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September 7, 2000

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

RE: FCC CS Docket No.: 00-30
Ex Parte Filing

Dear Ms. Salas:

On September 6, 2000, representatives of The Walt Disney Company ("Disney") engaged in a series of meetings with Commissioners and their staffs to elaborate upon Disney's concerns about the proposed AOL/Time Warner merger, reflected in Disney's May 11, 2000 Reply Comments and its July 25, 2000 written *ex parte* filing in this docket. Representing Disney at these meetings were Sandy Litvak, Vice Chairman of Disney, Bob Lambert, Senior Vice President for New Technology and Development, Preston Padden, Executive Vice President of Government Relations, Marsha MacBride, Vice President of Government Relations and Larry Sidman of Verner, Liipfert, Bernhard, McPherson & Hand, Chtd., counsel to Disney. Meetings occurred with Chairman Kennard, accompanied by Deborah Lathen, Chief of the Cable Services Bureau, Bob Pepper, Chief of the Office of Plans and Policy, and Karen Edwards Onyeije, Legal Advisor to Chairman Kennard; Commissioner Ness, accompanied by David Goodfriend, Legal Advisor; Commissioner Furchtgott -Roth, accompanied by Helgie Walker, Senior Legal Advisor; Commissioner Powell, accompanied by Kyle Dixon, Legal Advisor; and Jay Friedman, Legal Advisor to Commissioner Tristani.

During these meetings, Disney made the following key points: (1) interactive television is a reality today and promises to expand exponentially in the future; (2) the unique combination of distribution systems/platforms and content embraced by the proposed AOL/Time Warner merger will provide the merged entity with the technological capability and economic incentive to dominate the interactive television market and to discriminate against unaffiliated content providers; (3) the most direct and easily enforceable means to safeguard against the enormous potential anticompetitive implications of the AOL/Time Warner merger would be to require separation of the content and distribution assets; and (4) absent a structural remedy, conditions ensuring non-

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discrimination and open access applying to the entire AOL/Time Warner broadband delivery network, including upstream and downstream data paths and the video transmission portions of the system used to transport ATVEF data, should be imposed if the Commission is to grant approval of the license transfer applications. A general open access provision allowing multiple ISPs access to the AOL/Time Warner broadband network is not sufficient to protect against discrimination against unaffiliated content providers in the interactive television market.

During the meetings, the documents attached hereto were distributed: a paper entitled "Keeping the Gatekeeper Honest - The AOL/Time Warner/EMI Merger;"Memorandum of The Walt Disney Company Concerning Proposed Remedies In Connection with America Online, Inc.'s Proposed Acquisition of Time Warner, Inc.; a graph entitled "Typical Upgraded 750 MHz Cable System;" an excerpt from a retransmission consent agreement between Time Warner and Disney; a July 26, 2000 CableFAX Daily Article; and a Myers Group publication entitled "Interactive Television Outlook 2000."

If you have any questions, please do not hesitate to contact me.

Sincerely,

Lawrence R. Sidman

Lawrence R. Sidman

CC: Chairman William Kennard
Commissioner Susan Ness
Commissioner Harold Furchtgott-Roth
Commissioner Michael Powell
Deborah Lathen
Bob Pepper
Karen Edwards Onyeije
David Goodfriend
Helgie Walker
Kyle Dixon
Jay Friedman
Royce Dickens (w/attachments)
Darryl Cooper (w/attachments)
James Bird (w/attachments)
Linda Senecal (w/attachments)

KEEPING THE GATEKEEPER HONEST –
THE AOL/TIME WARNER/EMI MERGER
9/5/00

- The proposed AOL/Time Warner/EMI merger would be the single largest commercial transaction in history. Each of the three companies is already the dominant entity in their respective industries. This merger threatens to limit consumer choice and industry competition in the emerging field of digital information and entertainment services, including Broadband Internet Service, Interactive Television and Music.

- The proposed marriage of the closed and proprietary AOL "walled garden" marketing environment and the "sticky" AOL communications services such as e-mail, instant messaging and chat (which generate huge anti-trust "network effects"), with Time Warner's vast content library and bottleneck cable distribution pipes poses a clear threat to competition.

- The power of a combined AOL/Time Warner/EMI is simply breathtaking. The proposed entity would vertically integrate:

    - "last mile" cable distribution pipelines reaching more than 20 million U.S. households
    - more than 50% of the U.S. residential dial-up Internet subscribers
    - more than a dozen of the top cable channels including HBO, CNN, TNT, Cinemax, TBS and the Cartoon Network
    - set-top box hardware and software
    - the *overwhelmingly* dominant provider of Instant Messaging with more than 150 million registrants and more than ten times as many users as the next largest company
    - "sticky" applications such as chat rooms, buddy lists and e-mail
    - and the most popular music licensed by film and television producers

- In the past, comparable anti-competitive, anti-consumer content/distribution combinations have had to be separated by the Government

    - the Paramount Theaters divestiture in the 1940's
    - the Network Financial-Syndication Rules in the 1970's

- Traditional television and the Internet are converging into a new hybrid service called Interactive or Enhanced Television. Interactive/Enhanced Television is a reality today. For example, Disney currently offers the following Interactive Television applications:

    - Sunday Night Football on ESPN and Monday Night Football on ABC
        - Viewers can access on demand all of the statistics available from the production studio at the game site

    - Viewers can compete against other viewers nationwide in predicting the next play
    - 650,000 viewers interacted with ABC's last Super Bowl telecast

- "Who Wants To Be A Millionaire"
    - Viewers can interact with the telecast and play along in real time

- The Academy Awards
    - Viewers can interact with "backstage" information regarding nominees and winners

- Election Night 2000
    - ABC News will enable consumer interaction with real time election results of the viewer's choosing

Many broadcasters are developing other Interactive Television applications including the opportunity for viewers to "drill down" and gain detailed information about a particular news story. Advertisers have begun to produce commercials with interactive "triggers" that enable consumers to make a purchase or request additional marketing information. Interactive Television also provides consumers with the opportunity to simultaneously engage in e-mail, instant messaging or chat rooms while watching television on the same screen.

