July 21, 2003

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, DC 20554

Re: Ex Parte Notice – MB Docket No. 03-124

Dear Ms. Dortch:

This letter is submitted in response to the Opposition to Petitions to Deny and Reply Comments ("Opposition") filed on July 1, 2003 by The News Corporation Limited ("News Corp.") and General Motors Corporation/Hughes Electronics Corporation (collectively the "Applicants") in the above-captioned proceeding.[1]

In their Opposition, the Applicants attempt but fail to refute the evidence presented in the Comments of the National Association of Broadcasters ("NAB Comments")[2] demonstrating that News Corp.'s acquisition of control of DIRECTV would strongly disadvantage local, non-Fox-owned broadcasters, absent the imposition of suitable conditions. News Corp.'s failure to grapple successfully with the NAB's arguments underscores the need for the conditions if the acquisition is to be approved.

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[1] Pursuant to Section 1.1206(b) of the Commission's Rules and the Commission's Public Notice in this proceeding, this letter is being submitted electronically to the Secretary's Office and the persons identified for service under the Public Notice.

[2] Comments of the National Association of Broadcasters, *In re Application of General Motors Corp., et al., for Authority to Transfer Control*, MB Docket No. 03-124, filed June 16, 2003.

I. The NAB Demonstrated that Absent Appropriate Conditions the Acquisition Would Harm Local Broadcasters and Localism and Diversity.

As explained in the NAB Comments, the acquisition of control of DIRECTV would give News Corp. the ability and incentive to behave in a manner that would injure local broadcasters, endangering their ability to protect the core public interest goals of localism and diversity.

The acquisition will combine the leading DBS provider and one of three multichannel video programming distributors ("MVPD") in nearly all markets, with a major national broadcasting network. This unique combination will give News Corp. the ability and incentive to utilize a national network feed to bypass local Fox affiliates it does not own. As the Declaration of J. Gregory Sidak accompanying NAB's Comments explains, the marriage of News Corp. and DIRECTV creates an incentive to bypass local affiliates because DIRECTV will be able to avoid paying retransmission consent fees to Fox affiliates and Fox will be able to capture what were previously local advertising dollars. Thus, bypass or the threat of bypass will increase News Corp.'s bargaining power vis-à-vis Fox local network affiliates, benefiting News Corp. and harming Fox-affiliated stations. The National Rural Telecommunications Cooperative also points out how Fox could centrally provide "local" content and repurposed Fox broadcasting programs[3] to bypass affiliates.

The threat of bypass is no mere chimera. Rupert Murdoch himself recently stated that: "I think HDTV is basically going to be done by networks. We won't need to repeat each HDTV 200 times."[4] As Multichannel News reported: "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."[5]

The acquisition will also give News Corp. the ability and incentive to exercise "gatekeeper" control through its MVPD platform to discriminate against all local broadcast stations. Such discrimination could range from a complete denial of access to more subtle discrimination, particularly in newer technology-related areas such as interactivity, use of navigation devices and electronic program guides, manipulation of data transfer speed, and exploitation of downstream and return path traffic. Notably, while News Corp. appears to concede the potential for discrimination inherent in the proposed acquisition by agreeing to a

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[3] Petition of the National Rural Telecommunications Cooperative to Designate Application for Hearing, *In re Application of General Motors Corp., et al., for Authority to Transfer Control*, MB Docket No. 03-124, filed June 16, 2003, at 15-16.

[4] Ted Hearn, *Grilled Murdoch Drops HD Hints,* Multichannel News, May 26, 2003, at 40.

[5] *Id.*

non-discrimination condition involving unaffiliated cable programming networks, it resists similar provisions that would bar discrimination against television broadcasters. There is no logical reason why the anti-discrimination provisions should not extend to local television broadcast stations as well as cable programming services.

The American broadcast system depends on a delicate balance of power that compensates networks while providing local broadcasters with the ability to serve their viewers and communities. By threatening the viability of all local broadcast stations, the acquisition as proposed would undermine this system, harming the local service and diversity which it makes possible.

