Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:	)	
	)	
General Motors Corporation, Hughes	)	
Electronics Corporation, And The	)	
News Corporation Limited	)	MB Docket No. 03-124
Application To Transfer Control Of FCC	)	
Authorizations And Licenses Held By	)	
Hughes Electronics Corporation	)	
To The News Corporation Limited	)	

COMMENTS OF ADVANCE/NEWHOUSE COMMUNICATIONS, CABLE ONE, COX COMMUNICATIONS, AND INSIGHT COMMUNICATIONS

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EXECUTIVE SUMMARY

News Corp.'s proposed acquisition of DirecTV will amass an unprecedented combination of video programming content and distribution assets under a single corporate banner.

The Commission has never before evaluated under the public interest standard the magnitude of vertical market issues presented by this transaction. Never before has a single company been armed with a national distribution platform, a national broadcast network, local TV stations in virtually every major media market, the governmentally-created retransmission consent power, and the "battering ram" of sports programming.

Wielding this singularly potent array of content and distribution assets, News Corp. will have the ability and incentive to raise programming costs to consumers and damage competition in video programming distribution markets nationwide. News Corp.'s ability and incentive to raise prices will be particularly elevated in markets where it is dealing with smaller and medium-sized cable companies. The public interest benefits touted by the parties are insubstantial, especially in light of these likely harms.

By preemptively offering to abide by conditions that parallel the Commission's program access rules, News Corp. acknowledges the seriousness of at least some vertical issues at stake here. But these conditions do not even cover News Corp.'s broadcast stations, and they fail to address the most substantial potential harm associated with this transaction – the risk of higher programming costs and, thereby, higher consumer prices. The promise of "audit committee" review by Hughes independent directors of News Corp. contracts – when and how they choose – is a distraction, not a real safeguard.

News Corp. will use DirecTV to support demands for higher prices and mandatory carriage of Fox programming in local cable markets. If a cable operator refuses to accede to these demands in a particular local market, News Corp. can still be assured of reaching viewers in market via DirecTV, whose national reach provides News Corp. with a guaranteed outlet for Fox programming in all local markets. Further, any temporary costs associated with the loss of cable license fees and cable viewers for a particular Fox service in the operator's market, can be offset through additional monthly DirecTV subscriptions (which, on a per-subscriber basis, will be much higher than the programming license fees) gained from subscribers that disconnect their cable service in order to retain access to Fox programming. A similar dynamic will be at issue with respect to News Corp.'s regional sports networks.

The novel issues and unique harms associated with this transaction warrant close and thorough examination by the Commission. Absent targeted conditions that address the unique characteristics of this transaction, the proposed acquisition of DirecTV by News Corp. will lead to higher programming costs and higher cable television and satellite rates – a result that contravenes both competitive principles and the policy objectives of Congress and the Commission.

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The above captioned parties (the "Joint Cable Commenters"), by their attorneys, hereby submit these comments pursuant to the Commission's Public Notice in this matter. The Joint Cable Commenters are interested in this transaction as purchasers of video programming for distribution over cable systems nationwide.[1]

Advance/Newhouse, pursuant to its partnership with Time Warner Cable, manages cable systems serving 2.1 million subscribers in Florida, Alabama, Indiana, California, and Michigan.

[1] In addition to their cable interests, the Advance/Newhouse partners' other interests include Condé Nast Publications and a number of daily and weekly newspapers. The majority shareholder in Cox Communications (CCI-NYSE) is Cox Enterprises, Inc., which also holds a majority interest in Cox Radio (CXR-NYSE) and privately owns newspapers, television stations, Internet sites, and automobile auctions. Cable One is owned by the Washington Post Company, which is a diversified media and education company whose other principal operations include newspaper and magazine publishing, television broadcasting, electronic information services, test preparation, and educational and career services. Insight Communications delivers bundled interactive services to customers in mid-sized communities of the four contiguous states of Illinois, Kentucky, Indiana, and Ohio, delivering digital video and high-speed data access, as well as telephone services in selected markets.

Cable One provides basic cable service to approximately 718,000 subscribers. The company's cable systems are located in 19 Midwestern, Southern, and Western states and typically serve smaller communities. The largest cluster of systems (serving approximately 89,000 customers) is located on the Gulf Coast of Mississippi.

Cox Communications has approximately 6.5 million cable customers nationwide. Their 12 largest clusters are in Louisiana, Nevada, Arizona, California, New England, Virginia; Texas, Oklahoma, and Kansas.

Insight Communications serves approximately 1.4 million cable customers, all of which are concentrated in the four contiguous states of Indiana, Kentucky, Illinois, and Ohio. Insight also manages additional systems in Indiana and Kentucky that are owned by an affiliate of Comcast Cable.

INTRODUCTION AND OVERVIEW

News Corporation's ("News Corp.'s") proposed acquisition of DirecTV would amass an unprecedented combination of video programming content and distribution assets under a single corporate banner. This singularly potent array of content and distribution assets could be wielded to provide News Corp. with unprecedented power to impose programming cost increases on all providers of multichannel video programming, both cable and satellite.

The scale and scope of the vertical market issues presented by this transaction have not previously been evaluated under the public interest standard by the Commission. Never before has a single company been armed with a national distribution platform that reaches every local multichannel service market in the country, a national broadcast network, local TV stations in virtually every major media market, the crowbar of retransmission consent to leverage on behalf of existing and new cable programming services, and what Rupert Murdoch himself has described as the "battering ram" of sports programming. The combined entity also will have at its disposal, through News Corp.'s control of Gemstar/TV Guide, the industry's leading electronic programming guide, which functions as an operating system that controls the look and feel of cable operators' content offerings.

News Corp., without prompting, acknowledges the seriousness of at least some vertical issues at stake here by preemptively offering to abide by conditions that parallel the Commission's program access and program carriage rules. Such conditions, however, fail to address the most substantial potential harm associated with this transaction – the risk of higher programming costs and thereby higher consumer prices.

The overriding purpose of the Joint Cable Commenters' participation in this proceeding is to forestall such undue programming price increases. The Joint Cable Commenters are not involved in this proceeding to inhibit competition – each already faces vigorous competition from DirecTV and EchoStar that will continue regardless of whether or not the application is approved. Nor are the Joint Cable Commenters unalterably opposed to the transaction itself which, if properly conditioned, could operate without harm to consumer welfare.

The Joint Cable Commenters, however, recognize clearly that the unique combination of assets involved in this transaction will provide News Corp. with sufficient marketplace clout to impose higher prices for its programming content, leading to higher consumer prices not generated by consumer preferences. The economic analysis from the Commission's former Chief Economist William Rogerson attached to these comments ("Exhibit A") confirms this view. As Professor Rogerson concludes:

> News Corp.'s increased incentive and ability to raise prices will cause two important harms to consumers. In the short run, price increases to MVPDs will harm consumers because they will be passed through in the form of higher subscription prices. In the long run, price increases to MVPDs will harm competition at the MVPD level – especially in less dense regions of the country where the business case for multiple MVPDs is more tenuous – as DirecTV's rivals will be driven out of business or fundamentally weakened. In those markets, DirecTV will eventually be able to increase prices even more . . . . Therefore the Commission should be aware that there is potentially an extra cause for concern with this vertical relationship than with many other vertical relationships it has considered before.[2]

Analyst views as to how DirecTV could enhance News Corp.'s pricing power and bargaining leverage parallel the economic conclusions reached by Professor Rogerson: "'My sense is that the major purpose for News Corporation controlling DirecTV is to use it as a tactical weapon against the cable companies to get them to pay up for its proprietary programming,' said Robert Kaimowitz, chief executive of the investment fund Bull Path Management."[3] An SG Cowen analyst believes it "likely that News Corp. also would exercise its leverage as a content provider and make money in all markets by raising programming costs for everyone."[4]

News Corp. will use its new "weapon" as tactical support when demanding higher prices for, and broader carriage of, its Fox programming in local cable markets. If a cable operator refuses to accede to these demands in a particular local market, News

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[2] William P. Rogerson, *An Economic Analysis of the Competitive Effects of the Takeover of DirecTV by News Corp.*, attached hereto as Exhibit A, at 4, 27 ("Rogerson").

[3] *See, e.g.*, David Kirkpatrick, *By Acquiring DirecTV, Murdoch Gets Upper Hand*, N.Y. Times, April 10, 2003.

[4] *Hartenstein Sure News Corp. Deal Will Be Approved By Year's End*, Communications Daily, May 21, 2003, at 7.

Corp. can still be assured of reaching viewers in market via DirecTV, whose national reach provides News Corp. with a guaranteed outlet for Fox programming in all local markets. Further, any temporary costs associated with the loss of cable license fees and cable viewers for a particular Fox service in the operator's market, can be offset through additional monthly DirecTV subscriptions (which, on a per-subscriber basis, will be much higher than the programming license fees) gained from subscribers that disconnect their cable service in order to retain access to Fox programming. As one trade publication has observed: "DirecTV benefits every time a programmer and an MSO can't come to terms."[5]

News Corp. already wields considerable power in negotiations with cable operators over carriage of Fox broadcast stations. In return for providing retransmission consent to cable operators seeking to carry its local broadcast stations (which are located in 80 percent of the top 20 television markets in the country and feature Major League Baseball and NFL Football), Fox seeks either cash compensation or compensation by carriage of affiliated cable networks. This forces cable operators to choose between raising basic tier cable rates to carry broadcast stations, or devoting scarce channel capacity to Fox cable program networks they might not otherwise carry, in order to ensure that they have access to the MLB, NFL, and other programming featured on Fox broadcast stations.

With DirecTV, News Corp. can place itself into a "heads I win, tails you lose" bargaining position with cable operators, who will be compelled to choose between paying higher prices and carrying new Fox channels in order to retain access to existing

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[5] Staci D. Kramer, *Sports Programming: It's Spring and Hope Again Springs Eternal*, Cable World, March 17, 2003, at 11.

Fox broadcast content, or ceding that content to their most powerful competitor – DirecTV. No other local broadcast station owner has ever wielded such leverage in retransmission consent negotiations. DirecTV provides News Corp. with the economic ability to convert the retransmission consent process from the original vision of a local marketplace negotiation that protects the system of local broadcasting, into a scheme that raises prices to consumers and gives News Corp. a greater proportion of programming that reaches consumers, not because of consumer preference, but because of market clout. This problem will be particularly acute in the numerous markets where Fox has local broadcast duopolies.

A similar dynamic undoubtedly will arise in connection with carriage negotiations for Fox's regional sports networks ("RSNs") and other sports programming. Sports programming costs have been a principal driver of cable programming price increases, and News Corp. is a dominant provider of sports content. Not only does the Fox broadcasting network control the rights to NFL, MLB, and NASCAR racing, but DirecTV will provide it with the exclusive rights to the NFL Sunday Ticket package of out-of-market football games. Fox also is the largest regional sports programmer in the nation, with RSNs that control the television rights to games played by more than 75 percent of the 80 professional baseball, basketball, and hockey teams in the United States.

Rupert Murdoch has famously described News Corp.'s sports programming as "a battering ram" for its content offerings and pay-television services. Adding DirecTV to News Corp.'s arsenal only strengthens the force of that "battering ram." Fox can now threaten to migrate regional and national sports content to cable's biggest competitor, unless cable operators acquiesce to new price hikes, tiering restrictions, and additional carriage demands. The result will be (i) a proliferation of YES-like carriage disputes in which sports services are withheld from cable subscribers while programmers and cable operators battle over the price and terms at which sports programming is carried in a particular market or (ii) higher prices for sports content or both (i) and (ii). None of these outcomes promote consumer welfare.

News Corp.'s proposed commitments attached to its Application will not remedy the risk of increased programming costs that arises from this transaction. At most, those commitments attempt to address harms arising from the use of video content and distribution assets as tools of exclusion – *i.e.*, excluding competing distributors from content assets, and excluding unaffiliated content providers from the distribution platform. However, they are of little use here if the overriding purpose of the transaction is to "take DirecTV and use it as a battering ram against cable operators."[6] And the promise to submit certain transactions between News Corp. and DirecTV for review by independent directors is a makeweight of little meaning.

Thus, unless DirecTV somehow can resist higher prices or demands for carriage additional services on popular tiers sought by its corporate parent for Fox broadcast and cable channels – a highly unlikely prospect[7] – then a mere guarantee of non-discrimination against competing distributors will be insufficient to prevent this transaction from fueling higher programming costs and putting upward pressure on cable rates. The most likely scenario is that – regardless of any oversight provided by a board

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[6] *See* Amy C. Cosper, *The Curious*, Satellite Broadband, September 1, 2001, at 22 (quoting Michael Goodman, Yankee Group Senior Analyst).

[7] *See* Kirkpatrick, *supra* note 3 (quoting Sanford Bernstein analyst view that Mr. Murdoch "can say 'You do this – it may be to the detriment of one piece of News Corp. but you do it because it is a greater good for the other piece of News Corp.'").

audit committee[8] – DirecTV will absorb higher prices and broader conditions for carriage of Fox cable and broadcast programming. Those higher prices and added conditions absorbed by DirecTV likely will serve as the benchmark floor price for purposes of negotiations with virtually all other cable operators in the country.

Of course, those cable operators are likely to pay more than the DirecTV price, even with the non-discrimination guarantee. News Corp.'s proposed conditions will still permit differential pricing and volume price discounts,[9] and DirecTV is one of the three largest MVPDs in the country and at least five times larger than even a medium-sized, two million subscriber cable MSO. The non-discrimination guarantee places little constraint on the prices charged smaller cable systems, often found in rural areas.

Lurking beneath the surface appeal of this transaction, owing to the absence of the blatant horizontal harms associated with the EchoStar/DirecTV merger, lies a set of sharp vertical shoals that could damage consumer welfare and competition. The novel issues and unique harms associated with this transaction warrant close and thorough examination by the Commission. Absent targeted conditions that address the unique characteristics of this transaction, the proposed acquisition of DirecTV by News Corp. will lead to higher programming costs and higher cable television and satellite rates – a result that contravenes both competitive principles and the policy objectives of Congress and the Commission.

[8] In the analysis set forth in Exhibit B, Professor Lynn Stout of the University of California-Los Angeles School of Law, a corporate law expert, concludes that the internal audit committee proffered by News Corp. is unlikely to be effective in restraining price hikes to DirecTV for Fox programming.

[9] *See* Application at n.92 ("The Commission's program access rules and the precedent developed thereunder delineate those non-discriminatory ways in which a [programmer] may nonetheless differentiate between MVPDs (*e.g.*, based on size of subscriber base, creditworthiness, or technical quality")). *See also* 47 C.F.R. §§ 76.1002(b)(1)-(3).

STANDARD OF REVIEW

Sections 214(a) and 310(d) of the Communications Act[10] require the Commission to weigh the potential "harms to competition"[11] of a transaction against the unique[12] public interest benefits that the transaction will create.[13] The Commission cannot simply rely upon the Applicants' bald assertions that the transaction will result in unspecified and exaggerated efficiency gains. Rather, the burden is on the Applicants to prove by a preponderance of the evidence that the probable benefits of the transaction outweigh the

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[10] 47 U.S.C. §§ 214(a), 310(d).

[11] Among these harms are the enhancement of market power or slowing the decline of market power. *Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, 12 FCC Rcd 19985, 19987 ¶ 2 (1997) ("*Bell Atlantic/NYNEX*").

