

Testimony of Michael White
President, Chairman, and Chief Executive Officer
DIRECTV
before the
United States House of Representatives Judiciary Committee
Subcommittee on Regulatory Reform, Commercial and Antitrust Law
June 24, 2014

Chairman Bachus, Ranking Member Johnson, and members of the subcommittee, my name is Mike White, and I am the President, Chairman, and Chief Executive Officer of DIRECTV. Thank you for asking me to testify on DIRECTV's proposed transaction with AT&T.

I have always passionately believed that, for a business to succeed in the long term, it must continue to satisfy its customers' needs and wants and consistently do so better than the competition. This transaction will help us do just that. It is overwhelmingly about the combination of complementary assets and products. It will create a company that will offer new services at a better value for our customers. And it will help us compete long into the future.

With AT&T, we have the opportunity to combine America's premier video company with a world-class broadband and wireless provider. Both companies rank among the best providers in terms of customer satisfaction today. Combined, we will do what neither company can do on its own. We will:

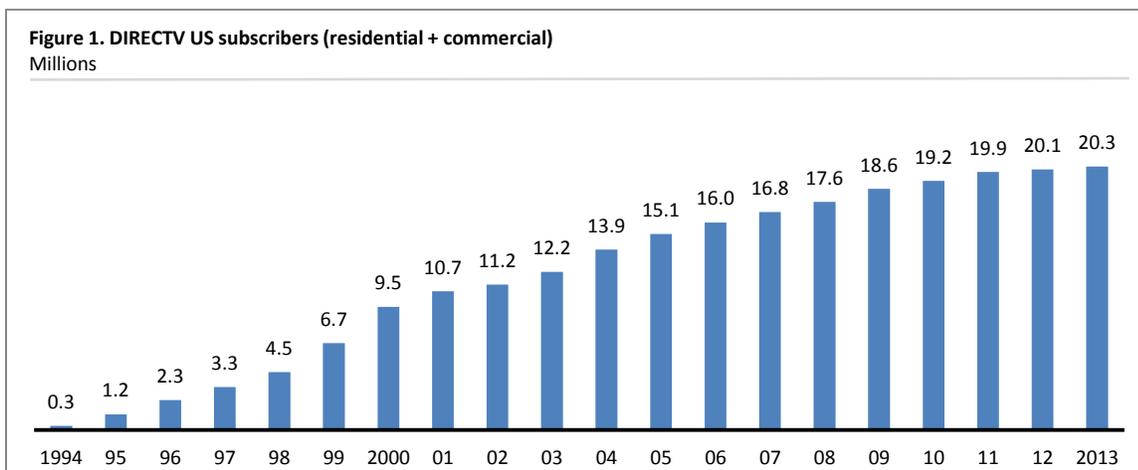
- Offer competitive bundles of services that neither company can offer today, enabling millions of consumers to watch more of what they want, when they want, and where they want.
- Provide new or faster broadband to at least fifteen million customer locations, most of which are located in rural areas.
- Compete more effectively with the cable bundle by creating a new and unique alternative for consumers.

We believe that combining AT&T with DIRECTV will benefit our twenty million subscribers in the U.S. as well as the millions of additional consumers who will have a stronger competitor to choose from.

I. DIRECTV MUST ADAPT TO CONTINUE TO COMPETE IN THE NEW, INTERNET-DRIVEN ECONOMY.

DIRECTV has enjoyed phenomenal growth in its U.S. business in the twenty years since we started service. One reason was early Congressional intervention to assure that the nascent satellite television industry could acquire the programming its subscribers demanded. Another is that we worked hard to deliver more channels, a clearer picture, more advanced equipment, and better customer service than incumbent cable operators.

Three years after launch, DIRECTV had already attracted over three million subscribers—the most successful launch of a consumer electronics product in U.S. history up to that point. By 2005, DIRECTV had grown to 15 million subscribers.



In recent years, however, the market has changed. Bundles have largely replaced pure video. Video itself has combined with the Internet to satisfy customers' demands for more video on demand, TV Everywhere, and expanded recording capabilities. Our competitors' advertising highlights our lack of an Internet offering and their speed advantages.



