reasons – to conclude that "[f]undamentally, the entire issue of whether or not it would be profitable to engage in a complete and permanent withdrawal of programming is a red herring" (p. 15). The conclusion that the proposed transaction does not raise foreclosure concerns also is confirmed by CRA's numerical analysis, which shows quantitatively that the benefit to DIRECTV from foreclosure does not outweigh the cost to News Corp. of reduced license fees from competing MVPDs.[4] Thus, the possibility of competitive harm from total foreclosure is dismissed by both opponents and proponents of this acquisition.

12. In his reports, Professor Rogerson raises a different concern about foreclosure – one that our analysis shows is as fishy as the "red herring" of total foreclosure. According to Professor Rogerson, "the proposed transaction is likely to harm consumers even in regions where it turns out not to be profitable for News Corp. to completely and permanently withhold programming" (p. 15). Professor Rogerson theorizes that, after the transaction, News Corp. will find it profitable to temporarily withhold programming from DIRECTV's competitors. He assumes that, rather than being permanent, "the withdrawal in programming [from competitors] lasts for only three months while it produces a permanent shift in subscribers" (p. 17, emphasis added).

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4. Professor Rogerson criticizes CRA's conclusion that foreclosure would be unprofitable for News Corp. unless, as a result, DIRECTV's share of MVPD subscribers increased permanently from 13 to about 30 percent. He claims that foreclosure would be profitable if DIRECTV's share instead increased permanently from about 13 to about 20 percent – an increase in DIRECTV's subscribers of about 50 percent. Professor Rogerson notes that "[w]hile this is still not a trivially small shift, it is one third the size of the 17 percent shift that CRA has announced would be necessary for complete and permanent foreclosure to be profitable" (p. 14). He then appears to acknowledge that there is no reason to expect that even the smaller shift in subscribership that he calculates would occur in response to foreclosure – "I believe that, by focusing on whether or not permanent withdrawals of programming will profitable [sic] after the takeover, CRA is missing the critical point I made in my initial Affidavit" (p. 14). We do not suggest that this criticism by Professor Rogerson of the CRA analysis is valid, but we note that, even if it were, foreclosure would be profitable only if it resulted in unrealistically large, permanent share shifts.

13. Professor Rogerson claims that such a strategy would be profitable, even though permanent foreclosure would not be, because the costs of implementing a temporary disruption strategy are sufficiently lower. In particular, permanent foreclosure requires permanent loss of program licensing revenues from the "foreclosed" distributors, while temporary foreclosure only requires a short-term loss of licensing revenue (a few months).

14. We disagree with Professor Rogerson's claim that temporary foreclosure would be profitable. His conclusion rests on several necessary conditions that he has made no effort to verify empirically, including:

- News Corp.'s RSNs are sufficiently appealing to induce switching to DIRECTV by the large number of subscribers necessary to make the temporary-disruption strategy profitable.
- Subscribers will assume that, if an MVPD loses News Corp. programming, the loss is permanent.
- Alternatively, subscribers will make a permanent change in MVPD provider in response to the loss to their MVPD of News Corp. programming, even if they realize that the loss is temporary (e.g., three months).
- Rivals will not respond to News Corp.'s conduct.

Moreover, he has ignored evidence that shows that these conditions are unlikely to hold.

15. As we now show, far from supporting his claims, available evidence shows that the required conditions are not met. Consequently, temporary foreclosure is unlikely to be a profitable strategy.

A. Economic Analysis Suggests that a Temporary Programming Withdrawal Likely Would Have a Small Effect on Switching.

16. Professor Rogerson's theory of harm from a temporary programming disruption requires that such a disruption have a large effect on switching, so that the cost incurred relative to the benefit obtained is lower than with permanent foreclosure. That is, for his theory to provide a basis for concern, temporary foreclosure must impose few costs in terms of lost programming revenue because it lasts a short time, yet it must quickly cause a large number of subscribers to switch to DIRECTV. However, he then appears to claim the opposite – that a temporary foreclosure likely would have a disproportionately <u>small</u> effect on switching, compared with permanent foreclosure. This is because MVPD subscribers face substantial "switching costs." In particular, Professor Rogerson recognizes that:

> [s]witching providers generally requires a visit by a service representative to the home and/or purchase and installation of new equipment. This can be costly and inconvenient. The common industry practice of subsidizing equipment and installation costs suggests that industry participants also recognize that there is some subscriber inertia and that, once a customer is induced to switch, the customer is likely to stay (p. 17, footnote 19).