[12] Assuming that they are not overly speculative or for some other reason unworthy of consideration, alleged public interest benefits will be considered by the Commission only if they are "likely to be accomplished as a result of the merger but unlikely to be realized by other means that entail fewer anticompetitive effects." *See, e.g., In the Matter of EchoStar Communications Corporation, General Motors Communications, and Hughes Electronics Corporation, Transferors, and EchoStar Communications Corporation, Transferee, Hearing Designation Order*, 17 FCC Rcd 20559, 20630 ¶ 189 (2002) ("*Hearing Designation Order*") (citing *Bell Atlantic/NYNEX*, 12 FCC Rcd at 20063 ¶ 158).

[13] *See* Hearing Designation Order, 17 FCC Rcd at 20574 ¶ 25; *see also, e.g.*, Applications of VoiceStream Wireless Corp., Powertel, Inc., and Deutsche Telekom AG, 16 FCC Rcd 9779, 9789 ¶ 17 (2001). The three "main concerns" underlying the Commission's analysis are whether the transaction would (1) violate the Commission's Act; (2) create market power or other anticompetitive effects; and (3) affect diversity in the market. Concurring Statement of Commissioner Michael Powell, *In the Matter of the Applications of Shareholders of AMFM, Inc. (Transferor) and Clear Channel Communications, Inc. (Transferee); For Consent to the Transfer of Control of AMFM Texas Licenses Limited Partnership, AMFM Radio Licenses, LLC, Capstar Texas Limited Partnership, WAXQ License Corp., WLTW License Corp., Cleveland Radio Licenses, LLC, and KLOL License Limited Partnership. Licensees of WTKE (FM), Andalusia, AL, et. al., Memorandum Opinion and Order*, 15 FCC Rcd 16062, 16113 (2000).

potential harms.[14] "If applicants cannot carry this burden, the application must be denied."[15]

The precedent-setting transaction at issue here represents the first time the Commission has ever reviewed the combination of a national broadcast network with a national multichannel video-programming provider. No other broadcaster has ever controlled a competing distribution platform. That DirecTV is the second-largest multichannel video programming provider in the country – and only one of two with national scope – raises even more substantial and complex issues. This is not a transaction in which it would suffice for the Commission merely to ensure compliance with its various structural ownership rules. Congress has not spoken to the particular form of integration at issue. Moreover, the unique combination of assets at issue portends significant changes to the competitive dynamic in local markets nationwide. The parties themselves appreciate this, as they recognize the importance of review under the "public interest" standard.[16] Accordingly, the Commission must ensure consumers will be well served once the transaction has closed.

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[14] *See Hearing Designation Order,* 17 FCC Rcd at 20574 ¶ 25.*; see also Applications For Consent to the Transfer of Control of Licenses and Section 214 Authorizations From Media One Group, Inc., Transferor, to AT&T Corp., Transferee,* 15 FCC Rcd 9816, 9820 ¶ 8 (2000).

[15] *Bell Atlantic/NYNEX*, 12 FCC Rcd at 19987 ¶ 2.

[16] *See* Application at 14-15 and cases cited therein (*citing Comcast Corporation, AT&T Corp., and AT&T Comcast Corporation*, 17 FCC Rcd 23246 (2002); *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America Online, Inc., Transferors, to AOL Time Warner Inc., Transferee,* 16 FCC Rcd 6547 (2001); and 47 U.S.C. § 310(d)).

Importantly, the Commission's review under the "public interest" standard includes inquiry into the potential anticompetitive effects of vertical relationships.[17] Concerns such as these have been the subject of combinations involving program providers and program distributors in the past.[18] From the perspective of consumer welfare, vertical integration can enable anticompetitive behavior when the integrated firm has market power at one or more of the levels of integration.

Of course, the Commission's task in reviewing license transfer applications incorporates issues of competitive concern but extends beyond a mere antitrust analysis.[19] In addition to traditional antitrust concerns, the Commission must consider the transaction's effect on the broader public interest, including its effect on the number and

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[17] *Bell Atlantic/NYNEX*, 12 FCC Rcd at 20009 ¶ 37 (citing *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal and Vertical Ownership Limits, MM Docket No. 92-264, Second Report and Order*, 8 FCC Rcd 8565 (1993) and Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 Antitrust L.J. 513 (1995)).

[18] *See, e.g., In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America Online, Inc., Transferors, to AOL Time Warner Inc., Transferee*, 16 FCC Rcd 6547, 6552 ¶ 13 (2001) ("*AOL/TW Order*"). *See also* Decision and Order, *In the Matter of Time Warner Inc., a Corporation; Turner Broadcasting System, Inc., a Corporation*, 123 F.T.C. 171 at Section V (February 3, 1997) ("*Time Warner/Turner*") (prohibiting Time Warner from "bundling" the most popular Time Warner networks with the most popular Turner networks, and vice versa, in order to forestall the leveraging of "marquee" networks into negotiations over less attractive programming). The current situation raises even more compelling issues, as News Corp. will have the incentive and ability to raise the cost of its retransmission consent rights and engage in other strategies to raise its rivals' costs. Restricting output in this manner is "the hallmark of monopolistic behavior." Statement of Commissioner Michael Powell, *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, Fifth Annual Report, 13 FCC Rcd 24284 (1998).

[19] *See Hearing Designation Order*, 17 FCC Rcd at 20575 ¶ 27 (citing *Satellite Business Systems*, 62 F.C.C.2d 997 (1977) *aff'd sub nom United States v. FCC*, 652 F.2d 72 (D.C. Cir. 1980) (*en banc*) and *Northern Utilities Service Co. v. FERC*, 993 F.2d 937, 947-48 (1st Cir. 1993)).

diversity of voices in the media, preservation of localism, and the quality of communications.[20]

Not surprisingly, the Applicants have presented a laundry list of the "efficiencies" that will be created by their proposed transaction. It is the Commission's task to inquire into the merits of these claims. In balancing asserted public interest benefits against the potential harms of a transaction, the Commission considers only those proposed benefits that are both merger specific and verifiable.[21] Efficiencies that could be achieved via more competitively neutral means or that will occur regardless of the transaction cannot be considered pro-competitive benefits of the merger.[22] Likewise, benefits that are merely speculative or that are predicted to occur in the distant future will be discounted or dismissed from consideration.[23] The weight of verifiable benefits will be considered only net of the costs of achieving them.[24]

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[20] *See Hearing Designation Order,* 17 FCC Rcd at 20575 ¶ 26.

[21] *Hearing Designation Order,* 17 FCC Rcd at 20630 ¶¶ 189-90 (citing *Bell Atlantic/NYNEX*, 12 FCC Rcd at 20063 ¶ 157 and *United States Department of Justice/Federal Trade Commission Horizontal Merger Guidelines* § 4 ("*Horizontal Merger Guidelines*")); *see also Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Section 214 and 310(d) of the Communications Act of Parts 5, 22, 24, 25, 63, 90, 95 and 101,* 14 FCC Rcd 14712, 14825 ¶ 255 (1999) ("*SBC/Ameritech Order*").

[22] *Hearing Designation Order,* 17 FCC Rcd at 20630 ¶¶ 189-90.

[23] *See id.* at 20630 ¶ 190; *see also Bell Atlantic/NYNEX,* 12 FCC Rcd at 20063.

[24] *Hearing Designation Order,* 17 FCC Rcd at 20630 ¶ 190 (citing *Horizontal Merger Guidelines* at § 4 ("cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.")).

ARGUMENT

I. THIS PRECEDENT SETTING COMBINATION OF BROADCAST AND SATELLITE ASSETS IS LIKELY TO HARM CONSUMERS AND DAMAGE COMPETITION IF NOT CAREFULLY SCRUTINIZED BY THE COMMISSION

The proposed vertical combination of News Corp. and DirecTV presents a new set of potential consumer harms and communications policy issues. News Corp. is not just a media company. It owns one of just four national broadcast television networks. It owns more television stations in local markets than anyone else, including numerous duopolies in major markets and perhaps soon "triopolies" and even more stations. And DirecTV is not just another multichannel video programming distributor ("MVPD"). It is the country's second largest MVPD. It is one of only two existing national direct broadcast satellite ("DBS") licensees. Bringing these assets together under unified command will harm consumers and damage competition in local markets for the distribution of video programming across the country.

Here, News Corp.'s incentive is reinforced, and its ability is enhanced, by the weapons at its disposal – a government-created retransmission consent right and a dominant array of sports programming, both supersized by the possession of an alternative distribution platform.

As Professor Rogerson puts it:

> I believe that there are two distinct but related economic reasons to expect that the merged entity will raise the prices that it charges for programming to MVPDs that are rivals of DirecTV. First, I believe that News Corp. will have an increased *incentive* to raise prices because raising the prices it charges to rival MVPDs will increase the profits of DirecTV . . . . It is an issue that the Commission has considered and addressed many times before and provides the underlying rationale for "program access" rules that prohibit programmers who are vertically integrated with cable MSOs from discriminating against rival MVPDs. Second, I believe that News. Corp will have an increased *ability* to raise prices to rival MVPDs because

> its bargaining power will be increased. News Corp.'s "bargaining power" is based on its ability, when negotiating with an MPVD, to credibly threaten to withhold programming from the MVPD. This threat will be less costly to News Corp. (and, therefore, more credible) after the merger because the cost of lost subscription and advertising revenues from withholding programming will be to some extent offset by the increased profits that DirecTV will earn when a rival MVPD is denied this programming.[25]

In addition, the merger will increase News Corp.'s incentive to raise programming prices to rival MVPDs in order to disadvantage them. Again, as Professor Rogerson indicates, a vertically integrated supplier generally has an incentive to raise rivals' costs:

> The idea is that a vertically integrated firm cares about maximizing the joint profits of its upstream and downstream division and that it can generally increase the profits of its downstream division by raising input prices to its rivals. Therefore, there is an extra benefit to raising price and a vertically integrated firm would rationally respond to this extra benefit by raising price higher than it otherwise would. To put this another way, the price that News Corp would charge rival MVPDs to maximize the joint profits of News Corp and DirecTV is larger than the price that News Corp. would charge to maximize the profits of News Corp. alone. It follows that, after the merger, News Corp. will want to charge a higher price to rival MVPDs for its programming.[26]

The precedent setting combination of assets in this merger give News Corp. the incentive and ability to raise prices, which will harm consumers and competition. For these reasons, the transaction merits close scrutiny by the Commission.

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[25] Rogerson at 2-3 (citations omitted).

[26] Rogerson at 22. Of course, to the extent that customers of the MVPD discontinue their service because of the price increases, News Corp. will lose both subscription revenue (since the MVPD pays News Corp. on a per subscriber basis) and advertising revenue (since News Corp. will be unable to sell its advertising as much if the subscribership to its programming falls.) After the merger, however, this cost of raising prices will be offset by a new benefit. Namely, it is likely that some of the consumers that leave the MVPD when it passes through price increases will switch to DirecTV and, as the owner of DirecTV, News Corp. will now earn positive profits on each of these consumers.

II. RETRANSMISSION CONSENT + DIRECTV = POWER TO RAISE PRICES

News Corp. already uses retransmission consent rights for its owned and operated ("O&O") broadcast stations to extract compensation from cable operators and other MVPDs. In many cases, such compensation takes the form of commitments to carry additional News Corp. programming. Control of DirecTV will allow News Corp. to raise the price of retransmission consent above competitive levels so as to dampen – and potentially eliminate – competition from DirecTV's weaker rivals.

A. Retransmission Consent Magnifies the Power of News Corp.'s Broadcast Network and Local Station Interests

News Corp. owns thirty-five broadcast stations, including two stations in three of the top five and five of the top ten markets.[27]

FOX OWNED AND OPERATED TELEVISION STATIONS

***DUOPOLIES IN BOLD**

DMA	Rank	O&O
New York	**1**	**WNYW, WWOR**
Los Angeles	**2**	**KTTV, KCOP**
Chicago	**3**	**WFLD, WPWR**
Philadelphia	4	WTXF
Boston-Manchester	6	WFXT
Dallas-Fort Worth	**7**	**KDFI, KDFW**
Washington, D.C.	**8**	**WTTG, WDCA**
Atlanta	9	WAGA

[27] Fox also owns numerous other cable programming assets, including Fox News Channel, Speedvision, FX, Fox Movie Channel, and the National Geographic Channel. And News Corp. controls the widest array of regional and national sports programming channels anywhere as well as valuable program production assets. *See infra.*

DMA	Rank	O&O
Detroit	10	WJBK
Houston	**11**	**KRIV, KTXH**
Tampa-St. Pete-Sarasota	13	WTVT
Minneapolis-St. Paul	**14**	**WFTC, KMSP**
Cleveland-Akron	15	WJW
Phoenix	**16**	**KSAZ, KUTP**
Denver	18	KDVR
Orlando-Daytona Beach	**20**	**WOFL, WRBW**
St. Louis	22	KTVI
Baltimore	24	WUTB
Milwaukee	31	WITI
Kansas City	33	WDAF
Salt Lake City	36	KSTU
Birmingham	40	WBRC
Memphis	43	WHBQ
Greensboro- H. Point-Winston Salem	46	WGHP
Austin	54	KTBC
Gainesville	162	WOGX

[28]

These stations carry UPN and Fox network programming, which includes the World Series and other Major League Baseball post-season games, the 16 National

[28] Source: Fox Entertainment Group, Inc., Form 10-K for the fiscal year ending June 30, 2002; Fox Television Stations, Inc., available at http://www.newscorp.com/operations/tvstations.html.

Football Conference ("NFC") teams in the National Football League ("NFL"), and shows like "The Simpsons," "24," and "American Idol."[29]

As the Commission is aware, the Communications Act prohibits cable operators and other MVPDs from retransmitting commercial television stations without first obtaining the licensee's permission (or "consent").[30] To be sure, this system was designed for an era when local broadcast station ownership was decidedly less concentrated, duopolies were prohibited, and broadcast licensees were prohibited from

[29] News Corp. makes clear the value of its broadcast programming. On its website, Fox trumpets its broadcast lineup's "exceptional ratings growth" and claims the "[h]ighest rated new series in key demographics" (Joe Millionaire) and the "[h]ighest rated series among all key demos including Adults 18-49" that "[e]asily wins time slot among all demos" of which it is able "to produce a new version each year – not a one-hit wonder" (American Idol). www.newscorp.com/investor/download/bearstearns03/sld019.gif.

[30] 47 U.S.C. § 325(b)(1).

owning a cable system in their local markets.[31] Most popular stations today choose retransmission consent over must carry. In this manner, the stations bargain with cable operators and other MVPDs for compensation in exchange for the right to retransmit their broadcast signal. Although the bargaining may take place across many dimensions, it is ultimately about the "price" a cable operator is willing to pay for carriage of the local broadcast station.[32]

That price might be in the form of a monetary payment or it may be structured as an in-kind compensation – such as where an operator provides channel capacity for a

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[31] In 1992, when Congress created the retransmission consent regime, cable-TV cross-ownership was prohibited. *See* 47 U.S.C. § 613 (a)(1) (repealed); 47 C.F.R. § 76.501(a) (vacated). Moreover, at that time, there were no local television station duopolies. *See Review of the Commission's Regulations Governing Television Broadcasting, Notice of Proposed Rulemaking*, 7 FCC Rcd 4111 at ¶ 14 (1992). In 1996, Congress relaxed the television duopoly rule. *See* Telecommunications Act of 1996 at § 202(d), Pub. L. No. 104-104, February 8, 1996 (relaxing "one-to-a-market" rule). In turn, the Commission relaxed its local ownership restrictions to permit local television station duopolies. *See* 47 C.F.R. § 73.3555(b). *See also Review of the Commission's Regulations Governing Television Broadcasting; Television Satellite Stations Review of Policy and Rules, Report and Order*, 14 FCC Rcd 12903 at ¶¶ 7-8 (1999). In the meantime, broadcast ownership concentration levels have increased dramatically. Among the top 25 group station owners, the average number of stations owned nearly doubled from 1996 to 2000. *See 1998 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, 15 FCC Rcd 11058 at Appendix (2000) (top 25 group station owners had 12 stations on average in 1996 and 21 stations on average in 2000; the top 5 owners had 63 stations in 1996 and 164 stations in 2000). *See also 1998 Biennial Regulatory Review - Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, 15 FCC Rcd11058 at ¶ 7 (2000) (since 1996 there has been "extensive consolidation in the radio and television industries."); *Special Report: Top 25 Station Groups,* Broadcasting & Cable, January 25, 1999, at 44 (noting Fox TV's increase from 10 stations in 1996 to 22 stations in 1999); *Special Report: Top 25 TV Groups*, Broadcasting and Cable, April 2, 2002, at 48-50 (noting Fox TV's increase to 34 stations in 2002).