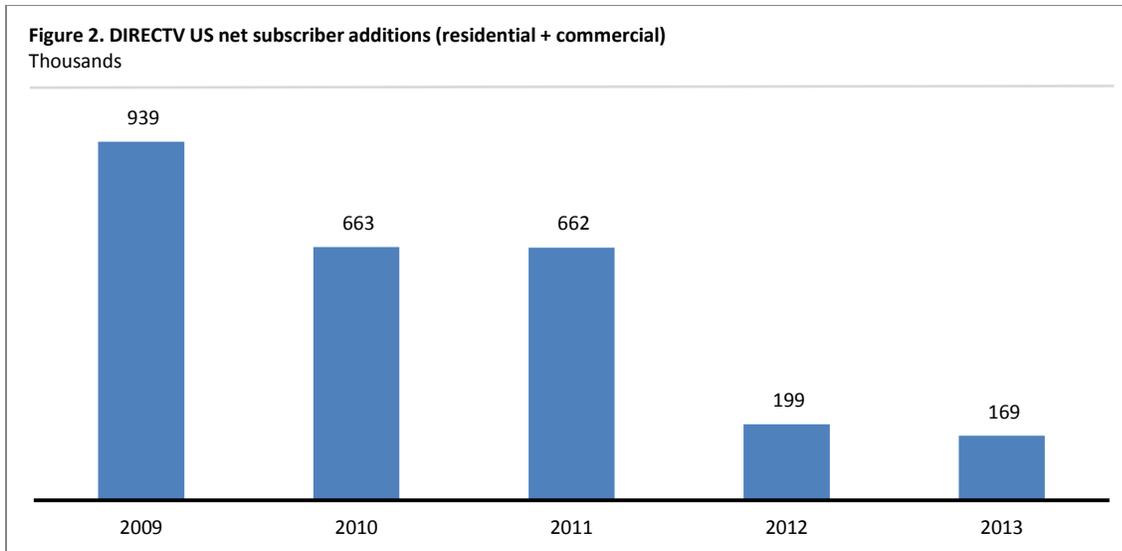
“We left satellite because they couldn’t offer a really good Internet package.”



satellite + slow DSL

“Are you missing out with satellite and slow DSL?”

Not surprisingly, DIRECTV’s U.S. subscriber growth has slowed in recent years.



If we want to compete effectively in today’s Internet-driven marketplace, we must adapt.

First, we must provide an integrated bundle of services. It should come as no surprise that consumers increasingly demand bundles. According to SNL Kagan, the number of bundled subscribers served by six of the nation’s largest cable operators (Comcast, Time Warner Cable, Charter, Cablevision, Mediacom, and Suddenlink) doubled between the second quarters of 2008 and 2013. Today, 78 percent of basic cable subscribers take at least two products (predominantly video and broadband), and 42 percent take three (video, broadband, and telephone).¹

Broadband has supplanted video as the most important element in a customer’s service bundle. J.D. Power’s 2013 Digital Lifestyle Study, for example, found that “[n]early two-thirds (61%) of consumers consider Internet service as the foundation of their future digital lifestyle

¹ See Tony Lenoir, *Cable’s triple-play penetration of basic video subs doubled in the last 5 years*, SNL KAGAN (Sept. 12, 2013).

bundle.”² We must offer our own integrated bundles if we hope to meet this new consumer demand. Otherwise, our subscribers must create their own bundles, generally at higher prices for standalone broadband. (As discussed below, our “synthetic” bundles are not a satisfactory option, either.)

Second, we must serve those who want over-the-top offerings as a complement to or substitute for traditional video service. This was less important five years ago, but it is enormously so today. Netflix now has 36 million U.S. subscribers. Hulu has surpassed 6 million subscribers—more video subscribers than either AT&T or Verizon. SNL Kagan estimates that 45.2 million U.S. households subscribed to online video services as of 2013, more than double the 19.8 million that did so in 2010.³ Unlike our competitors with broadband platforms, we cannot provide our subscribers with access to over-the-top providers. Nor can we combine our own offerings with theirs, at least not without relying on a third-party’s broadband platform.

Third, we must optimize our own video service. Just as non-linear viewing has increased, so too has the use of broadband in connection with traditional video service, especially video on demand and other “non-linear” programming. Our cable rivals can, for example, offer innovative features and services such as remote digital video recorders and video on demand programming stored in the “cloud.” Cable subscribers can watch thousands, perhaps even tens-of-thousands, of films and television programs whenever they want. Soon, cable subscribers will be able to engage other cloud-based features such as “lookback” and integrated Internet and

² Press Release, J.D. Power & Associates, 2013 Digital Lifestyle Study (Aug. 21, 2013), <http://www.jdpower.com/content/press-release/qEdZ9q3/2013-digital-lifestyle-study.htm>.

³ See SNL KAGAN, INTERNET VIDEO-ON-DEMAND REVENUE PROJECTIONS, 2009-2022 (Nov. 2012).

video products. All these and other innovative features will be facilitated by combining DIRECTV's video service with AT&T's broadband capabilities.

Because cable operators increasingly put their functionality in the cloud, moreover, they can improve their service much more quickly and easily. I understand, for example, that Comcast's cloud-based platform has enabled it to make 1200 system updates in the last 12 months. We will need to do the same if we want to keep up.

Fourth, we will have to manage content cost increases. Rising content costs are a challenge for *all* video providers. Yet bundled competitors are better positioned to handle the effects of such price increases because they earn revenue from multiple services, some of which have significantly higher margins than video service. Today, we absorb those price increases into our video business only, which means that we either have to raise prices or curtail investment. Nobody likes to see their bills go up, so we have tried to hold the line on these increases. We can only do so much, however, given the significant power of programmers to increase rates. The efficiencies of a multi-service bundle will help us mitigate the effects of these increases, for the benefit of our customers.

