Consumers Union

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Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
455 12th Street, S.W.
Washington, D.C. 20554

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

Dear Ms. Dortch:

Consumers Union ("CU") has reviewed the economic analyses submitted by Charles River Associates and Lexecon on behalf of News Corp. and DirecTV ("Applicants") in the above-captioned proceeding,[1] as well as the papers on corporate governance submitted on Applicants behalf by Professor Lawrence A. Hammermesh.[2] Here we reiterate comments submitted by Consumers Union, Consumer Federation of America, Center for Digital Democracy and Media Access Project.[3] Our principal concern with this transaction 7is that News Corp.'s acquisition of DirecTV will put new, upward pressure on cable rates. As detailed below, CU firmly believes that these expert submissions fail to refute the strong evidence on the record showing that News Corp's acquisition of DirecTV will likely lead to higher prices for consumers.

<u>The Transaction Will Likely Increase Cable Rates</u>

This transaction combines News Corp.'s stable of cable and broadcast programming assets – which include the FOX broadcast network, 35 local television

[1] Charles River Associates, "News Corporation's Partial Acquisition of DirecTV: Economic Analysis of Vertical Foreclosure Claims," July 1, 2003 ("CRA"); Lexecon Inc., "Economic Analysis of the News Corporation/DirecTV Transaction," July 1, 2003 ("Lexecon,"); Charles River Associates, "News Corporation's Partial Acquisition of DirecTV: A Further Economic Analysis," September 8, 2003 ("CRA II"); Lexecon Inc., "Response to William P. Rogerson and Daniel L. Rubinfeld and Duncan Cameron," September 8, 2003 ("Lexecon II").
[2] Affidavit of Lawrence Hammermesh, Exhibit C, Opposition to Petitions to Deny and Reply Comments, News Corporation Limited, General Motors Corporation and Hughes Electronic Corporation, MB 03-124, July 1, 2003 ("Hammermesh"); Reply Declaration of Lawrence Hammermesh, attached to Letter from News Corporation, General Motors Corporation and Hughes Electronic Corporation, to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket 03-124, September 10, 2003 ("Hammermesh Reply").
[3] Comments of Consumers Union, Consumer Federation of America, Center for Digital Democracy and Media Access Project, MB 03-124, July 1, 2003 ("Consumer Comments")

stations, 19 regional sports networks, FX, Fox News Channel, and Speed – with DirecTV, the second largest multichannel video programming distributor (MVPD) in the country.

As stated in our Reply Comments, we believe that the "merger between News Corp. and DirecTV is very unlikely to stop skyrocketing cable rates and could very well exacerbate the problem."[4] Our view is that News Corp. is likely to use DirecTV as "a tactical weapon" to force cable companies to pay higher prices for critical News Corp. programming content, such as its FOX broadcast network stations and its RSNs.[5] As we noted, "if a cable system refuses to pay the increased price, then News Corp./Fox will be able to threaten cable operators to use its newly acquired satellite system to capture market share away from cable in those communities.[6]

> We find it particularly noteworthy that, despite having had many opportunities to do so in testimony on Capitol Hill, not once have News Corp officials indicated that the acquisition of DirecTV will lead to lower prices for consumers.

There is nothing in any of the economic submissions furnished by CRA and Lexecon that prompts us to alter our view that the transaction will put upward pressure on cable rates. To the contrary, we believe that the two economic analyses submitted by Professor William Rogerson on behalf of Advance/Newhouse Communications, Cable One, Cox Communications, and Insight Communications ("Joint Cable Commenters") forcefully demonstrate the manner and means by which the transaction enhances News Corp.'s wholesale pricing power in the programming market:

> "[T]he acquisition of a controlling stake in DirecTV by News Corp. could provide News Corp. both the ability and the incentive to raise prices to rival MVPDs for its 'must have' programming – its regional sports networks and its owned-and-operated television broadcast stations. The acquisition of DirecTV will increase News Corp's bargaining power and negotiating leverage and will lead to higher prices for consumers, particularly in less dense regions of the country served by small to medium sized cable systems. . . . The basic idea is simply that when News Corp. is vertically integrated with DirecTV, its threat to withhold programming from rival MVPDs will become more credible because the loss in programming revenue that News Corp. would experience from withholding the programming will be offset to some extent by the increase in profits that DirecTV would earn when its rivals no longer offer the programming."[7]

The CRA/Lexecon submissions appear to us to be long on academic theory, and short on empirical analysis grounded in the realities of the programming marketplace.