[32] *See, e.g., Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, First Order on Reconsideration, Second Report and Order and Third Notice of Proposed Rulemaking*, 9 FCC Rcd 1164 at ¶¶ 91-93 (1993) (retransmission consent negotiations involve the price cable operators are willing to pay for local station carriage).

broadcast network's affiliated cable channel. Such in-kind payments typically enhance the coffers of the broadcast network – through additional license fees and advertising revenue for the cable channel carried by the system – but provide little, if any, compensation to the local station. Further, such in-kind compensation also puts upward pressure on cable rates, since the broadcast networks generally insist that their affiliated cable channels be carried on the operator's most popular tier of service.

While Congress intended the retransmission consent negotiation process to provide "incentives for both parties to come to mutually beneficial arrangements,"[33] the reality is that News Corp. wields considerable leverage in that process. A cable operator's only source of bargaining power in retransmission consent negotiations with a Fox-owned station is its ability to decide not to carry the signal of that station. That ability, however, is restricted both by rule,[34] and by practical reality – since it is the cable operator that bears the brunt of any public fall-out arising from a failure to reach agreement with a broadcast station, and a broadcast station also has the protection of the must carry provisions.

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[33] *Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Broadcast Signal Carriage Issues, Memorandum Opinion and Order*, 9 FCC Rcd 6723 at ¶ 115 (1994).

[34] *See* 47 U.S.C. 534(b)(9); 47 C.F.R. § 76.1601, Note 1 (2002) ("No deletion or repositioning of a local commercial television station shall occur during a period in which major television ratings services measure the size of audiences of local television stations. For this purpose, such periods are the four national four-week rating periods - generally including February, May, July and November - commonly known as audience sweeps."). *See also In the Matter of: Time Warner Cable; Emergency Petition of ABC, Inc. for Declaratory Ruling and Enforcement Order for Violation of Section 76.58 of the Commission's Rules, or in the Alternative for Immediate Injunctive Relief*, 15 FCC RCD 7882 (2002) (holding that the removal of ABC's signals from Time Warner's system during the sweeps period was in violation of Section 614(b)(9) of the Communications Act and Section 76.58 [now Section 76.1601] of the Commission's rules despite the expiration of the retransmission consent agreement).

Broadcasters' position in retransmission consent negotiations is further strengthened by the Network Non-Duplication rule[35] and the Syndicated Exclusivity rule,[36] which in particular make it very difficult for cable operators to obtain a substitute for the station. In implementing retransmission consent, the Commission expressly decided "to allow stations electing retransmission consent to assert network nonduplication and syndicated exclusivity protection."[37] As a result, each network affiliate is protected from intra-brand competition within its local marketplace.

To the extent that ready substitutes for particular network programs do not exist, the power of government-guaranteed exclusivity is further augmented. News Corp. has been particularly effective in garnering such "must have" programming for the Fox network. There are no ready substitutes for events like the Super Bowl and the World Series and other Major League Baseball post-season games carried by Fox stations. In the local markets of each of the 16 NFC teams in the NFL (which are present in 12 of the top 20 markets in the country), there is no substitute for the home team carried by the Fox station. And shows like "The Simpsons," "24," and "American Idol" dominate their time slots.[38] In each of these instances, the exclusivity guaranteed to each network affiliate amounts to significant marketplace clout.

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[35] 47 C.F.R. § 76.92.

[36] 47 C.F.R. § 76.101.

[37] *Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Broadcast Signal Carriage Issues*, *Memorandum Opinion and Order*, 9 FCC Rcd 6723 at ¶ 114 (1994).

[38] *See* Paige Albiniak, *What Will Fox's Sweeps Win Really Mean?*, Broadcasting & Cable, February 24, 2003, at 12.

B. News Corp. Exercises its Retransmission Consent Rights in Inflationary Ways that Raise Costs to Cable Operators and Raise Prices to Consumers

News Corp. has been using the leverage provided to its local stations by the combination of high-profile programming obtained for the Fox network, retransmission consent, and rules protecting broadcast program exclusivity, in order to launch and support numerous cable networks of its own, raising the costs of service to millions of cable subscribers.

Fox was the first of the broadcast networks to use retransmission consent as a means of spawning a new national cable network, FX, which was launched in 1994.[39] Offering little direct benefit to the local stations whose retransmission rights were leveraged to launch the service, FX brought Fox an additional $0.25 per subscriber per month – as well as advertiser revenues – for a brand-new, untested network.[40] While

[39] Jessell, *The Shifting Fortunes of Retransmission Consent*, Broadcasting and Cable, May 12, 2003, at 45 ("[M]ultimedia companies led by Fox used their retrans rights to get carriage (and license fees) for new cable networks. This is how FX came to be"); Bokiek, *Cablers, Programmers Duke It Out On the Hill,* Hollywood Reporter, May 7, 2003 ("News Corp., for example, launched the FX channel in 1994 using the retransmission consent leverage it had with cable operators from its Fox O&Os and many Fox affiliate stations").

[40] *See* Halonen, *Looking Back at Retransmission: Stations, Cable Operators Questioning Validity of Regulations 10 Years Later*, Electronic Media, March 4, 2002 ("But before broadcast signals disappeared from cable screens nationwide, News Corp. chief Rupert Murdoch broke the impasse with a face-saving deal in which he swapped retransmission rights for Fox stations to TCI in exchange for the cable MSO's support of a new Fox cable channel FX, along with a fee of 25 cents per subscriber").

some cable operators questioned whether FX justified such a high license fee,[41] leveraging of Fox sports content assets apparently helped to preserve and grow FX's revenue from cable operators.[42] By 2000, the support provided to FX by Fox's broadcast network and sports programming assets had succeeded in solidifying its status as a broadly distributed service that could not only command a significant license fee, but could be used to help launch other Fox services.[43]

Fox uses its "must have" programming as a crowbar as well. A recent example from the Washington, D.C., area is illustrative. News Corp. demanded carriage of Fox Movie Channel or Fox Sports World to all Cox Communications digital subscribers nationwide when the two were negotiating a retransmission consent agreement covering Fox station WTTG-TV. News Corp. demanded this even though less than a quarter of Cox Communications' cable customers were receiving service from News Corp. owned and operated stations.[44]

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[41] Dempsey, *Cablers, FX in Fee Battle*, Daily Variety, June 10, 1998, at 22 ("'FX doesn't have that kind of market power,' said Jedd Palmer, senior VP of programming for Media One, the third-largest cable operators in the U.S. Mike Egan, one of the partners of Renaissance Media, another owner of cable systems said, 'FX will be hard-pressed to maintain the kinds of license fees that it's accustomed to.' The license fee of FX is $0.28 a month per subscriber, which puts it at the mid- to high end of the scale for general-entrainment networks").

[42] *See FX Bullish on Distribution*, Multichannel News, May 8, 2000, at 78 (Quoting Fox executive: "We used to package FX with the sports deals").

[43] *See id.* (Noting two-year growth of FX from 35 million to 53 million by end of 2000, and quoting Fox executive: "FX is in such demand now that we have a couple of instances where we're using the strength of FX to get deals done for other nascent channels, smaller channels").

[44] *See Comments of Cox Enterprises, Inc.*, MB Docket No. 02-277, at 45 (January 2, 2003) ("*Comments of Cox*").

The dispute arose near the beginning of the NFL playoffs and subjected Cox Communications to significant negative customer relations in several markets.[45] During the course of negotiations, satellite providers "profit[ed]" from the disruption of service, aggressively marketing themselves to consumers as an alternative to Cox.[46] Eventually, Cox Communications agreed to carry the channels and to pay News Corp. a rate based on all Cox Communications digital subscribers nationwide, even though only approximately 65 percent of these customers subscribed to a service tier that contained Fox Sports World or Fox Movie Channel. Because the rate was based on all digital subscribers and not just those that receive these channels, the per-subscriber costs were inflated by nearly 50 percent.[47]

This pattern and practice is not unusual. According to other public reports, News Corp. has tied retransmission consent for the Fox network in one local market to carriage

[45] *See* Linda Moss, *Some Subs Who Lost Fox Get Refunds From Cox*, Multichannel News, January 17, 2002, at p. 3.

[46] Kristina Stefanova, *Satellite Soaring; Fox-Cox Flap Also Sells Antennas*, The Washington Times, January 4, 2000, at p. B8.

[47] *See Comments of Cox* at 46.

of Fox Sports, Fox News, FX, National Geographic Channel and even as-yet unnamed cable services in other markets.[48] Among other examples:

- On separate occasions, News Corp. demanded carriage of new Fox digital networks as a condition of retransmission consent for its Los Angeles Fox and UPN broadcast stations.[49]

- News Corp. demanded carriage of two additional Fox affiliate satellite channels, including a sports channel, as a condition of retransmission consent for its two Orlando Fox broadcast stations.[50]

- News Corp. demanded carriage of three Fox channels, including two Fox sports channels, as a condition of retransmission consent for its Atlanta Fox broadcast station.[51]

- News Corp. demanded carriage of Fox satellite services or substantial fees as a condition of retransmission consent for its Minneapolis/St. Paul Fox and UPN broadcast stations.[52]

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[48] *See American Cable Association Petition For Inquiry Into Retransmission Consent Practices* at 3 (October 1, 2002) ("*ACA Petition*"). *See also* McAdams, *National Around the Clock; National Geographic Goes For National Demographic With 24-Hour Cable Network*, Broadcasting and Cable, August 28, 2000, at 20 ("National Geographic gave Fox a 66% interest in the domestic channel, primarily to get the thing into homes according to industry sources. Fox has not only the cash to cover substantial launch support but has the negotiating leverage of retransmission consent and regional sports channels that cover some 72 million homes across the country. Fox has managed to launch four national networks in the past four years, copping hard-to-get analog carriage for each"); *Walley, Fox Takes 24-Hour Cable News Plunge*, Electronic Media, February 5, 1996, at 1 (Mr. Mudoch said "Fox will use retransmission consent for its owned TV stations as leverage to get carriage for the Fox news channel on U.S. cable systems"); *Time Warner, Fox Reach Agreement to Avoid Super Bowl Blackout*, Associated Press, December 18, 1996 (noting Time Warner's claim that Fox "was threatening to cut off the [local station] signals, a retaliation for Time Warner's decision not to carry the Fox News Channel").

[49] *See American Cable Association Petition For Inquiry Into Retransmission Consent Practices, First Supplement* at 12-13 (December 2002) ("*ACA Supplement*").

[50] *See id.* at 13-14.

[51] *See id.* at 14-15.

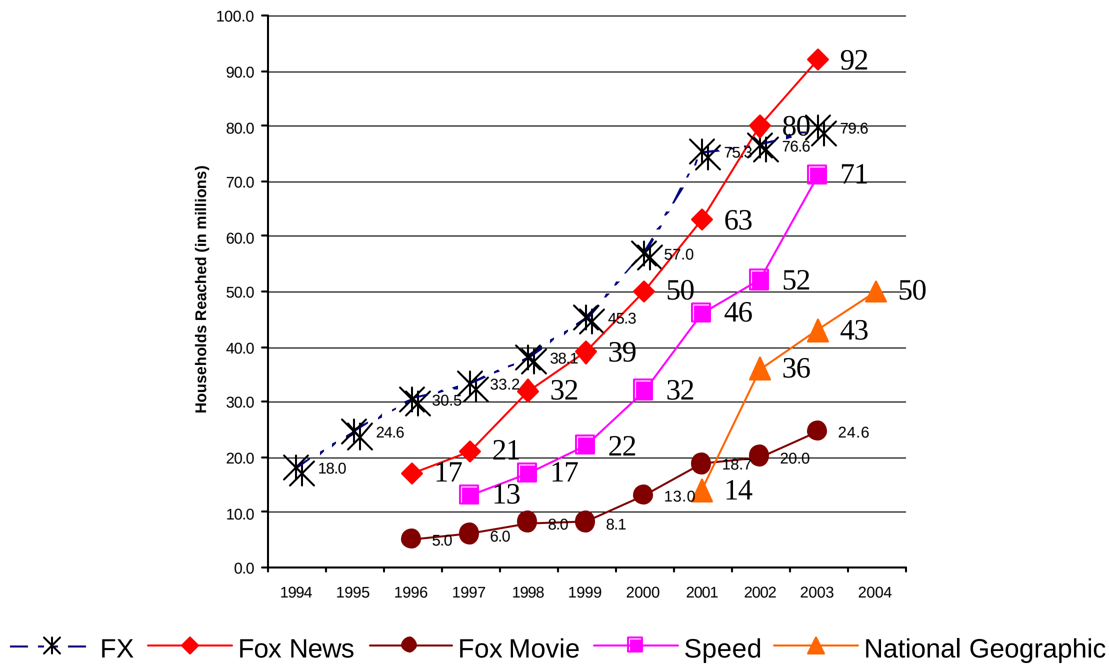
[52] *See id.* at 15-16.

- News Corp. demanded carriage of Fox-affiliated satellite channels as a condition of retransmission consent for its Wyandotte Fox broadcast station.[53]

This strategy has worked to grow these networks. In the first of the 2000-2002 three-year retransmission consent cycle, total subscribership for all Fox cable networks grew by 43 percent, higher than any other cable programmer.[54]

[53] *See id.* at 16-17.

[54] Moss, *Affiliate Squads' New Plays Still Require Lots of Locals,* Multichannel News, November 26, 2001, at 1.



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News Corp.'s retransmission consent negotiations bear little resemblance to the original Congressional vision of local broadcast stations bargaining with local cable operators in a negotiation reflective of local market concerns. News Corp. bargains over retransmission consent with a particular cable MSO for all of its owned and operated

[55] Sources: Joe Schlosser, *It Ain't Steelmaking; Shell's New Game Is Helping Determine The Future of Television*, Broadcasting and Cable, May 28, 2001, at 45; *Lay of the Land*, Cable World, March 25, 2002, at 12; *Cable Network Television Household Growth, 1991-2001*, Kagan Cable Program Investor, March 31, 2002, at 4; Simon Applebaum, *Fox Movie Channel Trumpets Originals, Lineage*, Multichannel News, April 1 2002, at 20; *Network Census*, Kagan Cable Program Investor, April 16, 2003; Jim Forkan, *Nat Geo Hunts for More Ad Dollars*, Multichannel News, April 28, 2003, at 9; www.newscorp.com; The News Corporation Limited, 2000 Annual Report, The News Corporation Limited, 1999 Annual Report, The News Corporation Limited, 1998 Annual Report, The News Corporation Limited, 1997 Annual Report, The News Corporation Limited, 1996 Annual Report, The News Corporation Limited, 1994 Annual Report.

broadcast stations within that MSO's service area.[56] This strategy maximizes the network's leverage over cable operators who serve customers in multiple markets.