Interactive Television has become so well established that prominent industry analysts such as Jack Myers and Paul Kagan have begun to organize annual Interactive Television conferences and have begun to produce compendia of Interactive Television industry statistics.

➢ The proposed merger will enable AOL/Time Warner/EMI to dominate the new Interactive/Enhanced Television service and to discriminate in favor of its own content and services by:

    - excluding competing content and services (e.g., dropping ABC)
    - force-feeding AOL/Time Warner/EMI content (e.g., sending the customer to CNN when he or she clicks on a "news" icon, instead of offering a selection of competitive news choices)
    - transmitting its own content "downstream" to consumers at preferential (i.e., faster) data rates
    - blocking or degrading critical, interactive "return path" communications between customers and competing content providers and services
    - limiting customers' ability to access locally "cached" data to their own content
    - favoring its own content in navigation systems and links and
    - favoring its own content with more simple and convenient consumer interfaces

➢ Cable lines owned or controlled by the combined AOL/Time Warner/EMI will enjoy a competitive advantage over other "pipes" to the home. For instance,

- DSL does not offer consumers *or* content/service providers a competitive alternative to the AOL/Time Warner/EMI cable systems because DSL data rates will not support live, full screen, full motion Interactive Television.
- Satellite is simply not available to many consumers. (e.g., multi-family dwellings; North or East facing residences; and is limited to a narrowband telco return path as opposed to cable's 2-way broadband infrastructure).

➢ Both AOL and Time Warner have histories of abusing their market power and acting to limit consumer choice and competition.

- <u>AOL</u>: (1) refuses to allow interoperability with its Instant Messaging, thereby assuring its monopoly share; (2) requires content partners in its "walled garden" to limit or eliminate links to sites outside the walled garden, thereby trapping consumers inside that restricted area for as much as 85% of their time online (by AOL's own admission); and (3) designs client software that automatically disables the client software of competing ISPs.

- <u>Time Warner</u>: (1) unilaterally shut off access to ABC Network programs and ABC local news to 8 million viewers; (2) refused to carry state and regional cable news channels in Texas, Florida, Ohio, New England and the Northwest to prevent competition to its own existing and planned news channels; (3) granted favorable channel positions to its own networks in New York; (4) refused to carry Disney Channel on the basic tier (in order to favor its own Cartoon Network) on most of its cable systems; and (5) blocks consumer access to electronic program guides (such as Gemstar) that compete with Time Warner's own program guides.

➢ AOL/Time Warner/EMI's "trust us" advocacy needlessly puts consumers at risk without a safety net. There is no substitute for effective government remedies.

- AOL/Time Warner/EMI offers a toothless "open access" commitment that is unenforceable and doesn't even purport to assure equal commercial terms.

- AOL/Time Warner/EMI's open access commitment is limited to the pure broadband access sliver of its overall capacity and is not even applicable to its Interactive Television service.

- AOL/Time Warner/EMI has refused to offer Disney/ABC any non-discrimination assurances regarding its bottleneck cable distribution pipes.

- With regard to AOL TV's stand-alone set-top boxes (not its proprietary cable pipes), AOL/Time Warner/EMI offers only unenforceable promises not to force feed its own interactive content over competing video programming or discriminate in favor of its own interactive content.

- AOL purports interest in Instant Messaging interoperability, but has dragged its feet for over a year.

- ➢ The AOL/Time Warner/EMI merger is a major threat to the open nature of the Internet. The beauty of the Internet for consumers is its "end-to-end" network architecture that is incapable of discrimination. Once the consumer has purchased Internet access, they can interact with any content or site and can engage in commercial transactions without their access provider erecting artificial tollgates. An Earthlink customer can purchase a sweater from Land's End without Earthlink seeking a "commission" on the transaction. **AOL/Time Warner customers who have paid for cable service and broadband internet access should be able to interact with any broadband website or video channel without AOL/Time Warner seeking a percentage of any related transactions.**

- ➢ By contrast, the monolithic Broadband/Interactive/Enhanced Television network architecture being designed by AOL/Time Warner/EMI will provide enormous opportunity for the company to discriminate, thereby limiting consumer choice and thwarting competition.

<u>Conclusion</u>:

- ➢ The government **must** act now before the architecture of discrimination is set in stone. Specifically, the government should:

    - Require the separation of content and conduit, thereby providing a simple structural safeguard against discrimination;
    - At a minimum, AOL/Time Warner should be required to divest to third parties a one third interest in its content or bottle neck conduit assets to prevent anti-competitive transfer pricing;
    - At the barest of minimums the government should condition approval of the merger on **non-discriminatory open access**;
        - Simply stated, **all** of the technical parameters of the AOL/Time Warner cable platform should work the same for AOL/Time Warner and for unaffiliated content providers and ISPs;
        - The technical parameters subject to non-discriminatory open access should include, without limitation,
            - Quality of service (bit rate, error rate and latency)
            - Return path
            - Crossover link triggers
            - Caching
            - Processing, rendering and display with the same fidelity and range of formats
            - Navigation
            - Program Guides and remote controls
        - **AOL/Time Warner must connect its video platform to both its own ISP and other ISPs. This will enable consumers to interact with any video programming without regard to which ISP they select.**
        - AOL/Time Warner's cable platform, including set top hardware and software, headend facility and operating systems must adhere to open industry standards with no proprietary "extensions."