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[4] Consumer Comments at 5.
[5] See id.
[6] Id.
[7] William P. Rogerson, *A Further Economic Analysis of the News Corp. Takeover of DirecTV,"* at 2-3 ("Rogerson II"), Attachment to Letter from Bruce D. Sokler, Counsel for Advance/Newhouse Communications, Cable One, Cox Communications, and Insight Communications, to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket 03-124, August 4, 2003

CRA asserts that "downward pressure on prices will result from the transaction," and that "as a result of a partial ownership acquisition, NC will have an incentive to set a lower price for programming."[8]

News Corp. has been a provider of broadcast and cable programming content to MVPDs in the United States for nearly a decade. Its cable television programming segment generated $2.2 billion in revenues for its fiscal year 2003, and earned "record profits" which were more than double the previous year's results.[9] As a company whose principal business in the U.S. has been the provision of content to MVPDs, News Corp's orientation and objective is to obtain from distributors the highest possible price for its content. Its acquisition of DirecTV must be viewed within the context of that overriding strategic company objective. News Corp is not spending $6.6 billion on DirecTV in order to "set a lower price for [its] programming."[10]

There is simply no basis in reality for concluding that this transaction will lower prices for News Corp.'s programming. Indeed, such a move would directly contravene guidance that Fox cable executives already provided to the financial community:

> While Fox Cable Networks will register a 28 percent revenue gain for 2002, Tony Vinciquerra, the group's president/CEO told analysts at the annual UBS Warburg media conference last week that revenue should increase more significantly in coming years as carriage deals come up for renewal. <u>"We expect to increase significantly the licensing fees paid by MSOs for these networks," Vinciquerra said.</u>
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> FX, which has grown from 34 million to 79 million subscribers since 1998, currently charges operators 30 cents per subscriber per month; the rate will rise to 31 cents in 2003, after which most of the net's carriage deals will be up for renewal. Vinciquerra said he believes FX should be charging in the 45-to-60 percent range that other entertainment services such as TNT and USA Network command. The Fox Sports Nets currently get $1.07 per sub; Vinciquerra said he believes the fee should be closer to ESPN's $1.75.
>
> Although Fox News Channel does not fall under Vinciquerra's purview, he said that network plans to grow its license fee from its current 23 cents per sub to more closely approach rival news network CNN's 36 cents to 38 cents.[11]

The most likely outcome here is that News Corp.'s ability to use DirecTV as a tactical weapon in program carriage negotiations will inevitably put upward pressure on cable rates.[12]

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[8] CRA II at 19, 20.
[9] <u>See</u> News Corporation, Earnings Release for the Fourth Quarter and Year Ended June 30, 2003, at 4 (August 13, 2003); <u>See</u> <u>also</u>, News Corporation Limited Fourth Quarter Earnings Conference Call, FD Wire, August 13, 2003, Tr. at 2.
[10] <u>Cf.</u> CRA II at 20.
[11] "DirecTV Pays Big Hike To Keep NFL Sunday Ticket," <u>Media Week</u>, December 16, 2002 (emphasis added).
[12] <u>See</u> Consumer Comments at 5.

The Transaction Hurts Consumers by Making Higher Prices and/or Service Interruptions for Key Programming More Likely

Program service interruptions -- even short-term interruptions -- caused by carriage disputes between programmers and distributors hurt consumers in two ways. First, consumers lose access to coverage of immediate events that may have no value at a later date, and may be forced to pay—for some period of time—for programming they do not receive. Second, resolution of the disputes invariably entails the payment of higher programming license fees for the affected program service. Indeed, the mere threat of a program service interruption often suffices to produce higher per-subscriber license fees for the affected service.

CU believes that the acquisition of DirecTV makes News Corp.'s threat to withdraw programming from a cable operator resisting its rate increase demands more credible.[13] Not only does DirecTV provide News Corp. with an alternative delivery path into viewers homes in any market where News Corp. is involved in a program carriage dispute, any incremental subscribers gained by DirecTV helps to offset any programming revenues "lost" to News Corp. during the period in which the service signal is withheld from the cable operator. Of course, those lost revenues also are likely to be recovered by News Corp. through the higher, post-dispute license fees gained once the dispute is resolved. In effect, the transaction lowers the costs and risks of a service interruption to News Corp., thereby enhancing its ability to obtain higher license fees for popular programming such as its regional sports and broadcast network channels.

The News Corp. Non-Discrimination Condition Will Not Alleviate the Upward Pressure on Cable Prices

CRA asserts that "any non-discriminatory elevation of affiliate fees by NC would cause a reduction in NC's programming profits," due to what CRA believes is "the elasticity of demand facing Fox programming."[14] Once again, CRA's theorizing bears no resemblance to what is occurring in the real world.

CRA's musings regarding the supposed "elasticity of demand" for Fox programming are of little value in connection with must-have content such as the FOX broadcast network and the Fox regional sports channels. The FOX broadcast network is required by law to be carried on the Basic service tier, and therefore must be made available (if it is to be made available at all) to all subscribers. News Corp. then packages its regional sports channels with its broadcast network.[15] Thus, by contract, News Corp insists that its RSNs be carried on the most popular tier of service, or not be carried at all. As a practical matter, every MVPD needs to carry, in some fashion, the FOX network (which features the NFL) and Fox regional sports programming. The fact that News Corp. requires MVPDs to make these must-have services available to all its subscribers – or none at all – effectively mutes, if not negates, any demand elasticity for

[13] See Rogerson II at 5-7, 16-21, 43-44.
[14] See CRA II at 20.
[15] cite

those services, since no distributor can afford to shun those service and no subscriber receives an opportunity to reject them.