While the sticking points in retransmission consent negotiations typically have little, if anything, to do with any particular local market issues, News Corp. attempts to increase local market pressure on the cable operator to adhere to its carriage terms and conditions. DBS providers (especially DirecTV) often play a key role in retransmission consent disputes. In News Corp.'s dispute with Cox Enterprises referred to above, satellite operators were eager to step in and market themselves to subscribers as well.[57] In another dispute involving Disney and Time Warner Cable in New York City, DirecTV's promotional efforts were closely coordinated with Disney and included the offer of free hardware and installation.[58] Time Warner lost an estimated 30,000 subscribers in New York City to DirecTV in this manner.[59] Moreover, joint promotions extended to Los Angeles and Houston where Time Warner also had cable systems.[60]

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[56] *See Comments of Cox* at 43-44.

[57] *See* Kristina Stefanova, *Satellite Soaring; Fox-Cox Flap Also Sells Antennas*, The Washington Times, January 4, 2000, at B8 ("Satellite companies are profiting from a dispute between Fox Entertainment Group Inc. and cable provider Cox Communications Inc.").

[58] Lisa Brownlee, *Paying the price – ABC Dispute Re-DirecTVs $150M From Time Warner*, The New York Post, May 18, 2000, at 37.

[59] *Id.* (estimating losses to Time Warner Cable based on 30,000 subscribers lost to a DirecTV promotion).

[60] *Id.*

News Corp.'s broadcast duopolies further enhance its retransmission consent bargaining strength.[61] Company executives have spoken publicly about being able to convince local advertisers to spend "two to three times what they normally would just by bundling two local TV stations and regional sports cable channels together."[62] And News Corp. is "just beginning to learn how to . . . leverage" its broadcast and regional sports network interests.[63]

If News Corp. can acquire control of DirecTV and entirely circumvent cable operators, there will be few restraints on the prices, terms and conditions it will seek for its programming:

> Cable systems that want to carry the broadcasts of local stations, such as Fox's Washington station, WTTG-5, must also pay to carry cable channels, such as FX and News Corp.'s National Geographic Channel,

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[61] In the broadcast television context, a duopoly exists where a single entity or network owns two stations in a single market. *See In the Matter of 2002 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996; Cross-Ownership of Broadcast Stations and Newspapers; Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets; Definition of Radio Markets, Notice of Proposed Rulemaking*, 17 FCC Rcd 18503, 18529, 18535 ¶¶ 80, 95 (2002) (discussing possible effects of broadcast duopolies and recounting history of duopoly rule).

While operating efficiencies account for some of the benefits of duopolies for News Corp., there is clearly "an incremental amount on top of that in terms of revenue." *Id.* Indeed, some would estimate almost as much in new revenues as in cost savings. *Id.* The duopolies' attractive economics are enhanced by being able to sell so-called "triopoly" placement that includes Fox's popular regional sports networks. *Id.* This "triopoly" is generating record cash flow and giving Fox "increased leverage in negotiating carriage agreements." Diane Mermigas, *Launch of the new X lifestyle channel coming*, Electronic Media Online, available at www.tvweek.com/topstorys/120202fox.html. News Corp. is "bundling the sales and marketing of its flourishing regional sports channels with the industry's largest TV station group." *Id.*

[62] Diane Mermigas, *Launch of the new X lifestyle channel coming*, *supra* note 61 (quoting Lachlan Murdoch).

[63] *Id.*

> which drives up subscribers' cable bills. Owning DirecTV could give Murdoch even more leverage over cable operators, some fear.[64]

Retransmission consent has worked for News Corp. to date, fostering the launch and expansion of several Fox cable channels that provide News Corp. with both advertising and license fee revenues. For consumers, however, that has meant that cable rates are higher than they might otherwise be. That dynamic is likely to be magnified by a News Corp.-DirecTV combination.

C. DirecTV Dramatically Expands News Corp.'s Leverage, Pricing Power, and Ability to Drive Cable Rate Increases via the Retransmission Consent Process

After the merger, a cable operator that fails to comply with News Corp.'s retransmission consent terms and conditions demands could risk providing DirecTV with a *de facto* exclusivity for Fox network and local programming in that operator's market. That will not be sustainable in the long term, and consumers will pay in terms of increased cable prices or reduced competition.

Today, when a broadcast licensee make exorbitant retransmission demands, a cable operator can refuse to carry the station or stations. If the two reach an impasse, the broadcast licensee can still reach a deal with the cable operator's competitors (typically, DBS providers) and bypass the cable operator entirely. DBS providers in particular can be expected to heavily promote their programming differential in order to win over customers. But the coordination between broadcast licensees and DBS is imperfect, and diverging interests are at stake. Broadly speaking, broadcast licensees seek to maximize

[64] Frank Ahrens, *Murdoch's DirecTV Deal Scares Rivals*, Washington Post, April 11, 2003, at p. E3.

the value of their station retransmission rights and DBS providers seek to maximize their subscriber revenue.

By acquiring control of DirecTV, News Corp. will unify these divergent interests and obtain the ability to harm consumers and competition in two ways:

<u>First</u>, News Corp. will acquire a potent new "threat point" in retransmission consent negotiations with cable operators. If a cable operator is not willing to give in to News Corp.'s demands, News Corp. will be empowered to credibly threaten to pull retransmission consent entirely and provide the signal to DirecTV, which would then be expected to market itself aggressively to that cable operator's customers.

While News Corp. might be expected to lose revenues in one local market out of the hundreds it serves, that loss would not be substantial, especially when seen from the perspective of the affected cable operator. To be sure, the cable operator would realize that News Corp. would benefit from customer defections to DirecTV in that market. On the other hand, the cable operator would lose its *only available source* of Fox network programming in such circumstances, causing immeasurable harm.

In theory, some cable companies might be able to turn down demands for higher programming fees or bundling of additional new networks under those circumstances. They could potentially withstand the assault by DirecTV and continue to hold on to subscribers. However, smaller and medium-sized operators are unlikely to be able to do so. Thus, the acquisition substantially enhances News Corp.'s ability to threaten cable operators credibly with the long-term withdrawal of retransmission consent. The likely outcome would be submission by cable operators to News Corp.'s retransmission demands, resulting in increased costs to cable operators, which would lead to higher prices for cable customers.[65]

Second, within the loose standard of having to engage in good faith negotiations,[66] News Corp. could also engage in "high stakes" bargaining with targeted cable operators. This approach would most likely focus on weaker cable operators that initially resist demands for increased compensation. News Corp. would simply pull its retransmission consent from the resistant cable operator and withhold consent long enough to cause disruption of service or other reputational harm to the cable operator, but not long enough to have a long term impact on local station viewership. At some point in the negotiations, News Corp. would "consent" again to retransmission. The resulting disruption from this strategy would certainly impose costs on the cable operator. Of course, at the same time, it would send a powerful signal to the market to reinforce the message that News Corp. is willing to walk from the table. And, of course, DirecTV – and News Corp. – would benefit the whole time from customer defections.[67]

Professor Rogerson recognizes that temporary withdrawal of programming during a targeted price dispute will be a particularly attractive and credible threat for News Corp. The temporary withdrawals have a minuscule effect on News Corp.'s revenues because

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[65] Were these costs not to be passed through to consumers, the result in the long run could predictably be the diminution of competition by cable operators unable to stay in business or make necessary capital investments due to reduced margins. *See* Rogerson at 26.

[66] 47 U.S.C. § 325(b)(3)(C)(ii); 47 C.F.R. §§ 76.65(c), 76.7. *See also Implementation of the Satellite Home Viewer Improvement Act of 1999: Good Faith Negotiations and Exclusivity*, 15 FCC Rcd 5445 (2000) (Commission may consider whether conduct is "outrageous" under the "totality of circumstances").

[67] News Corp. could even run advertising urging switches to DirecTV on other News Corp. services that the operator would have to run to its customers.

the revenue loss is temporary, but an enormous and lasting effect on the MVPD when the customer switch to rivals. Thus, as Professor Rogerson indicates:

> . . . once it owns DirecTV, News Corp. may well determine that it is a profitable strategy to begin to more routinely engage in temporary withdrawals of programming when negotiating agreements with rival MVPDs, even ignoring its effect on News Corp.'s ability to negotiate higher prices. After all, the effect of a short-term withdrawal of programming on News Corp.'s programming revenues would be minuscule but, as the owner of DirecTV, there would be a lasting and potentially significant increase in its profits to the extent that customers switch from the rival MVPD to DirecTV. Therefore, it may well be that, after the merger, News Corp. will be "looking for a fight," in the sense that it will actually be able to increase its profits by manufacturing a dispute that would create the pretext for a temporary withdrawal of service. This of course will simply create additional harms for the customers who are affected by these disruptions as well as further magnifying News Corp.'s bargaining power. [68]

With the added power provided by DirecTV, the Commission should expect that News Corp. will expand and intensify demands for monetary compensation in retransmission consent negotiations. The result will be that rates for cable operators' entry-level offerings will rise, since cable operators are required to carry retransmitted stations in the "basic tier."[69] While the Commission's rate regulations expressly permit cable operators to pass through any retransmission consent costs associated with carriage of local broadcast stations to basic tier subscribers,[70] it also is obligated to ensure that

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[68] Rogerson at 19-20.

[69] 47 U.S.C. § 543(b)(7)(A)(iii).

[70] 47 U.S.C. § 543(c)(2). "[F]ees paid or other valuable consideration granted by cable operators in exchange for retransmission consent clearly qualify" as costs related to prescribing basic service rates. *Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Broadcast Signal Carriage Issues, Notice of Proposed Rulemaking*, 7 FCC Rcd 8055 at ¶¶ 68 (1992). *See also Rate Order and Further Notice of Proposed Rulemaking*, 58 Fed. Reg. 29736 (May 21, 1993) (determining that retransmission consent costs could be treated as external to the price cap for the regulated tier of services).

retransmission consent does not yield basic tier cable rates that are unreasonable.[71] The pricing power afforded to News Corp. in retransmission consent negotiations by the take-over of DirecTV presents the very sort of upward pressure on cable rates that concerned Congress when it first adopted retransmission consent. Of course, at that time, Congress did not contemplate that the second largest broadcast network in the country also would be able to exploit same-market ownership combinations between the second largest MVPD in the nation and top local broadcast stations in most of the major media markets in the country – since such a scenario was neither lawful nor practicable.

While the instant transaction presents a retransmission consent environment wholly unanticipated by Congress, Section 325(b)(3)(A) of the Communications Act, 47 U.S.C. § 345(b)(3)(A), does authorize the Commission to take any steps necessary to ensure that retransmission consent does not adversely affect basic cable rates. News Corp.'s takeover of DirecTV is a market-altering transaction that gives News Corp. the ability to exercise market power and adversely affect those rates. Once News Corp. is running DirecTV, the "price" of retransmission consent will inexorably rise. Since these costs can be passed through to consumers, cable customers will pay more as a result,[72]

[71] *See* 47 U.S.C. § 325(b)(3)(A). While the Commission declined to adopt regulations specifically limiting retransmission consent rates, *see Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Broadcast Signal Carriage Issues, Report and Order*, 8 FCC Rcd 2965 at ¶ 178 (1993), it clearly "recognize[d] that there [are] costs associated with . . . complying with . . . retransmission consent obligations." *Implementation of Sections of the Cable Television Consumer Protection Act of 1992, Rate Regulation, Report and Order and Further Notice of Proposed Rulemaking*, 8 FCC Rcd 5631 at n.1402 (1993). *See also supra* note 31 and accompanying text.

[72] To the extent these costs are not passed through, however, the result of course will be to erode, or eliminate entirely, competition. Especially in smaller and rural communities, cable companies would be substantially weakened or exit the market altogether.

unless the Commission takes steps to mitigate the adverse rate impact associated with News Corp.'s takeover of DirecTV.

To date, News Corp. has proposed no conditions or limitations on its retransmission consent rights or commitments regarding how it will treat DirecTV and competing MVPDs regarding terms of carriage of broadcast signals.[73] News Corp.'s unwillingness in this regard is particularly noteworthy and ominous, since the statutory bar to exclusive retransmission consent carriage contracts and the statutory requirement that broadcast stations negotiate in good faith sunset on January 1, 2006.[74] Even if News Corp. does not immediately resort to an exclusive contract strategy, the threat of such a possibility, with its captive customer DirecTV, would exponentially increase News Corp.'s leverage with all other MVPDs.

III. THE MERGER WILL SUPER-CHARGE THE POWER OF NEWS CORP.'S SPORTS PROGRAMMING "BATTERING RAM"

News Corp. Chairman Rupert Murdoch has "long described sports programming as his 'battering ram' to attack pay television industries around the world."[75] Acquiring control of DirecTV will give News Corp. the ability to dictate the terms and conditions of carriage for such marquee programming. This will harm consumers through higher cable

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[73] *See infra* Part V, p.55 *et seq.*.

[74] 47 U.S.C. § 325(b)(3)(C)(ii).

[75] *See* David D. Kirkpatrick, *Murdoch's First Step: Make Sports Fans Pay*, N.Y. Times, April 14, 2003, at p. C1. Typically, this involves paying "top dollar to dominate" the most popular sports on television. *Id.* According to Mr. Murdoch, "[s]ports absolutely overpowers film and everything else in the entertainment genre." Annie Lawson, *Murdoch marks AFL boss for quiet chat*, Multimedia News, October 16, 2001, available at www.auspaytv.com/news/oct01/01101602.htm.

rates in the short term and diminished competition in the MVPD marketplace in the long term.

As the Commission knows, sports programming is an important component to any MVPD offering. News Corp. is already a powerful supplier of sports programming to MVPDs nationwide. With DirecTV as a guaranteed outlet for its comprehensive array of professional and college sports offerings, News Corp. will be able to demand more aggressive price increases from cable operators. Cable operators will be forced to pay higher prices and raise their rates to customers, or drop this "must have" programming entirely. Consumers will lose, and News Corp. will win either way.

A. Sports Programming Is An Important And Expensive Component Of Any MVPD Offering

Sports programming is an important element in any MVPD offering. Sports have been recognized as a unique product offering by the courts[76] and confirmed as such by

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[76] *See, e.g., International Boxing Club of New York, Inc. v. U.S.*, 358 U.S. 242 (1959) (championship boxing is a distinct product market); *Philadelphia World Hockey Club, Inc. v. Philadelphia Hockey Club, Inc.*, 351 F.Supp. 462 (E.D. Pa, 1972) (relevant product market is major league professional hockey). In *NCAA v. Board of Regents*, 468 U.S. 85 (1984), the Court approved a lower court's finding that "intercollegiate football telecasts generate an audience uniquely attractive to advertisers and that competitors are unable to offer programming that can attract a similar audience. These findings amply support its conclusion that the NCAA possesses market power. Indeed, the District Court's subsidiary finding that advertisers will pay a premium price per viewer to reach audiences watching college football because of their demographic characteristics is vivid evidence of the uniqueness of this product." *Id.* at 111-112 (footnotes omitted). The Court also noted that from the standpoint of the consumer, whose interests the Sherman Act was designed to serve, "there can be no doubt that college football constitutes a separate market for which there is no reasonable substitute. . . . Thus, we agree . . . that it makes no difference whether the market is defined from the standpoint of broadcasters, advertisers, or viewers." *Id.* at 111, n.49.