    - AOL/Time Warner communications applications must be fully interoperable with industry open standards.
- The Commission should impose a broad prohibition on discrimination by AOL/Time Warner against unaffiliated content on Interactive Television providers on the basis of price, terms or conditions for carriage where the effect of such discrimination is to unreasonably restrain the ability of such unaffiliated providers to compete fairly.
- The Commission should prohibit any AOL/Time Warner unreasonable refusal to deal with unaffiliated content or Interactive Television services providers.
- The Commission should prohibit AOL/Time Warner from demanding a financial interest in unaffiliated content or Interactive Television providers.
- The Commission should limit AOL/Time Warner's affiliated content on its system to no more than 40 percent of its broadband cable pipe's bandwidth capacity, both in total and by genre.
- The Commission should fashion a remedy to protect consumer privacy.
- Arbitration procedures should be used to enforce the safeguards necessary to prevent AOL/Time Warner from engaging in anti-competitive, discriminatory behavior in the Interactive Television market.

shall exist with respect to any such Upgraded System on a node-by node basis as and if such System becomes Upgraded.

(2) "Additional Content" means all content that is contained in the Signal that is transmitted to the public by the Station terrestrially without charge, is capable of being received by an antenna and exhibited on television sets via commercially-available equipment, and is related to and intended to attract and maintain viewership of the Station's programming. The term "Additional Content" is intended to include interactive content (including associated URL's) such as (i) "enhanced TV" content of the sort currently associated with programming such as *Monday Night Football, Who Wants to Be a Millionaire?* and the Academy Awards; (ii) additional content with respect to advertisers whose advertisements are carried as part of a program; and (iii) news, weather, traffic, sports and stock reports. For the avoidance of doubt, the following shall *not* constitute Additional Content: (A) paging services; (B) on demand services (other than those of a type mentioned above); (C) any content for which Station receives or seeks a fee from Operator, any System or any subscriber ("Subscription Services") and (D) electronic programming guide data such as Gemstar data (provided, however, that Operator shall be required to carry electronic program guide data related solely and exclusively to the Station's programming). Nothing contained herein shall obligate Operator to provide Broadcaster or any Station with access to any return path provided to subscribers by Operator for any purpose, including, without limitation, enabling subscribers to order goods and services; Operator shall not, however, interfere with or degrade the ability of a viewer to interact with the content contained in the Signal by means other than the return path provided to subscribers by Operator. Broadcaster and Operator shall discuss in good faith any Broadcaster proposal for Subscription Service.

(3) Operator will not, without Broadcaster's consent, insert or otherwise authorize the insertion into any broadcast stream any interactive television content, such as Advanced Television Enhancement Forum or Digital Video Broadcast, unless Broadcaster permits one or more other multi-channel video provider(s) to make such insertions, in which event Operator shall be authorized to do so in the same terms and conditional as the most favorable arrangement between Broadcaster and all such other multi-channel video providers. It is understood that the failure by Broadcaster, within 30 days after becoming aware thereof, to take action against another multi-channel video provider who is engaged, without authorization, in the insertions described in the preceding sentence shall be deemed to be de facto permission authorizing Operator to act in a substantially similar manner as the other multi-channel video provider.

(4) Notwithstanding anything to the contrary contained in this Agreement, all content inserted into the Signal by Broadcaster and all interactions by subscribers directly with the Signal other than through use of a return path provided by Operator shall, as between Operator and Broadcaster, be the sole property of Broadcaster.

BROADCAST COMMUNICATIONS
JUL 26 2000
JOHN DREYER

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Wednesday — July 26, 2000 | What the Industry Reads First | Volume 11 / No. 145