II. DIRECTV HAS HAD LIMITED SUCCESS IN ADDRESSING THESE CHALLENGES ON ITS OWN OR THROUGH CONTRACT.

DIRECTV has attempted to address its lack of a broadband network in various ways. We explored building or acquiring our own broadband network several times. In each case, however, we concluded both that the technology would not be competitive in terms of speed in much of the country and that the capital and other costs involved were so prohibitive that we could not offer consumers a competitively priced product on our own.

Since we could not build or buy our own broadband network, we instead attempted to address this challenge through the creation of synthetic bundles, in which video and broadband

services are provided by separate companies but marketed together to consumers. More specifically, we have formed commercial relationships with a range of providers, including CenturyLink, AT&T, Verizon, and others. Under all of these arrangements, DIRECTV offers to a customer the services of the broadband provider to create a synthetic bundle. DIRECTV receives a commission for each broadband and voice sale it initiates.

Unfortunately, this strategy has proven largely unsuccessful in creating a competitively attractive video and broadband bundle, for two primary reasons:

First, synthetic bundles make for a bad customer experience.

- **The initial sales call is difficult.** Actually, I should have said “sales calls,” because DIRECTV sales representatives cannot offer a one-call solution. Today, a customer interested in a bundle must first complete her video purchase and then be transferred internally to our “Bundles Desk” to speak with a bundles sales specialist for a broadband price quote and installation scheduling.
- **Installation is difficult.** DIRECTV is often ready to install a new subscriber’s video service before the broadband provider is ready to install the corresponding broadband service. As a result, customers must arrange separate installations, which need to be scheduled through separate service calls. Then, the customer must wait at home for separate technicians to arrive during separate installation windows, usually on different days. Moreover, when the video installer arrives before the broadband installer, the first installer cannot connect our Internet-enabled set-top boxes. Either the customer or the broadband technician must do so, and they may be unfamiliar with the process or unaware that this connection even needs to be made.

- Billing is difficult. Unlike integrated bundle customers, synthetic bundle subscribers do not receive a single bill for the combined services. Rather, they receive two bills which do not arrive on the same day, and any discounts take a long time to be applied.
- Customer support is difficult. Synthetic bundle customers lack a “one-call” solution to resolve service problems. Rather, they have to deal with two separate companies, which creates a difficult customer service environment.

Second, synthetic bundles are more expensive. The difficulty arises from the fact that two companies are involved in the sale and service rather than one. In any synthetic bundle, each company will seek its own margin on its contribution to the bundled service, making it harder to price the bundle attractively. This may explain why, for example, AT&T prices the broadband and voice components substantially lower when paired with U-verse video versus paired with DIRECTV. The current introductory price for 6 Mbps broadband when paired with U-verse video is \$14.95 versus \$34.95 when paired with DIRECTV. Thus, when viewed in total, the cost to consumers of signing up for an integrated AT&T bundle is substantially less than the cost of signing up with DIRECTV for a synthetic bundle.

IV. THIS TRANSACTION WILL ALLOW THE COMBINED COMPANY TO BETTER SERVE CONSUMERS.

The transaction will combine DIRECTV’s video assets with AT&T’s broadband and wireless assets. This combination of complimentary assets will allow the new company to better serve customers and compete more robustly with the cable bundle.

- **More and better bundles.** The transaction will allow DIRECTV to offer its subscribers integrated bundles of video, broadband, and wireless service for the first time and at a competitive price.⁴
- **Better video.** The transaction will give DIRECTV all of the features and functionalities made possible by a two-way connection, such as greatly expanded video on demand. It will also provide DIRECTV subscribers access to over-the-top service, which may be why Netflix's CFO recently called this transaction a "plus for Netflix."⁵
- **Lower content costs.** The transaction will allow programmers to reach more subscribers on more devices than ever before, unlocking much more value for them than DIRECTV or AT&T could do on their own. This should lead to lower content costs (and, for DIRECTV in particular, the ability to spread those costs over more services).
- **More broadband.** Lower content costs, along with other cost savings and synergies, will permit AT&T to offer more or better broadband to fifteen million locations, many of which are in rural areas.
- **More innovation.** The combination of our video service (and content relationships) with AT&T's wireless subscriber base will dramatically increase innovation to provide new content offerings over the top or on wireless devices.

In short, we at DIRECTV think that combining with AT&T will enable us to meet our greatest challenge and better compete in today's marketplace. We will unlock new growth

⁴ Of course, subscribers who wish to take standalone services—satellite video, fiber video, broadband, or voice—will also be able to do so.

⁵ Joyce Wang, *Netflix Talks AT&T-DirectTV, Plans Programming Boost*, CABLEFAX (May 21, 2014), <http://www.cablefax.com/programming/netflix-talks-att-directtv-plans-programming-boost>.

opportunities to provide new services to customers at a better value. As we offer subscribers better and more innovative services, cable operators and other competitors will have to respond in kind. The result will be more competition and a better video experience for all Americans.

Again, thank you for allowing me to discuss my enthusiasm for this transaction. I would be happy to take any questions you might have.