Congress.[77] Mr. Murdoch has indicated that "I don't believe that any cable operator can really operate without broadcasting the games of their local teams. It's a very, very strong cornerstone for all our cable strategies."[78]

The Commission itself has characterized regional sports programming as "must have" programming,[79] and has observed that foreclosure "harm to the competitive MVPD . . . is further increased in situations in which there is no readily acceptable substitute for the programming, such as regional sports programming."[80]

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[77] *See*, *e.g.*, 15 U.S.C. §§ 1291-1295 (1994) (Sports Broadcasting Act). *See also* Hearing on Media Ownership, Hearing of the Senate Commerce, Science, and Transportation Committee, May 6, 2003 (statement of Senator McCain) ("[w]hile not the only cause of cable rate increases, soaring sports programming costs passed along to all expanded basic cable subscribers . . . certainly appear to play a role."); 138 Cong. Rec. S14583 (daily ed. September 22, 1992) (statement of Sen. Lieberman); 138 Cong. Rec. H8681 (daily ed. September 17, 1992) (statement of Rep. Tauzin); Hearing Regarding Government Internet Regulation and Privacy Issues, House Judiciary Committee, July 18, 2000 (statements of Rep. Hyde). *See also* Alicia Mundy, *Cable Giants Allied With the Corduroy Crew?*, CableWorld, May 12, 2003, at 19 (interview with Sen. McCain).

[78] Steve Donohue, *News Corp. Bulks VP Sports: Liberty Buyout Strengthens Sports Presence*, Electronic Media, April 12, 1999, at 3.

[79] *In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution, Sunset of Exclusive Contract Prohibition, Report and Order,* 17 FCC Rcd 12124, 12139 ¶ 34 (2002) ("*Program Access Sunset Order*"); *id.* at 12145 ¶ 47.

[80] *Id.* at 12148 ¶ 54. *See also Fifth Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, 13 FCC Rcd 24284, 24380, 24381 ¶ 171 (1998) ("*Fifth Annual Video Competition Report*') ("Sports programming . . . warrants special mention because of its widespread appeal and strategic significance for MVPDs").

As the Commission has recognized, sports programming costs have been rising dramatically in recent years.[81] According to one estimate, from 1999 to 2002, affiliate revenue per subscriber increased by over 48 percent for Fox Sports – compared to about 17 percent for the top 39 other non-sports networks.[82] Fees paid for sports programming make up a significant portion of cable rates and, concomitantly, of cable rate increases.[83] Increased sports programming costs are one of the most significant reasons for increased cable rates.[84]

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[81] "Sports programming prices in particular are skyrocketing." Hearing on Media Ownership, Hearing of the Senate Commerce, Science, and Transportation Committee, May 6, 2003 (statement of James Robbins, President and CEO, Cox Communications). "At least one industry study has concluded that sports and entertainment programming costs have escalated . . . at a rate that far exceeds the general rate of inflation." *Fifth Annual Video Competition Report* at Appendix F ¶ 19 ("*Inquiry Concerning Cable Television Programming Costs*") (*citing* Kagan Media Appraisals, Inc., *TV Programming Costs: An Analysis of the Market Forces Driving Entertainment and Sports Rights Fees*, December 1997). "In their public statements, operators have identified programming costs, and the costs of sports programming in particular, as one of the major reasons for recent rate increases." *Id.*

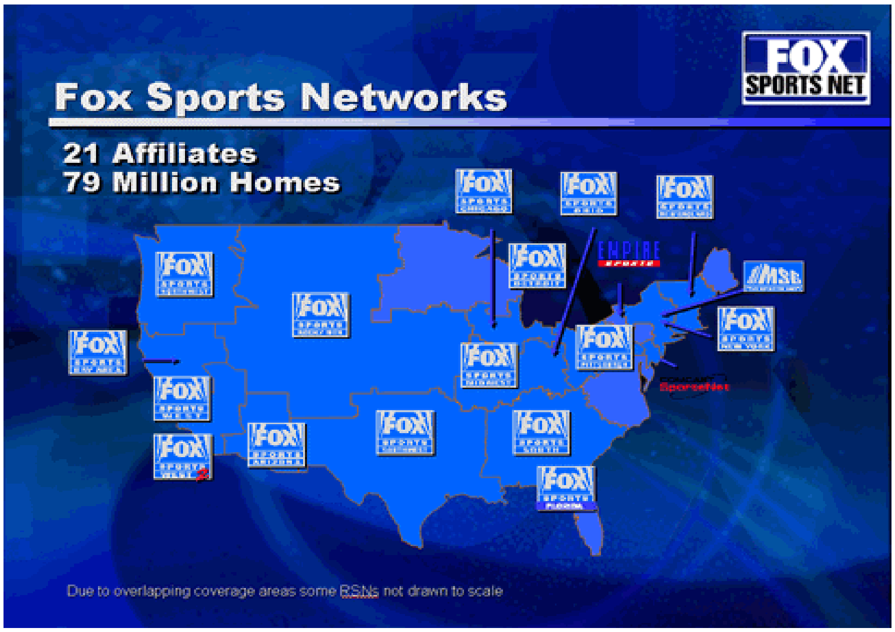
[82] *See Reply Comments of Mediacom Communications Corporation,* MB Docket No. 02-277, at 49-50 (February 3, 2003).

[83] *See, e.g.,* United States General Accounting Office, *Impact of Sports Programming Costs on Cable Television Rates,* GAO/RCED-99-136 at 5 (June 1999) ("*GAO Sports Programming Report*") ("in general, sports programming accounted for about 29 percent of the cable system operators' programming costs and about 6.8 percent of the monthly amount that the cable systems charged to their subscribers.").

[84] *See, e.g., 2002 Cable Pricing Report*, 17 FCC Rcd at 6303 ¶ 7 ("[f]or the 12 months ending July 1, 2001, competitive and noncompetitive operators attributed, on average, 64.7% and 58.2%, respectively, of rate increases to higher programming costs."); *2001 Cable Price Report*, 16 FCC Rcd at 4346 ¶ 5 ("[f]or the 12 months ending July 1, 2000, competitive and noncompetitive operators attributed 44.1% and 41.4%, respectively, of their rate increases to higher programming costs."); *Fifth Annual Video Competition Report*, 13 FCC Rcd at 24298 ¶ 25 (discussing recent leaps in cost of acquiring sports programming).

B. News Corp. and DirecTV Each Already Hold Powerful Positions In Sports Programming

Today, News Corp. today owns interests in 19 regional sports networks ("RSNs") reaching three-quarters of all television households.[85]



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The Fox RSNs carry 67 of the 80 professional MLB, NBA and NHL teams.[87] Fox RSNs wholly owned by News Corp. carry 45 of the 80 teams.[88]

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85 Application at Attachment F. However, News Corp. claims 21 RSNs on its website. *See* www.newscorp.com/management/fsn.html.

86 *See* www.newscorp.com/investor/download/MediaWeek12_02/sld024.htm.

87 *See* www.newscorp.com/management/fsn.html.

88 *See id.*

[89]

The RSNs produce over 4,500 professional live events annually.[90] News Corp. also controls the national broadcast rights to NFC professional football and major league baseball games as well as NASCAR races.[91] And, News Corp. controls several major packages of college basketball and football games nationwide.[92]

News Corp. has been proactive in demanding higher prices and more favorable carriage terms for its sports networks.[93] According to at least one recent account, News Corp. has raised the cost of its Fox Sports content to some cable systems by more than 30 percent in one year and has not been afraid to pull programming off of cable systems over

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[89] *See* www.newscorp.com/investor/download/MediaWeek12_02/sld029.htm.

[90] *See* www.newscorp.com/management/fsn.html.

[91] *Id.*

[92] *Id.*

[93] For example, in December 1996, Fox, while in a retransmission consent dispute with Time Warner Cable, placed newspaper ads in several cities warning that the Super Bowl, on Fox broadcast stations, the following month, might not be available via cable unless Time Warner Systems signed retransmission consent deals. *Communications Daily*, December 18, 1996, at 6.

rate disputes.[94] In addition to charging higher prices, News Corp. leverages the popularity of its sports networks to negotiate favorable carriage agreements for fledgling networks. Most recently, this has happened with Speed Channel and the new "X lifestyle" channel.[95] Thus, the "battering ram" delivers a "one-two" punch: higher prices and mandatory carriage of new – and expensive – networks.

For its part, DirecTV has from its inception used arrangements with the NFL, NBA, Womens' NBA, NHL, MLB, MLS, and the NCAA to target and retain subscribers. DirecTV's satellite-exclusive package of out-of-market professional football games, "NFL Sunday Ticket," has been widely credited with boosting DirecTV's subscribership and visibility in the marketplace.[96] A few months ago, DirecTV extended its exclusive NFL package through 2007, tripling the annual licensing fee it will pay the league from $130 million to $400 million.[97] And, until very recently, DirecTV had exclusive arrangements to offer out-of-market games from the National Basketball Association,

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[94] *See* Frank Ahrens, *Murdoch's DirecTV Deal Scares Rivals*, Washington Post, April 11, 2003. at E3; Staci D. Kramer, *Time Warner and Fox Cable Spar Over Sports Net Rates*, Cableworld, January 6, 2003, at 9 (reporting that Fox sought to increase the rate for the Sunshine Network at least 40 percent and Fox SportsNet North 45 percent).

[95] Diane Mermigas, *Launch of the new X lifestyle channel coming*, Electronic Media Online, *supra* note 61.

[96] *See* Andrea Figler, *Cable's Direct Threat Satellite Provider Boosts Subs as News Corp. Merger Looms*, Cableworld, October 22, 2001, at 1 (reporting that strong subscriber growth for DirecTV is attributable to NFL Sunday Ticket); Eric Fisher, *NFL has $2 Billion Deal with DirecTV for 'Ticket'*, Washington Post, December 12, 2002, at p. C4 (quoting DirecTV executive Eddy Hartenstein "Over the years, there have been significant programming additions to DirecTV, but none more constant or significant than . . . NFL Sunday Ticket."); Joe Flint, *DirecTV, NFL Hook Up on New Pact*, The Wall Street Journal, December 12, 2002, at B8 (reporting that keeping the NFL deal was a top priority for DirecTV because it relies heavily on exclusive sports programming to drive subscriptions).

[97] *DirecTV Pays Big Hike*, MediaWire, December 16, 2002. According to at least one account, Fox had veto power over any deal. Allison Romano, *DirecTV Hangs on to the Ball*, Broadcasting and Cable, December 16, 2002, at 1.

National Hockey League, and Major League Baseball, as well as out-of-market games during the NCAA Championship basketball tournament.[98] DirecTV clearly recognizes and has taken full advantage of its ability to use sports as a marketing tool and a competitive strategy vis-à-vis cable operators.[99] As set forth below, DirecTV is perfectly situated to "super-charge" Rupert Murdoch's "battering ram."

C. The DirecTV Platform Will Provide News Corp. With The Ability To Raise Prices And Reduce Output In Sports Programming

The acquisition of DirecTV provides News Corp. with a multichannel platform to leverage in negotiations for an entire suite of sports offerings, from popular Fox network programming like the NFL to regional sports networks and the exclusive rights to the NFL Sunday Ticket package. With News Corp. controlling DirecTV, the merged company will wield an unprecedented amount of "must have" programming. Moreover, News Corp. will be able to use DirecTV as a close ally in efforts to raise sports programming prices to cable operators.

News Corp. has already demonstrated its willingness to withhold its RSNs' programming signal from cable operators unwilling to adhere to its demands for higher

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[98] *See CBS, DirecTV Team UP Again*, Satellite News, December 17, 2001, (discussing DirecTV's renewal with the NCAA for exclusive broadcast of out-of-market games to supplement CBS coverage of the men's basketball championship); R. Thomas Umstead, *Games Still the Thing for DirecTV*, Multichannel News, June 4, 2001, at 86 (reporting that while cable operators have managed to make progress in their efforts to acquire out-of-market sports packages, such as MLB Extra Innings, NBA League Pass and NHL Center Ice, DirecTV still considers these types of packages the driver of subscriber acquisitions and retention).

[99] In December 2002, DirecTV renewed its agreement with the National Football League to be the exclusive multichannel distributor of NFL Sunday Ticket through 2005, and the exclusive satellite distributor through 2007. *See* DirecTV Press Release, *NFL and DirecTV Extend and Expand Exclusive NFL Sunday Ticket Agreement for Five Years*, December 11, 2002, available at www.directv.com/DTVAPP/aboutus/headline.jsp?id= 12_ 11_2002A.

carriage fees. In Minnesota, Fox Sports Net North was cut from than 150,000 Time Warner Cable homes when the two could not come to terms.[100] When Time Warner Cable refused to agree to high prices in Florida, Fox Sports' Sunshine Network cut its signal, even though that cost the network almost 2 million homes.[101] As the NBA playoffs approached after more than two months, Time Warner came back to the table and cut a deal.[102] As one observer noted, if this were to happen "when Rupert owns DirecTV, you can assume DirecTV will go into the market and just pound away at the cable system."[103]

That is not a far-fetched prediction. DBS providers repeatedly play a key role in siphoning customers away every time cable operators balk at News Corp.'s excessive pricing demands – just as they do when retransmission consent negotiations break down:

- During the Fox Sports Net North meltdown, EchoStar distributors reported their business "tripled as soon as [FSN] was taken off cable."[104] DirecTV officials likewise reported increases in sales.[105]

- During a 2001 dispute between Fox Sports Net West and Time Warner, hundreds of thousands of cable subscribers lost access to 40 Los Angeles Dodgers and 20 Anaheim Angels baseball games. DirecTV, "which carried the disputed games, conducted an

[100] John M. Higgins, *AOLTW Plays Tough With Fox Sports*, Broadcasting and Cable, January 6, 2003, at 6.

[101] *Id.*

[102] Dick Harmon, *Sunshine-Time Warner Blackout Over*, Tampa Tribune, March 14, 2003, at 1.

[103] Frank Ahrens, *Murdoch's DirecTV Deal Scares Rivals*, Washington Post, April 11, 2003, at E3.

[104] Judd Zulgadd, *Cable Squabble Leaves Sports Fans Pondering Options*, Star Tribune, January 27, 2003, at 1A.

[105] *Id.*

> aggressive acquisition campaign in the market in an attempt to lure Time Warner subscribers."[106]

Clearly, "DirecTV benefits every time an MSO and a programmer can't come to terms."[107] After the merger, that benefit will translate directly into increased revenues for News Corp. in the form of additional DirecTV subscriptions from customers who regard RSNs as "must have" programming. Thus, News Corp. will have an even stronger incentive to precipitate carriage disputes over RSNs with local cable operators, since they can migrate sports fans over to their affiliated DirecTV platform.[108] Absent intervention by the Commission, News Corp.'s takeover of DirecTV can be expected to lead to higher prices and more high-profile "showdown" negotiations such as these.

Controlling DirecTV will give News Corp. the ability to seek and obtain price increases from cable operators, which will harm consumers in the long run.[109] DirecTV's competitors would likely lose much more if "must have" programming was dropped from their systems and immediately trumpeted by their main competitor – DirecTV – than News Corp. would lose from the lost carriage. The local cable operator would immediately be at a competitive disadvantage facing the country's second largest program distributor with the resources of a large media enterprise behind it. News Corp.

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[106] *See* Thomas Umstead, *FSN West, Dodgers Settle Up*, Multichannel News, October 1, 2001; *see also* Linda Haugsted, *LA Baseball Dispute Prompts PR Battle,* Multichannel News, August 20, 2001; Linda Haugsted, *Subtracting Sports: Licensing Hassles Lead to Cable Drops*, Multichannel News, July 2, 2001, at 1.

[107] *Id.*

[108] *See* Rogerson at 19-20. *See also Program Access Sunset Order* at ¶ 54 ("it appears that the cost to a vertically integrated cable programmer of withholding regional programming would be proportionately lower than the cost of withholding national programming").