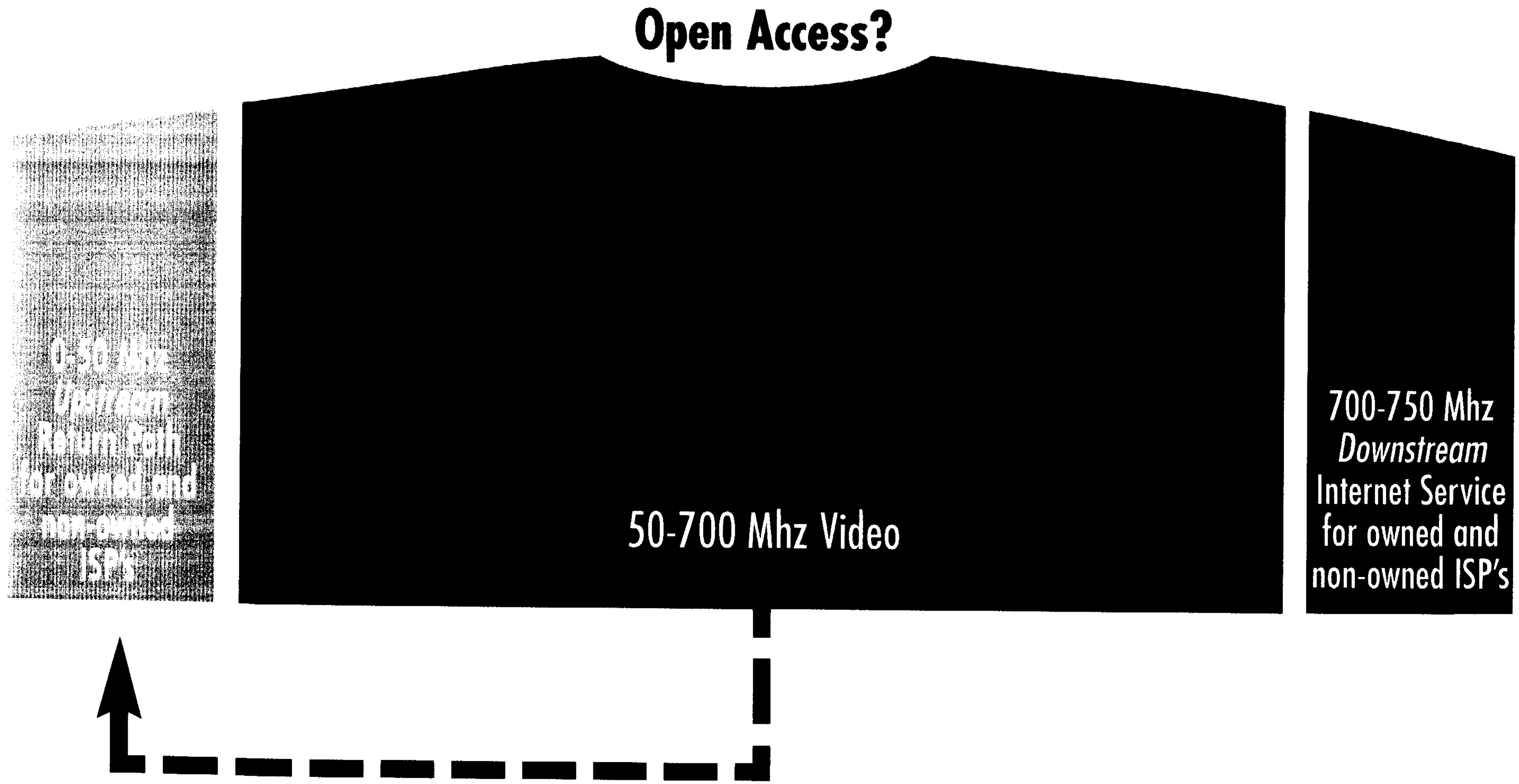
Reading List: What If Disney Does Not Get What It Wants From AOL-Time Warner?

The New Yorker's James Stewart offered his belated take on the **Time Warner Cable/ABC** dispute in the 7/31 issue, and once again, ya' gotta admire **Disney's** [DIS] aggressive PR, which revealed *Eisner's* shower times, *Iger's* workout locale and *Padden's* NYC hotel of choice (Four Seasons). Meanwhile, **Time Warner**, [TWX], faced with an assault on its **AOL** [AOL] merger, obviously wants the whole thing to go away. And herein lies the crux. Disney has room for error with its effort to assign common carrier regulation to its competition, while maintaining absolute control over its own platform. It has little before the powers-that-be. Time Warner, under intense regulatory and political scrutiny, though, has no such luxury, limiting its ability to defend itself publicly, and is left with the conservative option of apologizing and hoping the thing is forgotten. TNY's piece reflects that, with Time Warner offering little, and author Stewart lapping up everything he got from Disney. (Somehow, **Time Warner Cable** pulled ABC "off the air," even though it is ABC with the over-the-air spectrum, but we quibble.) Disney, and especially **Disney Cable**, needs to be very careful, however. While they all sit high now with conventional-wisdom proclamations of a Disney "victory" and a Time Warner "blunder," and other MSOs publicly distance themselves from Time Warner's hard-line stance, Disney better get all, or at least some, of what it is asking from DC. If it doesn't, there is certain to be retribution not only from Time Warner, but other MSOs as well. If Disney gets what it wants from AOL-TimeWarner -- basically the installation of common carrier regulations on all cable's platforms -- the rest of the industry won't be far behind. Disney's conditions on AOL-Time Warner, if granted, would have far-reaching implications on the entire cable industry's business paradigm. If they apply to the merger, why wouldn't they eventually apply to everyone else? Yet, Disney is taking a very dangerous risk. If it wins, it was worth it. But it better kill the king to secure the coup. If it loses, and AOL-Time Warner closes relatively unscathed, the balance of power will be demonstratively in the corner of Time Warner, and the cable industry, both of which should have a long memory of the tactics and methods Disney employed. Disney, and other over-the-airheads, already have lost the leverage of retrans (you think anyone will be able to pull a signal again? **FCC** said no, hence loss of over-the-airhead leverage). Without AOL-Time Warner to assault, what will they have? "Let's take a new look at the whole ABC/TWC dispute after AOL-Time Warner closes," a Time Warner exec suggests. What's left is a long memory of an increasingly sophisticated cable industry, tired of being a broadcaster and media stepchild. First place to start? Begin rattling cages and set the wheels in motion for "open access" to the broadcasters' digital spectrum. What's good for the goose is good for the gander..... — Meanwhile, **NBC** is jumping on the bandwagon, asking the **FCC** to impose "meaningful, enforceable commitments by AOL-Time Warner to provide non-discriminatory access" to both the AOL and Time Warner platforms. To show of good faith, NBC offered non-discriminatory access to its broadcast stations and cable networks by unaffiliated content providers. Just kidding....

On the Hill: Broadcasters had their knuckles whacked in a **House Telecom Subcomm** hearing that started with a stern

7-26
MKE
BF
SL
TST
PP
PMW
WW

Typical Upgraded 750 Mhz Cable System*



AOL/TW *Must* provide this connection to enable consumers to interact with non-owned video channels

* Source: "Broadband!, A Joint Industry Study by Sanford C. Bernstein & Co., Inc. and McKinsey and Company, Inc., January at pp.40 &42.