To ensure the continued viability of local broadcasters as a source of localism and diversity, the NAB suggested several conditions to counter the increased power News Corp. would gain from the acquisition: (1) DIRECTV should be prohibited from transmitting a Fox network feed to any market currently served by a Fox local affiliate; (2) News Corp. and DIRECTV should be prohibited from discriminating against local broadcasters just as they have agreed not to discriminate against non-Fox-owned cable networks; (3) News Corp. and DIRECTV should agree to a firewall preventing the exchange of information between the two entities concerning any dealings with local broadcasters; and (4) DIRECTV should be required to expand local-into-local service to cover all 210 markets by January 1, 2006.

II. News Corp. Fails to Provide any Evidence Refuting the Contention that the Acquisition Would Be Contrary to the Public Interest in the Absence of Appropriate Conditions.

News Corp. and General Motors advance a variety of arguments in response to NAB's documentation of potential harm to localism and diversity from the proposed transaction. Their assertions, however, are unsupported and fall decidedly short of their burden of proof in this proceeding: "The Applicants bear the burden of proving by a preponderance of the evidence that, on balance, the proposed transaction serves the public interest." *In re Application of GTE Corp. and Bell Atlantic Corp.*, Memorandum Opinion and Order, 15 FCC Rec. 14,032, 14,046 ¶ 22 (2000). NAB has demonstrated the likelihood of harm to compelling public interests resulting from the merger, and the Applicants must do more than cursorily state their disagreement with that assessment.

A. The Applicants Fail to Demonstrate that the National Bypass Feed Proposed by Rupert Murdoch Would Be Feasible in the Absence of the Proposed Transaction.

The NAB Comments suggested that the proposed transaction would create a shift in the economic incentives that currently exist in the market. As Mr. Sidak explained, the merger would give News Corp. the ability and incentive to realize incremental advertising revenues and retransmission consent fees that it would not be able to recover in the absence of vertical integration.

The Applicants respond by arguing that if such a strategy were possible, it would be implemented now pursuant to contracts between the parties. This argument is deficient in at least two respects. First, the Applicants ignore the significant economic costs and implementation barriers associated with such complex contractual relationships. Not only would such a contract be difficult to implement, but the costs associated with the relationship could easily exceed the potential benefits from the bargain. It is an elementary economic principle that the costs and practical difficulties of complex contractual relationships often compel rational economic actors to merge in order to achieve goals that would not be feasible from arms-length negotiations:

> Vertical integration economizes on transactions by harmonizing interests and permitting a wider variety of sensitive incentive and control processes to be activated. Thus, the hazards of defection and cheating that are posed when a qualified joint profit maximization agreement is reached between (what continue to be) autonomous or semi-autonomous units are greatly reduced if a comprehensive pooling (that is, merger) agreement is reached instead.[6]

Presumably, DIRECTV would not want to risk losing subscribers (by risking the loss of local Fox affiliates) unless the future stream of compensation from Fox was credible. The merger is the most credible form of a commitment by Fox to compensate DIRECTV for any subscriber losses due to the bypass strategy.

Second, the Applicants' argument fails to address the fundamental question – whether the proposed transaction would result in any *change* in economic incentives. Clearly, barriers exist that prevent the parties from engaging in bypass at this time. But as Mr. Sidak explained in his declaration, those barriers will be substantially lessened through vertical integration. The Applicants' observation that bypass is not currently taking place does nothing to call Mr. Sidak's conclusion into question.

B. <u>The Applicants Fail to Show that the Commission's "Carry One, Carry All" Regime Would Prevent the Cited Change in Economic Incentives</u>.

The Applicants argue that the proposed transaction will not result in the ability or incentive to bypass local affiliates because the affiliates may choose "must carry" status under the Commission's "carry one, carry all" scheme. This argument ignores several pertinent facts outlined in the NAB Comments.

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[6] Oliver E. Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* 104 (1975).

First, if an affiliate is forced to choose must carry status, it loses all retransmission consent revenues – and News Corp. enjoys a corresponding cost savings. As explained in the NAB Comments, the economic incentive to eliminate retransmission consent fees threatens a shift in power between Fox and its local affiliates. By depriving the affiliates of revenues, this power shift would result in harm to localism and diversity as affiliates would be less able to offer local news and public affairs programming as well as attractive syndicated programming.

