, but crash headlong into a solid wall of controlling legal authority. That is obviously not a permissible role for staff to play.

Nor could the Bureau unilaterally attack Data Free TV on the theory that the *Open Internet Order* superseded any prior Commission guidance on these issues. Again, the *Open Internet Order* did not purport to overrule the core *Computer Inquiries* principle allowing telecommunications carriers to "provide[] 'enhanced services' over their own transmission facilities" so long as they "separate out and offer on a common carrier basis the transmission

²⁸ 47 C.F.R. § 0.331.

component underlying their enhanced services.”²⁹ To the contrary, it quoted and embraced that very principle.³⁰

Moreover, even if the *Open Internet Order* had abolished that prior precedent, the *Order* could not itself plausibly justify any exercise of delegated authority to attack Data Free TV. As the Bureau Letter acknowledges, the *Order* pointedly declined to prohibit sponsored data arrangements as a general matter, observing that they can “provide benefits to consumers.”³¹ The Bureau Letter thus cites the multi-factor “Internet conduct standard” as a basis for invalidating this sponsored data arrangement. Of course, AT&T and others have challenged that “standard” as unlawfully vague, and that challenge remains pending. Yet no matter how that challenge is resolved, the existing formulation of this supposed “standard,” with its “non-exhaustive list” of seven factors,³² cannot possibly provide the requisite clear support for any challenge to Data Free TV, particularly given the pro-competitive benefits discussed above. Indeed, Chairman Wheeler himself admits that he “do[esn’t] really know” what conduct is prohibited under that standard.³³

Finally, despite a mountain of filings on the issue, the Commission has issued no guidance on sponsored-data practices in the nearly two years since it released the *Open Internet Order*, even though, in the meantime, those practices have become an integral part of the competitive telecommunications landscape. The Bureau would act in flagrant disregard for the limits on its delegated authority if it now got out in front of the Commission, isolated one company’s sponsored-data practices for condemnation, and left intact the similar sponsored-data

²⁹ See *Open Internet Order* ¶ 311; see also *id.* ¶¶ 63-64, 312-313.

³⁰ See *id.* ¶ 311.

³¹ *Id.* ¶ 151.

³² See *id.* ¶¶ 138-145.

³³ February 26, 2015 Press Conference (165:30-166:54).

practices of that company's chief competitors, including market leaders such as Verizon and Comcast. The victims in that scenario would include not only AT&T's existing Data Free TV customers, but consumers overall, who benefit overwhelmingly from the disruptive competition this program poses for Comcast and other dominant providers of broadband and pay-TV services.