HOWREY SIMON ARNOLD & WHITE
HOWREY LLP
WHERE LEADERS GO™

MEMORANDUM OF
THE WALT DISNEY COMPANY
CONCERNING PROPOSED REMEDIES
IN CONNECTION WITH
AMERICA ONLINE, INC.'S
PROPOSED ACQUISITION OF
TIME WARNER INC.

September 5, 2000
Washington, D.C.

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I. REMEDIES

Disney has described in detail above the breadth of the market power of AOL and Time Warner and the propensity of both to use that market power in an anticompetitive fashion. We have also shown the threat posed by the acquisition to the development of a vibrant, competitive market in interactive television as the incentives and ability of the merged entity change toward development of a closed, monopolized system.

To avoid such an anticompetitive result the Federal Trade Commission should impose a structural remedy by requiring the separation of content and conduit or, in the alternative, impose meaningful and detailed conditions to ameliorate the anticompetitive impact of the acquisition by prohibiting discrimination by AOL/Time Warner against unaffiliated content providers. Following is a discussion of what conditions would be necessary to achieve that purpose.

A. If the Merger Is to Go Forward, AOL/Time Warner Should Be Required to Separate Its Ownership of Content From Its Ownership of Its Broadband Cable Distribution Facilities

The most efficient and effective way for the Commission to cure the anticompetitive problems of the AOL/Time Warner merger, short of blocking the transaction entirely, is simply to require the separate ownership of one of two main assets of the fused entity: the content or the conduit. The underlying principle of such a condition is this: if an entity is in a position to exercise monopoly or monopsony power in a market – in this case, gatekeeper control over the broadband pipe and ownership of much of the content that will flow through that pipe – then it is almost inevitable that the monopolist will favor its own content and disfavor unaffiliated content. This can occur in multiple ways, as we have seen from AOL and Time Warner's past practices. First, the monopolist could favor its own content by denying unaffiliated content providers access to its distribution network. Second, the monopolist could engage in discriminatory pricing schemes. Third, the monopolist could engage in technological discrimination to make what access it does provide to unaffiliated content providers woefully inferior to its own. In essence, the monopolist could make it extremely difficult, if not impossible, for unaffiliated content providers to access the broadband pipe on a commercially reasonable basis, or for the public to enjoy the same interactive television experience and technological capabilities with unaffiliated content and interactive services as it does with AOL/Time Warner's content and services. The result under any of these scenarios is the same: reduced output and *denial of meaningful choice to consumers.*

AOL/Time Warner's denial of access to unaffiliated content providers would deter the development of competing interactive content. This, in turn, would create barriers to entry to any firm that dares to compete with Time Warner's cable systems, such as a cable overbuilder. Such an overbuilder would not have the interactive content necessary to compete in the coming world of interactive television. The only certain way to avoid these outcomes is to compel the monopolist to choose between content or conduit, requiring separate ownership of the other set of assets.

Disney recognizes that this separation of ownership of content and broadband distribution facilities should be reserved for exceptional transactions. However, the proposed AOL/Time Warner merger is exactly such a transaction. This marriage of a monopoly cable television and content owner with the dominant OSP provider and monopolist in the instant messaging market will create a behemoth that will monopolize the interactive television market from its infancy. Such a combination may well be unprecedented. It is significant, though, that in the last half century, when confronted with combinations resembling this one, courts and agencies have required separation of content from conduit in order to preserve competition and consumer choice. Accordingly, there is ample precedent in law and regulation to require separate ownership of content and broadband conduit.

1. *Paramount Pictures*

In 1948, the Supreme Court found in the *Paramount Pictures* decision[1] that the major motion picture studios had unreasonably restrained competition in violation of the Sherman Act

1 United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948).

by entering into anticompetitive agreements with exhibitors by vertically integrating the production, distribution, and exhibition of motion pictures. The Supreme Court affirmed the District Court's conclusion that such agreements eliminated "competition *pro tanto* both in exhibition and in distribution of features since the parties would naturally direct the films to the theatres in whose earnings they were interested."[2]

As a result, in *Paramount Pictures* and in subsequent related cases, the motion picture studios were required to divest themselves of all the movie theaters they owned, and were prohibited from acquiring theatres in the future, except upon application to the Attorney General.[3] When permission was granted by a court to a movie studio to own and operate a theater, the studio was required to license its features solely on the merits, theater by theater, and without discrimination in favor of affiliated theaters.[4] Similarly, in this case, there is a clear and present danger that AOL/Time Warner would use its position of bottleneck control over the broadband distribution platform to favor its content to the detriment of unaffiliated content providers.

2. "Fin/Syn" rules

In the 1970s, the Federal Communications Commission implemented its financial interest and syndication rules ("Fin/Syn rules") that prohibited a broadcast network from syndicating programs produced by the network for rebroadcast by independent television stations, or purchasing syndication rights to programs that it obtained from outside producers, or otherwise

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2 *Paramount Pictures*, 334 U.S. at 149.

3 *Paramount Pictures,* 334 U.S. at 150-151 (affirming lower courts' decisions to enjoin future acquisitions); United States v. Loew's, Inc., 882 F.2d 29, 30 (1989) (consent judgments prohibited acquisition of theaters in the future except upon application to the Attorney General and a showing that such engagement shall not unreasonably restrain competition in the distribution or exhibition of motion pictures).