News Corp.'s proposed non-discrimination condition can be useful in preventing egregious competitive abuses such as selling Fox programming to DirecTV's competitors at prices that are substantially and unjustifiably higher than the price paid by DirecTV. Accordingly, the scope of the condition should be broadened so as to cover News Corp's owned and operated broadcast stations as well, so that News Corp will not have the opportunity to wield its broadcast network programming in an anti-competitive and discriminatory manner.

However, the proposed non-discrimination condition, even if broadened to cover Fox's broadcast programming assets, still will not be an effective check against the upward pressure on Fox programming prices arising from this transaction. Indeed, CU has already expressed its concern that "the pledge could end up being nothing more than a tool for pumping up cable prices."[16]

The non-discrimination commitment does not stop News Corp. from charging DirecTV an artificially high price for Fox programming, and then requiring any cable operators seeking to carry the programming to either pay a rate based upon that same high rate or allow DirecTV to become the major distributor of that programming in the operator's market. Moreover, because the News Corp.'s commitment does not prevent volume discounts, DirecTV is likely to pay a lower rate than any MVPD other than perhaps Comcast.

News Corp's Proposed Audit Committee Will Not Protect Against DirecTV Paying Inflated Prices for Fox Programming

News Corp. has suggested that its proposed Audit Committee will prevent DirecTV from paying inflated prices for Fox programming.[17] We do not believe that the proposed Audit Committee can or does provide any protection for consumers. Indeed, its stated purpose is to protect non-News Corp. *shareholders* of DirecTV from self-dealing by News Corp., the controlling shareholder.

Even if the Audit Committee can effectively accomplish that objective, which is a matter of considerable uncertainty,[18] it is not charged with protecting consumers against artificially inflated prices for Fox programming paid by DirecTV and other MVPDs. Indeed, we are hard-pressed to see how an Audit Committee could even come to the

[16] Consumer Comments at 5.
[17] Opposition to Petitions to Deny and Reply Comments, News Corporation Limited, General Motors Corporation and Hughes Electronic Corporation, MB 03-124, July 1, 2003, at 57-59; Letter from News Corporation, General Motors Corporation and Hughes Electronic Corporation, to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket 03-124, September 10, 2003, at 2.
[18] See Affidavit of Lynn A. Stout, Exhibit B to Initial Comments of Advance/Newhouse Communications, Cable One, Cox Communications, and Insight Communications, MB Docket No. 03-124; Reply Affidavit of Lynn A. Stout, attached to Letter from Christopher J. Harvie, Counsel for Joint Cable Commenters, to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket 03-124, September 10, 2003.

conclusion that DirecTV is paying an artificially high price for a Fox programming service, if, consistent with the non-discrimination guarantee, that price is the same as, or lower than, the price paid by most other MVPDs -- as will almost certainly be the case. The Audit Committee simply cannot protect against the potential harms to consumers arising from this transaction.

Conclusion

Because of the clear shift in economic incentives that would result from this transaction, we urge the Commission to impose significant conditions that aim at alleviating these new upward pressures on cable rates.

The original rationale that underpinned the development of Retransmission Consent does not hold in the context of the DirecTV/News Corp. merger, and must be revisited. Congress found in the 1992 Cable Act that "[c]able television systems often are the single most efficient distribution system for television programming." Because a majority of the country was receiving broadcast television service through cable, it was necessary to require that cable systems carry local broadcast signals.

However, a merger between News Corp./Fox and DirecTV would dramatically shade and shift the landscape within which Retransmission Consent was crafted. This transaction will provide News Corp./Fox with assets no local broadcaster had in 1992 when Retransmission Consent was created: the merged company will have a satellite distribution system capable of reaching a majority of the country in addition to its Must Carry/Retransmission Consent levers. The original logic behind the rule is strained in the present circumstances. Not only will News Corp./Fox own its own transmission system, but it also owns other programming that it bundles with its network programming; the result is likely undue market power in negotiating cable and other carriage agreements. Congress should rethink the necessity of Retransmission Consent as it pertains to stations owned and operated by News Corp./Fox.

Finally, another appropriate tool for dealing with the danger of excessive cable rate increases would be to impose a restriction similar to what the Federal Trade Commission applied in the Time Warner/Turner merger.[19] In that instance, the Commission established a cable programming price index mechanism to evaluate whether the merging companies were raising programming prices at a more accelerated pace than their historic pattern. A similar mechanism here would help ensure that the alleged efficiencies of this transaction will not merely accrue to the merged entities in the form of bloated market power, resulting in bulging cable bills for consumers.

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[19] Agreement Containing Consent Order, *In the Matter of Time Warner Inc., Turner Broadcasting System Inc., Tele-Communications, Inc., and Liberty Media Corporation, File No. 961-004*, Before the Federal Trade Commission (Sept. 12, 1996). http://www.ftc.gov/os/1996/09/timewar.pdf.