[109] *See* Mike Farrell, *No Death Star: Cable Takes News-DirecTV Deal in Stride*, Multichannel News, April 14, 2003, at 1 (discussing ability of DirecTV under News Corp. control to "beat up" cable operators and raise programming prices).

would still have access – through DirecTV – to local subscribers and to a national audience, and the costs of adding new subscribers would be trivial. Because of the risk of losing customers to DirecTV, cable operators would more likely comply with News Corp.'s threats than stand up to price increases. Mr. Murdoch certainly believes that no cable operator can really operate without offering the games of the local professional sports teams.

Additionally, News Corp. can expand its recent practices and insist on bundling carriage of its RSN with other newer or less desirable programming. This would exploit the undeniable market power than the RSNs have. Concerns such as these led the Federal Trade Commission to include in its *Turner-Time Warner* consent decree a provision preventing Time Warner from bundling HBO with any Turner programming and CNN, TNT, and WTBS with Time Warner programming.[110]

By picking and choosing its targets and timing with care, News Corp. would also send powerful signals to the marketplace to discourage resistance to its price and carriage demands. This would harm consumers in two ways. First, consumers will pay more. As sports programming becomes an even more potent "battering ram," license fees for that programming will inevitably rise. History is prologue: consumers will bear the burden of those costs. Second, competition will suffer and consumers will eventually lose choices in the MVPD market. Investment and innovation at the MVPD level could be affected and, perhaps, some weaker MVPDs might exit the market entirely. Either way, News Corp. will win, and consumers will lose.

[110] *Time Warner, Inc.* (FTC file No. 961-0004), 61 Fed. Reg. 50301 (September 25, 1996).

IV. NEWS CORP.'S TRACK RECORD IN OTHER MARKETS SUGGESTS THAT IT WILL EXPLOIT THE POWER OFFERED BY ITS BROADCAST, CABLE, REGIONAL SPORTS AND DBS DISTRIBUTION ASSETS TO RAISE PROGRAMMING PRICES

Standing alone, either News Corp.'s retransmission consent rights or its "must have" sports programming, when either is coupled with DirecTV, will foreseeably lead to higher programming costs. But when combined, and perhaps assisted by other News Corp. assets, the Company will have an unprecedented opportunity to impose higher programming costs on providers of Fox content. Furthermore, the Commission need only examine News Corp's strategies and tactics in international markets to obtain a flavor for how the DirecTV distribution platform can be used by News Corp. in support of efforts to raise programming costs for distributors of Fox content and to understand the danger to the public interest the transaction holds without the imposition of proper safeguards.

A. Combining DirecTV's National Footprint with News Corp's Existing Broadcast and Cable Assets Unduly Enhances Fox's Pricing Power in the Programming Marketplace

This transaction represents the first instance in which an established provider of both broadcast and cable content has sought to integrate downstream into the retail video programming distribution market by purchasing an existing MVPD.

In this instance, vertical integration by News Corp. into the retail MVPD market can improve the margins of its core business offerings by increasing programming fees paid by purchasers of Fox content. Combining DirecTV with Fox's existing local television, broadcast network, cable network and regional sports channel assets furthers this objective by offering News Corp. "unprecedented negotiating leverage with cable operators."[111]

> The biggest, most powerful weapon News Corp. has is "four-way leverage against cable operators, competing with satellite and using the requirement that cable get retransmission consent to carry Fox-owned TV stations, while potentially leveraging price for Fox-owned regional sports networks and its national cable and broadcast networks," Mr. Wolzien [analyst at Sanford Bernstein] said. . . . "The threat to cable is that News Corp. might legally withhold programming in a rate dispute in favor of telecasting it exclusively on satellite. At best, this will result in higher program costs to cable operators" and shift viewers to satellite, Mr. Wolzien said.[112]

As noted above, DirecTV already is used by programmers involved in retransmission consent and cable network carriage disputes with cable operators. Acquiring DirecTV allows News Corp. to intensify the pressure on a cable operator involved in a carriage dispute while also bringing in more retail MVPD revenues through increased DirecTV subscriptions in order to offset the costs associated with a dispute in any particular local market:[113]

> "There certainly would be some incremental leverage News Corp. would have over cable operators in terms of regional sports-network rights fees,"

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[111] *Mermigas on Media*, April 16, 2003.

[112] *Id.*

[113] Kirkpatrick, *Murdoch Gets Upper Hand on Cable With Hughes Deal*, N.Y. Times, April 14, 2003, at C1 ("At the same time that News Corporation's DirecTV unit competes with cable companies for subscribers, it can raise their costs by bargaining more aggressively for access to its programming or pressure cable companies for better placement for its channels"); Scanlon, Neel and Lafayette, *The Dish on DirecTV*, Cable World, April 14, 2003, at 15 ("One senior network affiliate relations exec says that owning a distribution platform gives Murdoch leverage to get top dollar for existing services"); Krause, *Would DirecTV Deal Lead to Price Wars*, Investor's Business Daily, April 11, 2003 ("If he owned both DirecTV and Fox, Murdoch would have plenty of bargaining chips to negotiate fees and cable carriage"); Patsuris, *Murdoch Masters His Media Universe*, Forbes, April 9, 2003 ("With Murdoch becoming a more powerful distributor, News Corp.-owned networks such as Fox News and its many regional sports networks will gain even more bargaining power when negotiating programming terms with competing cable and satellite distributors").

> Kagan Associates sports analyst John Mansell said. "There's greater chance of YES-type situations – only it'll be Fox [networks], and they'll be even more inclined to go out and promote DirecTV in regions where the cable operator doesn't pay up."[114]

DirecTV's national footprint renders it ideally suited to offer tactical support to News Corp. in program negotiations with cable operators, since it can reach any and every local cable market in the country. News Corp. need not fight battles with every cable operator or in every local market – selective disputes in particular local markets can send a powerful message to other distributors.

News Corp. might also run promotions on Fox broadcast and cable channels for both DirecTV and any channels dropped by cable operators due to carriage disputes. News Corp./DirecTV also could attempt to siphon local advertising revenues away from cable operators involved in carriage disputes over Fox content, by offering advertisers in that market special discounts for spots purchased on DirecTV, as well as Fox broadcast and regional sports services:

> News Corp. already has been very effective selling triopoly coverage in key markets such as New York, Chicago and Los Angeles where it owns duopoly TV stations and a regional cable sports network. Bringing that strength to the mix will help DirecTV generate much more than the $50 million to $100 million in total ad dollars it now does, according to Merrill Lynch. . . . By virtue of owning cable and broadcast networks, TV stations and a satellite platform, and regional sports networks, "News Corp./Fox will be in a unique position to influence and possibly bundle a disproportionate share of ad dollars. There may also be an impact on the national level as DirecTV is a point-to-multipoint network."[115]

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[114] Mike Farrell, *No Death Star: Cable Takes News-DirecTV Deal in Stride*, Multichannel News, April 14, 2003, at 1 (quoting cable programming executive saying that Murdoch will "use every ounce of his leverage to beat up cable operators who don't carry his content").

[115] *Mermigas on Media*, April 16, 2003.

News Corp. could also use its control over Gemstar/TV Guide's electronic programming guide ("EPG") to promote DirecTV during carriage disputes.[116] The proliferation of cable programming channels has enhanced the importance of EPGs as navigational aids for multichannel subscribers.[117] The EPG functions as both a navigational device and an operating system for a subscriber's multichannel service, thereby heightening the significance of the content categories, channel links, and banner – or "above-crawl" – content. Gemstar is the dominant provider to cable operators of EPGs compatible with the GI/Motorola digital platform; DirecTV's and EchoStar's EPGs are as well based on technology licensed by Gemstar.[118]

In a carriage dispute, the EPG could be used to exploit subscriber dislocation and resentment associated with dropped channels, through heightened promotion of DirecTV or by placing text messages and click-through DirecTV marketing materials on the EPG channel slot normally associated with the dropped service. Gemstar/TV Guide's broad patent claims and restrictive licensing agreements[119] – which already provide it with excessive control over the "look and feel" of cable operator's on-screen guides – would facilitate the use of its EPG in this manner.

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[116] *See* Scanlon, Neel and Lafayette, *The Dish on DirecTV*, Cable World, April 14, 2003, at 15 ("DirecTV's reach can be extended by cross-promotion with TV Guide").

[117] *See* Duffy Hayes, *Nick in the Armor*, CED, October 1, 2002, at 30 (describing the EPG as "a crucial 'portal' for users to directly interact with their cable service.").

[118] *See U.S. v. Gemstar and TV Guide*, D.D.C., complaint filed February 6, 2003, at ¶ 28 (CV No. 1:03CV00198).

[119] *See* Duffy Hayes, *Nick in the Armor*, CED, October 1, 2002, at 30 ("today more than 100 million users interact with the guide. And over time, Gemstar has protected that virtual monopoly through an aggressive strategy of patent litigation and endless court battles.").

Indeed, News Corp. could use its ownership of Gemstar to disadvantage DirecTV's downstream rivals' in other ways as well, particularly via the terms, conditions and price for licensing its dominant electronic program guide technology.[120] Cable operators that have committed to upgrade their systems would not regard incompatible EPGs as viable substitutes and are thus "locked in" to agreements with Gemstar.[121] News Corp. could raise the costs of the Gemstar EPG or otherwise discriminate against cable operators in the content, unique features, or license terms and conditions offered to these competitors.

B. News Corp's Track Record in Overseas Markets Underscores the Risks that the Transaction Will Foster Higher Programming Costs

News Corp's track record in the United Kingdom markets offers a glimpse of the manner in which the company may seek to exploit the combined leverage associated

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[120] Navigational tools and electronic program guides are an important component to any digital cable system. EPGs essentially act as the operating system for the digital set-top box. According to the DOJ, such guides are a relevant antitrust product market and there are numerous barriers to entry into that market. *See U.S. v. Gemstar and TV Guide,* D.D.C., complaint filed February 6, 2003 (CV No. 1:03CV00198). These barriers include:

> the difficulty and cost associated with inventing around existing intellectual property (and the consequent legal costs of researching and defending against patent infringement claims, as well as the legal costs of indemnifying service provider customers against such claims); the cost and delay associated with software development; and the need for technical cooperation from set-top box manufacturers and other providers of hardware or software with which an EPG must interact.

Id.

[121] This discussion addresses these harms only in terms of the price paid by cable operators for a necessary input. Other harms, such as the stifling of innovation in the market for EPGs due to Gemstar's absolute monopoly, are not addressed here.

broadcast, content and national multichannel distribution assets.[122] In the U.K., News Corp. owns a 35 percent interest British Sky Broadcasting ("Sky"). In addition to its delivery platform, Sky provides content channels on its satellite system. These channels include six basic channels (including Sky One, Sky News, Sky Travel and others) and seven premium channels (including three channels of Sky Movies and four channels of Sky Sports).

News Corp. "has been able to steadily grow Sky's market share in the U.K. despite frequently raising prices on content [it] controls, which forces cable operators to either raise customer prices or suffer financial losses."[123] After launching Sky B in 1989 News Corp. "offered what seemed vast sums for exclusive rights to key sporting events like Britain's Premier League soccer games . . . ."[124] Capitalizing on the popularity of British soccer, "Murdoch simply bought the national game out from under the BBC and ITV. British soccer fans need to have Sky."[125]

Sky's strategy has been to bid high to secure long-term television rights, and then use those rights to develop "must have" channels for sports and premium movies. By securing a critical mass of rights, Sky has been able to restrict the ability of third parties in the U.K. to develop and sustain an independent source of top-flight programming. The staggered nature of the auctions for sports and first-run movie rights hampers rivals from

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[122] *See* Cowell, *For BSkyB, Big Gains Come After Big Gambles,* N.Y. Times, April 11, 2003 at C1.

[123] *Mermigas on Media,* April 16, 2003.

[124] Cowell, *For BSkyB, Big Gains Come After Big Gambles*, N.Y. Times, April 11, 2003 at C1; Bale, *Murdoch Always Gets His Man*, CBS Marketwatch, April 18, 2003 ("Paying what then seemed unthinkable sums for soccer rights gave Murdoch control of a game").

[125] *See* Cowell, *supra* note 124.

securing an adequate content rights foundation to develop competing services.[126] The upshot is that Sky's retail competitors depend on it as a critical source of programming, and are thereby particularly vulnerable to programming cost increases.[127]

As a result of bidding up the costs for sports and other popular programming, BSkyB's main cable rivals have been weakened significantly.[128] The two main providers of cable television in the U.K., Telewest (1.7 million subscribers) and NTL (1.2 million subscribers), have each lost dramatic amounts of money and market share competing with BSkyB,[129] and rising programming costs have been identified as a key culprit.[130]

The program pricing stratagems employed by Sky against its rivals have come under close scrutiny by British regulators. In 1995, the Office of Fair Trading began investigating allegations of anticompetitive behavior on the part of Sky to determine

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[126] *See* Horsman, *Murdoch's Hold Over Pay TV Under Attack*, The Independent, May 27, 1995, at B16 (Noting UK cable companies view that "Mr. Murdoch has secured key programming rights at high prices, limiting the amount of non-Sky broadcasts available to the cable industry").

[127] *See, e.g.*, Hayes, *US West Sees Control of Cable Company as Key to Taking On BT*, The Independent, January 25, 1998, at B3 ("Telewest depends on its biggest rival, British Sky Broadcasting, for TV programming. Telewest has lost a third of its market value in the last year as new TV customers fell by 39 percent . . . in part because BSkyB raised programmed prices).

[128] *BSkyB Kicks its Rivals Into Touch*, Mail on Sunday, August 26, 2001, at 9 ("Using sports content as its battering ram, BSkyB has established a leading market position over ITV Digital . . . and cable companies NTL and Telewest").

[129] *See Tony Ball*, Financial Times, October 29, 2002, at 10 ("during the past year, the shortcomings of ITV Digital, the digital terrestrial platform that collapsed into bankruptcy this year, and the crippling debt burdens of cable groups Telewest and NTL have served only to exaggerate BSkyB's s strength").

[130] *See* Price, *Telewest Attacks BSkyB Price Rise*, Financial Times, January 23, 1998, at 20 ("Telewest Communications, the UK's second biggest cable company, yesterday blamed price increases by BSkyB, its main supplier of television programmes, for a rise in the number of customers failing to renew their subscriptions last year").

whether Sky should be subject to further examination from the U.K. Monopolies and Mergers Commission.[131] The report was prompted by allegations that Sky was exploiting market power and acting anticompetitively by setting excessive wholesale prices and placing unreasonable conditions on supplying the Sky programming channels.

In particular, Sky employed a "retail minus" pricing structure to minimize cable operator margins gained from retail distribution of Sky content, while maximizing Sky's returns at the wholesale level. It was alleged that this prevented price competition because each time Sky raised its retail price, the immediate effect was to raise wholesale prices to cable operators. The OFT concluded that tying the wholesale price paid for Sky programming to the retail price for Sky's multichannel satellite offering "might have the effect of limiting potential price competition between DTH and cable."[132] As a result of the OFT investigation, Sky agreed to supply certain channels separately rather than solely on a bundled basis and pledged to relax its 100 percent penetration requirement.[133] It also agreed "not to insist that new premier channels, such as Disney, are available only to those who first agree to purchase two BSkyB movie channels."[134]

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[131] "Director General to Conduct BSkyB Review," Office of Fair Trading, PN No 50/95, 1 December, 1995, attached as Appendix B to Office of Fair Trading, "The Director General's Review of BSkyB's Position in the Wholesale Pay TV Market," December 1996 ("1996 OFT Report"), available at http://www.oft.gov.uk/nr/rdonlyres/eupiym w5hitxeuawrxfukg44iowwyubhp33q4nimzdezdp33wgfi2kg2vigxp6r5ma55pmtejiigl7a3f ottlsocjwb/oft179.pdf.