4 *Loew's, Inc.*, 882 F.2d at 31 (1989) (the Court granted a movie studio permission to own and operate a theater, however, it did so under the theory that the movie industry had evolved and changed dramatically).

obtaining a financial stake in such programs.[5] The concern behind the rules was that the networks, which, in the 1960's, controlled a large part of the system for distributing television programs to American households, would, unless restrained, use this control to seize a dominant position in the production of television programs, and in other words, "lever their distribution 'monopoly' into a production 'monopoly.'"[6] In sum, the Fin/Syn rules were crafted in an era of limited distribution mechanisms,[7] and were premised on the theory that when there is only a limited distribution system, there should be separate ownership of the content distributed over that system to ensure nondiscrimination.

While the rules were ultimately repealed once the overall structure of the television industry changed profoundly,[8] the very market condition that was the predicate for the creation of the Fin/Syn rules has reappeared in the interactive television marketplace. The broadband cable pipe is *the* principal distribution facility in the United States for the delivery of interactive television. Given the gatekeeper position that would be occupied by a merged AOL/Time Warner in distribution, separate ownership of either content or "bottleneck" conduit is required to assure consumer choice and competition in the interactive television services market.

3. Advantages of a separation of ownership condition

Requiring the complete separation of the bottleneck conduit from the content traveling over it unquestionably would be the most direct and sure means of preventing the irreparable harm to competition that otherwise is almost certain to result from the proposed AOL/Time

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5 Schurz Communications, Inc. v. FCC, 982 F.2d 1043, 1045 (7th Cir. 1992).

6 *Id.*

7 At that time there were only the three big networks – FOX, WB and UPN did not yet exist; there were few independent television stations; rather, most were affiliated with the networks; cable was in its embryonic stage; and direct broadcast satellite and the Internet were nonexistent.

8 *Schurz Communications*, 982 F.2d at 1046 (the television industry has changed in large part because of the expansion of cable television and videocassette recorders, the introduction of a fourth network, the Fox Broadcasting Corporation, the increase in independent stations, and the decrease of prime-time program producers).

Warner merger. It has the further advantage of avoiding the enforcement problems which inevitably attend non-structural, behavioral/conduct remedies.

4. If the Commission does not require complete separation of ownership of content and conduit, it should, at a minimum, compel AOL/Time Warner to divest a one-third interest in all of its content *or* bottleneck conduit and interactive television operating system assets to third parties

In the event that the Commission elects to impose anti-discrimination conditions rather than require separation of content and conduit, a nondiscrimination remedy concerning prices, terms and conditions standing alone is different to frame and enforce. AOL/Time Warner could evade the intent of the prohibition, and undermine the ability of unaffiliated interactive television providers to reach consumers cost-effectively, by manipulating transfer prices within a vertically integrated company.

To prevent discrimination under these circumstances, the Commission must assure that the transfer prices recorded in the accounting ledger have a real economic impact on the company as a whole. The only sure way to do this is to require AOL/Time Warner to divest a substantial minority interest in all content or conduit. For example, if AOL/Time Warner divested a one-third interest in its content subsidiary, one-third of any return path fee would be paid by independent interest holders. This would have real world consequences.

In addition to ordering a partial divestiture, the Commission should require AOL/Time Warner to collect and maintain information related to its licensing of interactive programming. The Commission should further require AOL/Time Warner to report this information on a quarterly basis to the board for the partially divested subsidiary. This board would have a fiduciary duty to maximize the return of the subsidiary, and hence, would have the incentive to assure that all interactive programming licenses are arm's length transactions. This proposed provision is adapted from the Commission's Time Warner/Turner consent order that required Time Warner to report certain competitive information to Time Warner Entertainment.[9]

B. The Commission Should Require Open Access, Including Clear and Enforceable Prohibitions on Discrimination Against Unaffiliated Interactive Television Content Providers and ISPs

In the event that the Commission does not require a complete separation of AOL and Time Warner's content and interactive services from ownership of its bottleneck conduit, it should require that AOL and Time Warner adhere to meaningful open access requirements and standards. Prior to the announced merger between AOL and Time Warner, AOL led a crusade for the better part of two years advocating a government mandated "open access" policy. AOL repeatedly asserted the need for ISPs to enjoy open and equal access to the "bottleneck" broadband pipelines leading into millions of American homes. As George Vradenburg of AOL stated:

> As we move to the broadband world, real and substantial threats are emerging to the competitive Internet access market that necessitate strong, immediate and unequivocal Congressional action to preserve competition and openness in the Internet marketplace across all facilities.[10]

Equally strong pronouncements from AOL propounding the virtues of "open access" came from AOL CEO Steve Case, who stated:

> Market-driven policies need only a few baseline principles from policymakers – minimal requirements needed to ensure consumer choice. One such principle is open access, which has proved its worth in making the Internet what it is today.[11]

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9 Federal Trade Commission Consent Agreement 62 F.R. 11202 (March 11, 1997) ("Time Warner/Turner Consent Decree").

10 Prepared Statement of George Vradenburg, Legislative Hearing on H.R. 1686, The Internet Freedom Act and H.R. 1685, The Internet growth and Development Act Before the House Judiciary Committee, 106th Cong. 1st (June 30, 1999) at 10.

11 Prepared Statement of Steve Case, Legislative Hearing on Internet Access and the Consumer Before the Senate Commerce Committee, 106th Cong. 1st Sess. at 24 (April 13, 1999).

After AOL and Time Warner announced their merger plans, however, they abruptly jettisoned their support for mandatory open access. AOL and Time Warner then took the remarkable position that the market, all by itself, would cure any possible problem concerning discriminatory treatment with respect to unaffiliated company access to broadband cable facilities or consumer access to unaffiliated services. Clearly, the market working alone will not address these issues, especially given the tremendous market power AOL/Time Warner will possess if the Commission approves the merger without conditions.