Second, the Applicants fail to consider the possibility that News Corp's high definition Fox broadcast feed could be transmitted whether or not local broadcast stations accept "carry one, carry all" status. As the MVPD gatekeeper, News Corp. would be in a prime position to offer specialized programming and other competitively significant features to migrate DIRECTV subscribers to the Fox national feed. The network would suffer no losses from such migration, as viewers of either option would accrue benefits to Fox national advertising.

C. The Applicants' Demand for Quantification Highlights Their Failure to Provide Evidence Supporting the Proposed Transaction.

Rather than advancing facts to support the public interest benefits of the proposed transaction, the Applicants attempt to divert the Commission's attention by pointing to the lack of an exact profitability calculation supporting the merger-caused detrimental change in economic incentives. Again, the Applicants' simplistic, "back-of-the-hand" response fails to satisfy the burden of proof in this proceeding.

Naturally, neither the NAB nor Mr. Sidak are able to precisely quantify the profitability of a bypass strategy given that the data supporting such a calculus is under the exclusive control of the Applicants. As a third-party commenter to the transaction, NAB's analysis is appropriately limited to the consequences that one would expect to result from the vertical integration of the leading MVPD satellite provider with one of the world's principal owners of television broadcast properties. The NAB Comments cogently outline the savings and incremental revenue gains that would naturally result from a bypass strategy by the merged entity. That the Comments lack specific accounting data is immaterial to the analysis. To the contrary, it is the burden of the Applicants to provide specific evidence showing that the transaction will benefit the public interest. Their failure to do so is instructive as to the likely harms that would result in the absence of market protection through appropriate conditions.

The Applicants' Lexecon analysis, which itself is completely devoid of quantification, also advances the argument that Mr. Sidak's conclusions are "based on his implicit – and unwarranted – assumption that News Corp. derives no value from having a national network of affiliates." This unfounded statement mischaracterizes, and in fact ignores, the substance of Mr. Sidak's declaration and NAB's arguments. There is no doubt that Fox derives value from its affiliation with local broadcasting stations. That question is not at issue. The relevant inquiry is whether the proposed transaction will create a shift in the balance of power between Fox and its local affiliates sufficient to harm localism and diversity in broadcast programming.

As Mr. Sidak explained, the vertical integration of Fox and DIRECTV would likely create an incentive for Fox to bypass its local affiliates in favor of a national network feed. This strategy would allow Fox to save significant costs and capture incremental advertising revenue, which could be used to compensate its downstream affiliate (DIRECTV) for any subscriber losses associated with the bypass strategy. The result would be an incremental gain to News Corp. at the expense of local broadcast stations and localism and diversity. The Applicants have offered no evidence to contradict this eventuality.

D. The Applicants Fail to Establish any Costs Associated with an Integrated Bypass Strategy.

The Applicants argue that a bypass strategy would result in massive costs from the undermining of Fox as a national advertising medium and from a reduction in the value of Fox affiliation. Thus, as the argument goes, "there is no reason to believe that News Corp. will bypass Fox network affiliates via DIRECTV."

Notably, the Applicants wholly ignore Rupert Murdoch's statement that high definition television "is basically going to be done by networks. We won't need to repeat each HDTV 200 times." This statement by the chairman of News Corp. offers a unique and persuasive insight into the future. Not only is a national broadcast feed economically feasible; News Corp. already has stated its intention to employ such a feed.

As the chairman's statement indicates, a national bypass feed is not likely to result in massive costs to Fox, but should instead be highly profitable. First, a bypass strategy would have little effect on the value of Fox national advertising because such a strategy would result in little change to the Fox viewing audience. News Corp. would still be able to sell advertising based on the total number of Fox viewers, regardless of whether the viewers were watching the local or national broadcast feed.

As to the value of the Fox affiliation, Fox affiliates would have little recourse in the face of increased leverage by the network. The bypass strategy, after all, would not entirely eliminate Fox local stations, at least at first – it would simply weaken them and detract from their ability to serve local interests. Moreover, Fox affiliates may have few alternative choices. Finally, any loss in the value of the Fox network affiliation could be recouped at the network level by News Corp. through increased advertising revenues and cost savings from the elimination of retransmission consent fees.