[132] *See* 1996 OFT Report at 14-15.

[133] Buckingham, *OFT Inquiry Leaves BSkyB Unscathed*, The Guardian, July 25, 1996, at 18.

[134] *Id.*

Notwithstanding these pledges, BSkyB continued to resist unbundling the set of content offerings made available to UK cable operators.[135] In one instance, Sky proposed to alter the terms and conditions under which programming was made available to cable operators, in order to blunt competition from rival content suppliers. When cable operators dropped Sky News in favor of the BBC's News 24 channel, Sky sought to revise the wholesale price charged to cable operators for Sky News and Sky One, an entertainment channel carrying programs such as The Simpsons, Friends, ER, and the X-Files.[136] More recently, Sky has been engaged in a carriage dispute with the BBC, and has threatened "to remove BBC1 and BBC2 from the most prominent slots on its televised program guide."[137]

In December 2000, the OFT launched an inquiry into Sky's "supply of wholesale TV."[138] In December 2001, OFT announced a proposed decision that BSkyB "has a dominant position on the wholesale market for the provision of pay premium sports and film channels" and that "BSkyB has abused its dominant position in that market and in the market for the distribution of pay channels."[139] The OFT's proposed decision

[135] *See* Price, *Telewest Attacks BSkyB Price Rise*, Financial Times, January 23, 1998, at 20.

[136] *BSkyB Threat to Start Price War Against BBC News Rival*, The Observer Business, March 22, 1998, at 1.

[137] Cowell, *For BSkyB, Big Gains Come After Big Gambles*, N.Y. Times, April 11, 2003, at C1.

[138] "BSkyB: Competition Act Inquiry," Office of Fair Trading PN 50/00, 5 December 2000, http://www.oft.gov.uk/news/press+releases/2000/pn+50-00.htm.

[139] "OFT Proposes to find BSkyB in breach of law," PN 51.01, 17 December 2001, http://www.oft.gov.uk/News/Press+releases/2001/PN+51-01.htm.

suggested that Sky's wholesale pricing of premium movie and sports channels were so excessive as to impose a "margin squeeze" on third party distributors.[140]

In its final report, the OFT reiterated that BSkyB had a "dominant market position" in the wholesale supply of premium sports and film content. While concluding that on the "margin squeeze" issue, BSkyB was "around the borderline of anticompetitive behaviour," the OFT determined that there were "not sufficient grounds to conclude that BSkyB has broken competition law." In short, BSkyB's track record in the U.K. underscores the risks that this transaction will expand opportunities for News Corp. to artificially inflate programming costs and impose unfair tying and bundling requirements for content it controls in order to harm rival content suppliers and distributors.

C. Consumers Will be Harmed by The Merger

When News. Corp. raises the prices it charges rival MVPDs for programming, consumers will be harmed in the short run because most, if not all, of these programming price increases will be passed through to consumers in the form of increased cable subscription prices. Cable programming networks charge cable systems for their programming on a per subscriber per month basis.[141] Therefore the cable system views the per month per subscriber fee as a marginal cost of providing service to a customer. It is of course standard economic theory that a firm facing a downward sloping demand

[140] *Id.* The proposed decision also suggested that "the discounts BSkyB gives distributors when they take packages of premium channels may be set at a level that prevents rival premium channel providers from entering the market." *Id.*

[141] *See Reply Comments of MediaCom Communications Corporation* for a general discussion of pricing practices for cable network programming.

curve (as cable systems surely do) will respond to an increase in its marginal costs by increasing price.[142]

In the long run, the potential harm to consumers will be even greater to the extent that rival MVPDs are either driven out of business or at least weakened to the point where competition is reduced. A reduction in competition would of course cause further price rises for all consumers. The danger of this occurring is especially acute in less dense regions of the country where the business case for multiple MVPDs is weakest. In particular, there are many regions of the country served by small cable systems that have not yet invested in digitalizing their networks.[143] Weakening or causing them to exit will strengthen News Corp./DirecTV's ability to raise prices in those markets.

V. NEWS CORP.'S APPLICATION "COMMITMENTS" ARE INSUFFICIENT TO ADDRESS THE PRINCIPAL HARMS ASSOCIATED WITH THIS TRANSACTION

In its application and public statements, News Corp. has offered to comply with certain "program access"-style commitments. Clearly, the fact that the commitments were made in the first place is a sign that the parties themselves recognize the transaction's serious potential anti-competitive effects. Still, the commitments do not go far enough to protect consumers against likely abuses, and do not address News Corp.'s

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[142] *See* Rogerson at 25.

[143] *See* Rogerson at 26.

ability to raise prices across the board. Importantly, the proposed commitments do not extend to broadcast stations.[144]

A. News Corp's Commitments Will Not Deter the Upward Pressure on Fox Programming Costs Triggered by this Transaction

While vertical integration in the video programming business is not new, this transaction presents new issues that implicate a different set of potential vertical harms than those previously addressed by law- and policy-makers. Up until now, the primary concern with vertical integration in the cable industry had been that carriage arrangements between MVPDs and affiliated programmers would be structured to benefit the MVPD retail distribution arm.

To be sure, the instant transaction presents these issues. News Corp./DirecTV's upfront willingness to embrace conditions constitutes an implicit acknowledgement that this transaction implicates those harms – although, as set forth below in Section V.B, the application of program access-like remedies to the instant transaction needs to be clarified and perfected.

The proposed merger does not, however, simply create a significant risk that News Corp. will seek to employ exclusionary or discriminatory strategies facially designed to preclude DirecTV's rivals from gaining access to Fox programming. As set forth above, the evidence shows that News Corp. has a track record of using its multiple ownership interests in highly desirable programming to obtain increasingly higher prices

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[144] When asked at a House Judiciary Committee hearing on May 8, 2003, about the proposed commitments, Mr. Murdoch confirmed that News Corp.'s commitment did not extend to broadcast stations. Oversight Hearing on Direct Broadcast Satellite Service and Competition in the Multichannel Video Distribution Market, House Judiciary Committee, May 8, 2003 (statement of Rupert Murdoch).

from its customers. In addition, DirecTV is primed to provide critical support for these efforts, as it currently benefits whenever cable customers migrate as a result of program carriage disputes. Bringing DirecTV inside the News Corp. tent will transform reciprocally reinforcing self-interested conduct of DirecTV and Fox that occurs during carriage negotiations with cable operators, into formal coordination aimed at maximizing Fox's leverage.

The real and present danger posed by the transaction is that of disproportionate price *increases*, and News Corp.'s "commitments" do not and cannot safeguard against across-the-board price increases.

> Vertical integration in this case does increase News Corp.'s advantage, said Stephen Blum of Tellus Venture Assoc. "You don't really lose money in a transaction. It's money that goes from one pocket into another. News Corp. said they would offer programming to everyone for the same price, but if it's high so be it," Blum said.[145]

News Corp. is promising to treat unaffiliated program distributors no worse than DirecTV. If News Corp. obtains artificially *high* prices for its programming from DirecTV, it will not be "discriminatory" to seek the same prices from non-affiliated distributors:

> Although Mr. Murdoch has pledged to offer News Corporation's programming to other pay television operators on the same terms as they are offered to DirecTV, he may still raise the price of some events or channels, since one company he controls, DirecTV, will be paying another, Fox Entertainment, owned by News Corporation.[146]

The inefficacy of News Corp.'s commitments in deterring price inflation derives, in part, from one of the key differences between DirecTV and its cable competitors:

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[145] *Mermigas on Media*, April 16, 2003.

[146] Kirkpatrick, *Murdoch Gets Upper Hand on Cable with Hughes Deal*, N.Y. Times, April 10, 2003, at C1.

unlike cable operators, DirecTV has a national footprint that provides it with a presence in every local market. Because a cable operator has a limited footprint – no cable operator reaches more than about one-third of the country – its vertically-integrated cable services will always be dependent upon third-party cable and satellite distributors to deliver programming to households located in markets where the operator owns no systems. This dependence effectively places a constraint on the wholesale price a vertically-integrated programmer can charge, since no third-party cable operator would have an incentive to pay an inflated rate for an unaffiliated programming service owned by another operator, particularly since that channel also would be available to the operator's rivals via program access.[147]

Thus, the need for a vertically-integrated programmer to sell its programming beyond its affiliated cable operator's footprint deters the establishment of an inflated benchmark price for purposes of meeting any non-discrimination requirement imposed by program access. Since DirecTV, however, can reach every household in the country, this deterrent is absent:

> . . . it is interesting to note that the failure of the proposed condition to prevent the "charge high prices to everyone" strategy is caused to some extent by the fact that DirecTV has a national footprint. If News Corp. were to merge with an MPVD with a less-than-national footprint, then News Corp. would have an incentive to charge lower prices in its out-of – region areas. In this case, the non-discrimination condition would impose a real constraint on New Corp…. The "problem" with the News Corp.-DirecTV case is of course that DirecTV has a national footprint so there will be no out-of-region MVPDs that News Corp. will want to charge low prices to. Therefore, it can charge as high a price as it wishes to its rivals simply by charging an equally high price to DirecTV.[148]

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[147] *See* Rogerson at 29-30.

[148] *Id.*

The Commission should not expect the Application commitments to provide any constraint on its incentive and ability to increase programming costs for Fox content. The commitments will not provide a check against the upward pressure on cable rates and prices associated with this transaction.

B. News Corp.'s Proposed Internal Audit Committee Will Not Deter DirecTV from Paying Higher Prices for Fox Content

In its Application, News Corp. further contends that the requirements of the Sarbanes-Oxley Act, as well as an Audit Committee review of programming contracts between DirecTV and News Corp. programming affiliates, will ensure that such contracts are "on arms' length terms."[149] All the proposed new Hughes corporate documents actually state is that the board audit will define what related party transactions they will review and will approve such transactions.[150]

There is, however, evident skepticism among market observers about whether DirecTV will be able to offer any meaningful resistance to program price hikes sought for Fox content.[151] Further, the actual measures cited by News Corp. cannot be expected to prevent DirecTV from paying inflated rates for Fox programming. The enclosed Affidavit of Professor Lynn Stout of the UCLA School of Law, an expert in corporate

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[149] Application at 59.

[150] Proposed Hughes Revised Articles of Incorporation, Article V, § 5 (filed at SEC on June 5, 2003); Proposed Hughes Amended and Restated By-Laws, Article III, § (filed at SEC on June 5, 2003).

[151] *See Mermigas on Media*, April 16, 2003 ("But one investment banker views it another way. 'The way he (Mr. Murdoch) set it up is so brilliant. He is advantaging Fox and disadvantaging Hughes'"); *Murdoch Always Gets His Man*, CBS MarketWatch, April 18, 2003 ("Over at broker Oppenheimer & Co., analyst Peter Mirsky identified the age-old problem with anyone investing in a company controlled by News Corporation and therefore by Rupert Murdoch. Is he working for their interests or those of News Corp? 'It exacerbates concerns that the company is run for the benefit of" News Corp").

law and securities regulation, makes clear that transactions entered into between Hughes and its controlling shareholder News Corp. are "intrinsically suspect" because they raise the problem of "controlling shareholder self-dealing."[152] The safeguards News Corp. proposes are not an effective means to address such a problem.

First, the Sarbanes-Oxley Act has little relevance to deterring News Corp. from subjecting DirecTV to inflated prices for Fox content. News Corp. will be the majority shareholder of DirecTV and the day-to-day manager of its operations. There is nothing in Sarbanes-Oxley that would, by its terms, prevent a controlling stockholder such as News Corp. from exerting undue influence over the company of which it holds a controlling block of shares. While the passage of the Act has certainly led to a heightening of awareness on the part of United States publicly traded corporations of issues surrounding conflicts of interest between the corporate entity and a company's officers, directors and significant stockholders, there are no provisions in the Act that would require pre-approval of, or otherwise regulate, conflict of interest transactions involving controlling stockholders.

The Act's provisions relating to conflicts of interest primarily address transactions between a corporation and its officers and directors, such as the prohibition on loans to executive officers and directors and the prohibition on trading in company stock by officers and directors during pension fund blackout periods. Accordingly, the provisions

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[152] Lynn A. Stout, Affidavit, attached hereto as Exhibit B ("Stout") at 4-5; 7. As Professor Stout explains:

> The classic example of this is the case where a parent uses its influence to cause a partially-owned subsidiary to enter a contract requiring the subsidiary to buy or sell goods or services from the parent on terms that are less favorable than those the subsidiary could obtain in arms-length transactions.

Id. at 5.

of the Act itself will not protect any interested stakeholders from potential overreaching on the part of News Corp. as a controlling stockholder of Hughes. As Professor Stout notes, Sarbanes-Oxley does not remedy the problem of controlling shareholder self-dealing because, "in a very basic sense, no director can be 'independent' of a controlling shareholder's influence."[153]

Second, it is unlikely that the Audit Committee proffered by News Corp. could effectively prevent Fox from pushing program price increases on DirecTV. As a threshold matter, there will be obvious disparities in expertise between the News Corp. officials in charge of day-to-day program sales and distribution activities, and the Audit Committee members. It is impractical to expect that an Audit Committee will be able to parse the complicated programming contracts or other related party transactions to ensure that the price is the same as would have prevailed from an arms-length transaction. The Audit Committee would not have access to News Corp.'s contracts with others.[154] And, as a legal matter, Professor Stout makes plain that review and approval of transactions

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[153] *Id.* at 8. Professor Stout continues:

> Each director owes a fiduciary duty to that shareholder, and each also must recognize that if he goes against the controlling shareholder he will likely lose his position on the board. The result is that even "independent" directors may, as a practical matter, be dominated by and defer to a controlling shareholder.

Id.

[154] While it may be easier for an Audit Committee to utilize a review process in the case of particularly noxious transactions, it would be much more difficult to do so in the case of most agreements. Certainly, showing that the price charged under a program supply agreement was not "fair" and was intended to maximize News Corp.'s profits rather than those of Hughes would be difficult in the extreme.

between News Corp. and DirecTV "does not remedy the problem of controlling shareholder self-dealing."[155]

Further, News Corp. offers no indication as to how the Audit Committee will function, or when contracts will be subject to review.[156] In addition, since DirecTV, by virtue of its status as the second largest MVPD in the country, is likely to receive a better price for Fox content than many other distributors, any reliance on comparative data between fees paid by DirecTV and other distributors, even if available, is unlikely to be probative of whether the benchmark fee sought by Fox is above-market. Professor Stout makes this very clear in her Affidavit, where she concludes that the acquisition would raise problems "that cannot be addressed" by any of the proposed mechanisms suggested by News Corp.[157] Each director owes a fiduciary duty to the controlling shareholder.[158] Each director must recognize that resisting the controlling shareholder could result in

[155] Stout at 8. As Professor Stout notes, the solution offered by News Corp. is for an entirely different problem, that of officer and director self-dealing, which is "not particularly relevant" in this transaction. *Id.* at 7.

[156] There is no independent requirement in the New York Stock Exchange proposed governance standards for a company such as Hughes to have its audit committee approve any related party transactions with News Corp. The only requirement is that the fact of any related party transactions be disclosed. The Application merely states that any programming contract between DirecTV and a News Corp. programming affiliate "*would be subject*" to review and approval, in a manner that is "determined by the Audit Committee." Application at 59. Such statements leave a great deal to the discretion of the Audit Committee, and do not by any means require that such transactions be reviewed and approved before they are entered into.

[157] Stout at 9.