In tacit recognition of this fact, AOL/Time Warner created a Memorandum of Understanding acknowledging that unaffiliated ISPs need to have access to the AOL/Time Warner broadband platform so that consumers will have a choice of multiple ISPs. While the Memorandum of Understanding is significant because it admits the potential for discrimination, it is worthless as a remedy because it is too vague and legally unenforceable. As Chairman Hatch noted:

> [d]oubts concerning the resoluteness to, and vagueness of, this memo could be overcome should [AOL and Time Warner] agree to condition the approval of this merger, or the transfer of any licenses by the FCC, on AOL/Time Warner's compliance with the promises made therein and its yet to be articulated terms.

AOL/Time Warner certainly cannot, given its recognition of the importance of "open access," object to conditioning its merger on complying with a meaningful, unambiguous and easily enforceable non-discriminatory access commitment.

In the context of interactive television, such standards should include provision of open access to unaffiliated interactive television content providers as well as to ISPs, and strict adherence by AOL/Time Warner to industry open standards in all components of its interactive television architecture.

The most important aspect of such an open access remedy should be clear and enforceable conditions preventing discrimination to the detriment of consumers against

AOL/Time Warner's rivals. The open access concern was well stated by the *New York Times* in a May 5, 2000 editorial.

> The fundamental problem for the FCC is that cable companies like AT&T and Time Warner own not only the cable wire that runs into everyone's home, but also some of the programs delivered over that wire. That puts them in position to discriminate in favor of the information and commercial opportunities presented to cable subscribers. Monopoly is bad enough in the orange juice or suspenders markets. It is downright dangerous when it compromises the public's right to diversified sources of news and entertainment.
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> * * *
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> [F]ederal regulators, as they study the merger, should be guided by the same principle in regard to Internet access and digital television services: non-discrimination.

The New York Times correctly identified the problem. In the absence of a complete structural separation, an effective open access remedy must include an absolute and effective prohibition on AOL/Time Warner's use of their control over the technical parameters of the system to confer any advantage to their own channels, content or ISP. Such technical parameters must be defined broadly to include the cable headend facility, the cable plant and set top hardware and software. To achieve true open access, consumers must have access to the same technical features and be provided with the same quality of service, whether they are accessing AOL/Time Warner content or that of others and whether their Internet access is through an AOL/Time Warner ISP or a competitive ISP. True open access will require open standards and strict observance of the non-discriminatory architectural principles that have governed the Internet to date. As Professor Lawrence Lessig has put it, "The Internet is built on a principle called 'end-to-end' . . . the network is to be kept simple, incapable of discrimination."[12]

Specific elements of a meaningful and non-discriminatory open access remedy would include the following requirements for AOL/Time Warner's cable systems:

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12 Lawrence Lessig, *Architecting Innovation*, THE STANDARD, Nov. 14, 1999.

1. To ensure that all consumers enjoy the same ability to interact with any content on the cable system, both AOL/Time Warner's own ISP and any non-owned ISPs must be connected to the video portion of the cable bandwidth in a technologically equal manner;

2. Consumers should enjoy the same quality of service (bit rate, error rate and latency) on downstream and return path, whether the interactive television signals they receive come from AOL/Time Warner or an alternate provider. Data embedded in video, such as crossover link triggers, shall enable any content providers' interactive television applications to access appropriate web sites and data servers through alternate ISPs for downloading interactive content and uploading user inputs.

3. Once received by the consumer, all interactive content providers' data signals, shall be interpreted, cached, processed, rendered and displayed by AOL/Time Warner's set top hardware and software with the same fidelity and range of display formats (e.g. video surrounded by data) as those of AOL/Time Warner or AOL/Time Warner's partners.

4. AOL/Time Warner must give consumers the choice of alternative ISPs and shall provide those ISPs the same quality of service for both forward and return path communication as it does for its own ISP services. This includes providing alternative ISPs the ability to locally cache other content providers' content to the same degree that AOL/Time Warner can locally cache its own content.

5. Consumers should be provided with navigation to other content providers' interactive television applications and programming in as simple and straightforward a manner as for AOL/Time Warner's interactive television

applications. AOL/Time Warner shall not provide preferential placement or display of its own (or its partners') programming or services on browsers, interactive program guides, remote controls or other navigation vehicles.

6. AOL/Time Warner will not display its own programming content or services around other content providers' programming or interactive television applications, without consent of the content providers concerned.

7. AOL/Time Warner's cable interactive television infrastructure, including set-top hardware and software, shall faithfully adhere to open specifications, such as ATVEF, and shall introduce no proprietary extensions to these standards or other changes that have not been approved by governing industry organizations.

8. Communication applications associated with interactive television programming, including instant messaging, chat, e-mail, telephony and video conferencing, shall be fully interoperable with industry open standards such that consumers receiving unaffiliated content providers' interactive television programming and services over AOL/Time Warner's systems can communicate with other users as openly and freely as they can while using AOL/Time Warner interactive television applications.

9. Similar anti-discrimination provisions should apply where AOL/Time Warner delivers programming over the AOL TV platform in areas where AOL Time Warner does not control the distribution pipe to ensure that AOL TV customers are able to access unaffiliated content providers' interactive television services on the same basis as those of AOL/Time Warner.

10. To protect consumers' ability to access all interactive television products, AOL/Time Warner must be required to strictly adhere to industry open standards in all components of its AOL TV infrastructure.

The Commission has the benefit of a clear operating history in the narrowband world. In narrowband, customers contract for Internet access (from an ISP such as Earthlink), buy a device (such as a Compaq computer) and then are able to interact with any site of their choosing and engage in commercial transactions without either the access provider or the device manufacturer trying to "gatekeep" such interactions or commercial transactions. For example, the consumer can elect to buy a sweater from Land's End without Earthlink and Compaq demanding some piece of that commercial transaction.