E. The Applicants Advance No Reason Why Anti-Discrimination Provisions Similar to Those They Voluntarily Agreed to for Cable Networks Should Not Also Apply to Local Broadcasters.

The Applicants voluntarily agreed to be bound by an "enforceable undertaking" not to "discriminate against unaffiliated programming vendors with respect to the selection, price, terms or conditions of carriage on the DIRECTV platform", thus, in their view, eliminating any "potential for a vertical foreclosure strategy in the programming market."[7]

Notably, however, the Applicants carefully limited this pledge to cable programming services. Other content providers, such as local television broadcasters, are not covered by the Applicants' promise. The NAB Comments explicitly raised this issue, recommending that the Commission impose an additional condition prohibiting News Corp. from blocking the access of any non-Fox-owned broadcast stations to consumers or from discriminating against content owners, including broadcast stations, in any way.[8] The Applicants' Opposition fails to address this recommendation nor could they do so successfully. The same vertical foreclosure concerns that led the Applicants to pledge non-discrimination to cable programming services apply with equal weight to local broadcast television stations not owned by Fox. The Applicants' failure to respond to the issue can only lead one to infer that they wish to protect their ability to discriminate against non-Fox-owned broadcasters.

F. The Applicants Provide No Evidence as to Why Local-to-Local Transmission of All Broadcast Signals Should Not Be Required.

To counter the harm to localism and diversity that would otherwise occur as a result of the acquisition, the NAB suggested that DIRECTV be required to offer local-to-local service in 150 Designated Market Areas by January 1, 2005 and in all 210 DMAs by January 1, 2006 (DIRECTV already plans to offer such service in 100 DMAs by the end of 2003).

While News Corp. proclaims that the provision of local-into-local service is "a vital, priority project" the Applicants resist any actual commitment to extend local-to-local service to additional DMAs. However, they provide no evidence that provision of such service would be impractical.[9] Given that News Corp.'s Fox Entertainment Group has expressed its view that:

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[7] General Motors Corporation *et al.*, Consolidated Application for Authority to Transfer Control, MB Docket 03-124, May 2, 2003 at 53.

[8] NAB Comments at 26.

[9] The Commission has already asked the parties to explain how the transaction will increase their provision of local-into-local high definition service. It should amend that request to also ask for information as to the Applicants' plans to extend local-into-local coverage generally.

"The Commission's preoccupation with localism is difficult to explain or justify,"[10] it seems unlikely that the Applicants will voluntarily extend local-into-local to all DMAs. Because this Commission does, appropriately, consider localism to be important, it should take steps to mandate that local-into-local is indeed treated as a "vital, priority project."

III. Conclusion

News Corp.'s acquisition of control of DIRECTV will create the first vertically integrated MVPD and broadcast network, giving the combined entity extraordinary power. The careful balance of power on which the network/affiliate economic model is based will be ruptured, absent appropriate conditions.

Because the existing system of local broadcast stations is at the heart of the principles of localism and diversity, those core values are also threatened by the acquisition. The Commission should protect those values by conditioning the acquisition in the manner outlined in the NAB Comments.

Sincerely,

Henry L. Baumann
Benjamin F. P. Ivins

Cc:
W. Kenneth Ferree
Barbara Esbin
Simon Wilkie
James Bird
Marcia Glauberman
Douglas Webbink
JoAnn Lucanik
Neil Dellar
Tracy Waldon
Linda Senecal

Qualex International
Richard E. Wiley, *Counsel for General Motors Corporation and Hughes Electronics Corporation*
Gary M. Epstein, *Counsel for General Motors Corporation and Hughes Electronics Corporation*
William M. Wiltshire, *Counsel for The News Corporation Limited*

[10] *Statement on Media Ownership Rules of Dr. Bruce M. Owen*, at 10, attached as Exhibit 3 to Comments of Fox Entertainment Group *et al.*, *In re 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*, MB Dkt. 02-277, filed Jan. 2, 2003.