[158] *Id.* at 8.

losing the board seat.[159] As a practical matter, "independent" directors are likely to be "dominated by and defer to the controlling shareholder."[160]

Fundamentally, as Professor Stout notes, there are "substantial barriers" to the ability of non-controlling shareholders to prevent self-dealing of the sort that could arise in connection with transactions between News Corp. and Hughes.[161] Non-controlling shareholders cannot be expected to know of self-dealing transactions in advance, nor even detect them when they occur.[162] Even if self-dealing is suspected, non-controlling shareholders may lack the resources or inclination to undertake the litigation necessary to establish a breach of duty.[163] And it would be difficult in the extreme to establish what a "fair price" would be under those circumstances in any case.[164] For all of these reasons, neither the safeguards News Corp. mentions nor the provisions of applicable law are adequate to ensure that News Corp. does not take advantage of its position as the controlling shareholder of Hughes in connection with transactions entered into by the two parties.

C. News Corp.'s Commitments Must Be Expanded and Refined In Order to Accomplish Their Stated Objective of Ensuring Fair and Non-Discriminatory Access to All News Corp. Affiliated Programming Content

[159] *Id.* at 8.

[160] *Id.* at 8.

[161] *Id.* at 6.

[162] *Id.* at 6.

[163] *Id.* at 6.

[164] *Id.* at 6.

News Corp.'s commitments, while helpful in preventing *de jure* exclusionary conduct with respect to both Fox content and the DirecTV platform, require further refinement.

<u>First</u>, News Corp. has tellingly avoided making its local broadcast television stations unambiguously subject to these "program access" commitments. There is no logical rationale for subjecting News Corp.-affiliated cable programming content to a non-discrimination requirement while exempting its broadcast content from the same directive.[165] The fact that the program access rules do not apply to broadcast programming is of no relevance, since, at the time those rules were enacted, it was unlawful for a cable operator to be vertically integrated with a broadcast station operating within the footprint of any of the operator's cable systems.

News Corp. clearly would have the incentive and ability to place cable operators and other MVPDs at a disadvantage relative to DirecTV with respect to retransmission consent terms for Fox broadcast stations. While the good-faith negotiation requirements for retransmission consent negotiations established in the Satellite Home Viewer Improvement Act do not preclude a local broadcast station from negotiating different terms and conditions with different MVPDs competing in the same market, such differences must be based upon "competitive marketplace considerations."[166] The Commission's implementing order never considered whether it would be consistent with that standard for a broadcast station to accord more favorable treatment to an affiliated

[165] *See* Rogerson at 30-31.

[166] 47 U.S.C. § 325(b)(3)(C).

MVPD than to an unaffiliated rival distributor competing in the same market.[167] This too may reflect the fact that same market MVPD/broadcast combinations were either unlawful (in the case of cable) or unlikely (in the case of DBS) at the time those rules were adopted. If, however, DirecTV is afforded more favorable retransmission consent terms and conditions by an affiliated Fox local broadcast station than a rival MVPD competing in the same market, such favoritism is unlikely to reflect solely "competitive market considerations." Thus, broadening News Corp.'s commitments to cover its affiliated local broadcast stations (or any Fox affiliates on whose behalf it negotiates retransmission consent agreements) would not be inconsistent with the Commission's rules.

Second, News Corp. proposed that the commitments sunset whenever the cable program access commitments are ended by the Commission.[168] These conditions, and the additional conditions that are required to address the competitive and public interest harms posed by the transaction are not a matter of regulatory parity, but a matter of need to protect the public interest and consumer welfare. Their duration should be uncoupled from other regulatory deadlines, particularly in the case of broadcast station retransmission consent conditions, for which there are no direct analog.

Third, the need to broaden News Corp.'s commitments also is underscored by Rupert Murdoch's recent suggestion that there might be a single national feed of Fox

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[167] *See In the Matter of Implementation of the Satellite Home Viewer Improvement Act of 1999, Retransmission Consent Issues: Good Faith Negotiation and Exclusivity*, 15 FCC Rcd 5445, 5465-70 ¶¶ 48-59 (2001).

[168] Application at Attachment G.

network programming in HDTV format.[169] It is unclear whether such a national HD feed of Fox broadcast network programming would be covered by News Corp.'s commitments, though News Corp. clearly appears to view such an offering as providing a competitive advantage.[170] Fidelity to both the principles underlying the program access commitments, as well as the Commission's goal of ensuring a smooth, rapid and efficient transition toward digital and HD television, militate strongly in favor of ensuring that competitive MVPDs have non-discriminatory access to any HD feed of Fox network programming made available to DirecTV by News Corp.

VI. THE APPLICATION OVERSTATES THE SUGGESTED PUBLIC BENEFITS ATTRIBUTABLE TO THE MERGER

In their consolidated application, the Applicants claim that News Corp. currently expects that within three years the transaction will create synergies and efficiencies of between $610 million to $765 million annually. Applicants evidently claim these efficiencies as potential public interest benefits that mitigate the competitive and public interest harms raised by the transaction. However, the Applicants' showing does not meet the criteria the Commission applies before accepting a claim of benefit, and the

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[169] *See* Hearn, *Grilled Murdoch Drops HD Hints*, Multichannel News, May 26, 2003, at 40 ("Murdoch hinted to reporters that there might be a way around the capacity problem. 'I think HDTV is basically going to be done by networks. We won't need to repeat each HDTV 200 times,' he said. That comment suggested that during primetime – when HDTV is expected to see its most intensive use – a national network feed would replace the local signal, evidently cutting affiliates out from crucial advertising time during the key evening hours").

[170] *See id.* at 40 (quoting News Corp. spokesman as saying "under News Corp. ownership, Hughes would strongly support HDTV. 'It's a great way to differentiate ourselves.'").

assertion of $610 million to $765 million in annual synergies and efficiencies should be given no weight.

As the Commission delineated in the EchoStar designation order, the Commission applies several criteria in considering potential public interest benefits:

- First, claimed benefits must be *merger specific* – i.e. the claim benefits must be likely to be accomplished as a result of the merger but unlikely to be realized by other means that entail fewer anticompetitive effects.[171]

- Second, claimed benefits must be *verifiable*. The merging parties "must provide sufficient support for any benefit claims so that the Commission can verify the likelihood and magnitude of each claimed benefit" . . . "speculative benefits that cannot be verified will be discounted or dismissed."[172]

- Third, benefits are generally counted only to the extent that they can mitigate any anticompetitive effects of the merger. Reductions and marginal costs are more likely to reflect in lower equilibrium prices and thus the Commission would more likely find marginal cost reduction cognizable than fixed-cost reductions.[173]

- Fourth, the Commission applies a sliding scale approach to weighing claim benefits against potential harms.[174]

Against these criteria, the Application fails to meet the burden of persuasion that exists on the parties to the transaction here.

A. News Corp. Does Not Have The Demonstrated Ability To Bring Local-into-local To A Single Additional DMA

The Applicants apparently recognize that the Commission is skeptical of claims that all 210 DMAs will be served in the near future with local broadcast channels via

[171] *Hearing Designation Order,* 17 FCC Rcd at 20650 ¶ 242.

[172] *Id.* at 20650 ¶ 243.

[173] *Id.* at 20651 ¶ 245.

[174] *Id.* at 20651 ¶ 246.

DBS.[175] News Corp. instead asserts that it will do its best to offer local-into-local in as many markets as economically feasible. But this promise to "dramatically increase" the number of DMAs that can receive local-into-local service does not withstand scrutiny.

The Applicants themselves admit that Hughes will expand DirecTV's local-into-local offerings to 100 DMAs in 2003 regardless of the merger. In fact, Chairman Powell has already noted that DirecTV alone is already "capable of offering local broadcast stations to 80-85 percent of American homes in a very short period of time."[176] Plus, it has "the economic incentive to do so, since [it is a] much stronger competitor[] to cable in markets where [it] offer[s] 'local into local' service."[177] Additionally, the Commission noted in the *EchoStar/DirecTV Hearing Designation Order* that any benefit of serving DMAs 101-210 with local-into-local service would clearly be outweighed by the costs of doing so, as these 110 DMAs account for only 14 percent of the U.S. population.[178] Taken together, these two facts suggest that News Corp.'s acquisition of Hughes will bring local-into-local service to few if any additional DMAs since doing so would not be "economically feasible."

B. The Applicants' Claims That News Corp. Will Dramatically Increase Operating Efficiencies At Hughes Are Speculative And Non-Cognizable

News Corp. offers the Declaration of Peter Giacalone, its Vice President of Finance, in support of its non-specific assertions that the combination of News Corp. and

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[175] S*ee Hearing Designation Order,* 17 FCC Rcd at 20634 ¶ 203.

[176] *Statement of Chairman Michael K. Powell, In the Matter of EchoStar Communications Corporation, General Motors Communications, and Hughes Electronics Corporation, Transferors, and EchoStar Communications Corporation, Transferee, Hearing Designation Order,* 17 FCC Rcd 20559 (2002).

[177] *Id.*

[178] *Id.*

Hughes will result in hundreds of millions of dollars per year in operating efficiencies. The Application itself makes dramatic claims about these efficiencies and cites to the Giacalone affidavit for support; but upon turning to the Giacalone Declaration, one finds only puffery and not hard evidence or analysis.

News Corp. alleges that "it will be able to reduce DirecTV's annual overhead and other expenses . . . in the range of $65 million to $135 million annually – which will free up funds for investment in research, development, and marketing, and will make DirecTV a better competitor."[179] Even if this statement were merger related and verifiable,[180] such an economic windfall for DirecTV does not translate into a public interest benefit absent an explanation of how that translation will occur. The Commission has held that mere economic benefits to the merging parties are indicators of "the Applicants' private benefit, not the public interest."[181] Neither the Application nor Mr. Giacalone undertakes the requisite "welfare analysis that specifically considers whether claimed cost reductions result in net increases in social surplus which can be balanced against any anticompetitive effects of the merger."[182]

Under any circumstances, the huge dollar amounts attributed to efficiency gains in the application lack any support and are entirely speculative. All of Mr. Giacalone's dollar estimates are top-of-the-head guesses, and Mr. Giacalone offers no specific plans or calculations or so much as a detailed explanation to back up his numerous assumptions. For example, $40 million of annual savings are alleged to be forthcoming

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[179] Application at 31.

[180] S*ee* discussion *supra* note 21 and accompanying text.

[181] *Hearing Designation Order*, 17 FCC Rcd at 20633, 20637 ¶¶ 200, 211.

[182] *Id*.

once News Corp. is able to apply its “best practices” to Hughes’ customer service department,[183] despite the fact that Hughes is currently overhauling its own customer service department and will realize up to $40 million in annual savings by its acts alone (regardless of the merger).[184] Mr. Giacalone fails to give any explanation of how News Corp. will double the efficiency gains that Hughes, a firm currently short on cash with every incentive to downsize, is able to make on its own.

The Applicants claim that they are “only beginning to discuss the ways” in which their companies could be combined to decrease duplication and increase efficiency.[185] This would explain Mr. Giacalone’s estimates, such as his estimate that the merger will result in unspecified “synergies and efficiencies of approximately $610 million to $765 million per year in cost savings and increased operating earnings.” Even Mr. Giacalone admits that his estimates are “necessarily based on incomplete data and are inherently inexact.”[186] As discussed above, such unverifiable predictions about economic efficiencies, particularly when no evidence is presented to associate the parties’ private economic benefit with the public interest, are typically discounted or dismissed by the Commission.[187]

C. The Additional Economies Of Scope And Scale Touted By The Parties

The parties claim that News Corp.’s global dominance of satellite delivered DTH service will result in economies of scope and scale that will eventually translate into more

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[183] Giacalone Declaration at ¶ 11.

[184] *Id.*

[185] Application at 32.

[186] Giacalone Declaration at ¶ 8.

[187] *See* Standard of Review, *supra* p.9 *et seq*.

innovative programming and technology.[188] News Corp. claims that its "[g]reater efficiency in developing and producing STBs alone will reduce costs by approximately $60 million annually within two years."[189] This efficiency gain is premised upon News Corp.'s "opportunities for spreading the costs of research and development of technology,"[190] thereby resulting in a decrease in STB costs of $10 per box.[191] This argument incorrectly assumes that News Corp. manufactured all of its own STBs. However, STBs are currently provided on the open market by manufacturers such as Sony, RCA, Samsung, Zenith, and Philips (as well as Hughes Electronics). These third-party STB vendors, and even Hughes Electronics, already compete among each other to provide the best new technology at the lowest price. The basic assumption that a free market will allocate resources efficiently argues that competition between these third-party manufacturers will drive the price for STBs to an efficient level. This transaction will merely decrease the number of buyers in that market.

D. Increased Customer Satisfaction

The Applicants' fifth asserted efficiency gain, higher profits due to increased customer satisfaction arising from innovation that only News Corp. can foster, is a simple re-statement of the parties' initial claim that News Corp. will bring a vaguely defined "spirit of innovation" to DirecTV. As such, this "efficiency" is far too vague to be given weight by the Commission. The parties' further assertion that they will benefit the public

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[188] Application at 33.

[189] Application at 33, citing Giacalone Declaration at ¶ 22.

[190] Giacalone Declaration at ¶ 21.

[191] This estimated $10 per box cost saving becomes $60 million when combined with Mr. Giacalone's top-of-the-head "assumption given our expectation for increased subscriber growth" in the next two years. Giacalone Declaration at ¶ 22.

interest by increasing the number of DirecTV subscribers cannot be considered merger specific.[192] The Application claims that News Corp. is uniquely situated to increase revenue within DirecTV and invest the excess in research and development of new services, thereby increasing customer satisfaction, increasing subscribership, decreasing churn, and producing additional earnings of $450 million to $525 million per year.[193] The Commission should give these assertions little or no weight.

E. The Transfer of Control Will Not Alter DirecTV's Commitment To Diversity And Equal Opportunity

News Corp. claims that it has "a deep commitment to equal opportunity and diversity that is among the best in the entertainment industry, and it will bring this commitment to Hughes."[194] We take no issue with News Corp.'s commitment. However, DirecTV has traditionally held an identical commitment to diversity and EEO.[195] While equal employment would certainly remain an important goal in the merged company, it cannot be said that this commitment to diversity is in any way related to the merger or that there would be any less diversity at DirecTV without News Corp.

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[192] As discussed above, only those public interest benefits that are unique to the proposed transaction will be considered in balancing the harms associated with the merger.

[193] *See* Application at 36-37.

[194] Application at 39.

[195] DirecTV's employment policy states that:

> DIRECTV is committed to fostering and maintaining a diverse work force that reflects the varying cultures of our customers and our nation. Our commitment to diversity is the reason we devote our resources to activities directed to females and minorities such as supporting professional organizations, sponsor national professional conferences, target recruitment efforts in many appropriate publications and job fairs, offer diversity training to our employees, and maintain policies which ensure diversity hiring and promotions. We are dedicated to maintaining a balance of ethnicity and gender so that every employee feels equally valued and welcome at DIRECTV. *Available at* www.directv.com/DTV APP/aboutus/WorkingHere.jsp.

CONCLUSION

The Commission needs to consider carefully the consequences of this first attempt to combine a national MVPD with a broadcast network, major broadcast station group owner, and major content provider, particularly in the area of sports. The Joint Cable Commenters believe that the Commission cannot conclude that the grant of the Application is in the public interest <u>until and unless</u> – through conditions on the grant of the Application, or through provisions in a legally-enforceable consent decree – the competitive concerns and threats to consumer welfare identified above are eliminated or substantially mitigated.

Respectfully submitted,

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I, Bruce D. Sokler, hereby certify that on this 16th day of June 2003, I served a copy of the foregoing document on the following individuals via ECFS, E-mail, or via first class mail, postage prepaid.

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