The Commission must act now to make sure that this architectural model survives the transition to AOL/Time Warner cable broadband. Once the consumer has paid for cable broadband Internet access and has a set top box, AOL/Time Warner should not be permitted to use their control of the infrastructure to erect an artificial tollgate for the purpose of extracting a part of the consideration for each commercial transaction. The same consumer that can order a sweater without Earthlink demanding a commission from Land's End, should be able to effect the same transaction over cable broadband without AOL/Time Warner demanding a commission.

The non-discrimination open access provisions outlined above are premised on the assumption that the end-to-end architecture of narrowband survives the transition to AOL/Time Warner broadband. And, there is no reason why the interactive television subset of general interactivity should be treated any differently. There is nothing about television related interactivity that would provide any special justification for the broadband access provider to erect an artificial tollgate for the purpose of extracting a "commission" from commercial transactions. Once the consumer has paid for cable television service and broadband ISP service, that consumer should be free to interact with any content of his/her choosing without AOL/Time Warner trying to extract a financial percentage.

C. The Commission Should Impose Other Important Anti-Discrimination Provisions In A Consent Order

In addition to the anti-discrimination provisions necessary to make an open access standard effective, the Commission should require the following anti-discrimination conditions:

1. The Commission should impose a broad prohibition on discrimination by AOL/Time Warner against content on interactive television providers on the basis of price, terms or conditions for carriage where the effect of such discrimination is to unreasonably restrain the ability of such unaffiliated providers to compete fairly.

A similar provision was included in the Time Warner/Turner Consent Order at VII(c) and is clearly warranted here.

2. The Commission should prohibit any AOL/Time Warner unreasonable refusal to deal with unaffiliated content or interactive television services providers.

Perhaps the most basic form of discrimination by the owner of a bottleneck pipe simple is to refuse to deal. Any such unreasonable refusal to deal should be prohibited to the merged entity due to its monopoly power over the conduit for interactive television.

3. The Commission should prohibit AOL/Time Warner from demanding a financial interest in unaffiliated content or interactive television providers.

Without adequate safeguards, AOL/Time Warner will be tempted to extract financial interests from unaffiliated content and interactive television providers, and will use those interests as leverage to undermine the ability of such providers to compete against AOL/Time Warner's content and interactive television offerings. This anticompetitive behavior will have the effect of restricting output and the choices of consumers. The Commission should avoid this result by attaching a condition to the AOL/Time Warner merger modeled on the similar provision in the Time Warner/Turner Consent Order at VII(A).

4. The Commission should limit AOL/Time Warner's affiliated content on its system to no more than 40 percent of its broadband cable pipe's total bandwidth capacity, both in total and by Genre.

The Commission should ensure that the AOL/Time Warner merger will not reduce the American public's current access to a diverse selection of news, information and entertainment. With its sizable interests in the news media and its bottleneck control over the broadband pipe, there is an enormous potential for AOL/Time Warner to flood its total bandwidth capacity with its own or affiliated news, sports and other content, as well as interactive services.

This potential conduct has serious implications for competition as well as the First Amendment rights of viewers to have access to diverse sources of news and information. The importance of protecting the ability of the public to access diverse news sources was recognized in Section IX of the Time Warner/Turner Consent Order which required the carriage of at least one independent advertising supported news and information national video programming service with specified carriage penetration rates.

To preserve consumer access to a diverse selection of news, information and entertainment, the Commission should prohibit AOL/Time Warner from using more than forty percent of its broadband cable pipe's total bandwidth capacity for content or interactive television services it owns or that are affiliated with AOL/Time Warner, and should apply that forty percent limit by programming genre, including news, sports and entertainment programming.

D. The Commission Should Require Interoperability Among AOL/Time Warner Instant Messengers and Rival Instant Messengers

AOL has an overwhelmingly dominant share of the instant messaging market. Instant messengers will be a central feature of interactive television, as "buddies" will be able to exchange views in real time about any program they are viewing. AOL's monopoly position gives it an enormous advantage in the interactive television world over competing interactive systems without the network of instant messenger users. AOL has already excluded rivals from AOL's 150 million registrants, deliberately sabotaging any rival's attempt at interoperability. In the absence of a Commission order, AOL is likely to be just as exclusionary in the way it operates its set top box, denying interoperability to viewers of competing interactive television operating systems. This would give AOL/Time Warner the whip hand to foist a closed system on content providers and viewers alike. The obvious remedy is a requirement that AOL/Time Warner facilitate interoperability so that users of rival interactive television systems could communicate with users of AOL instant messengers.

E. The Commission Should Fashion a Remedy To Protect Consumer Privacy.

As a result of the data gathering capability of the new interactive television technologies, AOL/Time Warner will be in a position to gather data regarding transactions entered into by users of its systems, even when such data is gathered as a result of transactions with unaffiliated content providers and ISPs. The gathering and use of such data by AOL/Time Warner should be prohibited.

F. Arbitration Procedures Should Be Used To Enforce The Safeguards Necessary To Prevent AOL/Time Warner From Engaging In Anticompetitive, Discriminatory Behavior In The Interactive Television Market.

So that the Commission does not find itself embroiled in every dispute concerning discrimination in the interactive television market, the Commission should utilize arbitration to enforce anti-discrimination conditions imposed on the AOL/Time Warner merger. The Commission should establish a private right of action allowing complainants to arbitrate disputes arising from the conditions attached to any approval of the AOL/Time Warner acquisition.