Yet, somewhat inconsistently, Professor Rogerson claims that because of substantial switching costs, "customers that switch during a temporary withdrawal of programming are unlikely to switch back after the programming is restored" (p. 17). If so, he fails to explain why customers who face substantial switching costs would switch in response to the temporary withdrawal in the first place.

17. Professor Rogerson recognizes that the empirical evidence is inconsistent with a claim that temporary programming withdrawals lead to large share shifts. For example, he concedes that "the very limited information available from public reports suggests that the demand shifts in response to temporary withdrawals of programming associated with price disputes" were relatively small (p, 14, footnote 17). Professor Rogerson observes that "[w]e

would expect the size of shifts in response to withdrawals that consumers expected to be permanent to be larger than this" (p. 15, footnote 17).

18. Moreover, the costs to subscribers of switching from cable to DIRECTV likely will increase further in the future if the practice of "bundling" cable service with broadband access (and local telephony) becomes more common. Cable subscribers are even less likely to drop their cable service to switch to DIRECTV in response to a temporary loss of News Corp. programming if they would also have to incur costs (in money and time) to switch their broadband and local telephone service as well, or if the cost of these other services increases when purchased "a la carte" from the cable company. This means that, in the future, we expect that a temporary withdrawal of programming will result in even less switching than might occur today.

B. Customers are Unlikely to Assume that Temporary Programming Disruptions Would be Permanent.

19. Although we agree with Professor Rogerson that permanent withdrawals of programming likely would cause more subscribers to switch than would temporary withdrawals, we believe that it is unlikely that subscribers would assume that a short-term programming loss would be permanent.

20. Professor Rogerson seems to imply, although he provides no basis in theory or historical evidence to expect, that consumers would be fooled by, and would react immediately and irrevocably to, a temporary disruption strategy. Professor Rogerson foresees the following strategy. News Corp. enters into bad-faith negotiations for higher licenses fees with an MVPD, such as a cable company. Those negotiations quickly break down, as News Corp. demands exorbitant license fees that the cable company refuses to pay. News Corp. refuses to allow the cable company to exhibit the networks after negotiations fail. Although News Corp. follows a

strategy of disrupting the networks only temporarily, consumers assume that the disruption is permanent. Thus, during this period, a sufficient number of subscribers move permanently to DIRECTV to more than compensate for the loss of programming revenue. After several months, News Corp. and the rival MVPD reach an agreement and the programming is restored.

21. Even on theoretical grounds, this scenario is implausible. If Professor Rogerson realizes that permanent foreclosure is a "red herring," and therefore is unlikely to occur, then presumably consumers will realize this as well, particularly given the absence of significant permanent foreclosures in the past. In addition, the cable company would recognize the strategy, and would not sit by idly while its customers switch to DIRECTV. Rather, it could counter the News Corp. strategy with advertising and marketing efforts, including pricing reductions and offers of free premium programming to its customers.

22. Moreover, some cable subscribers may be more valuable to their incumbent cable company than they would be to DIRECTV because they purchase other services, such as broadband access and local telephony, from the cable company. Thus, when Comcast loses a subscriber, it may also lose the profits it makes on the sale of broadband and telephone services to the customer if these services are "bundled" together with cable. DIRECTV currently does not provide a comparable suite of services. As the total profits obtained from a cable customer increase, the likelihood increases that the cable company would seek to retain its subscribers through targeted promotions or other incentives in the event of a temporary disruption.

23. Thus, Professor Rogerson errs by assuming that consumers and DIRECTV's rivals will react to News Corp.'s hypothetical "temporary disruption" strategy by behaving as if they believed the strategy to be permanent. Rather, they are more likely to act as if they believed the strategy to be temporary. Moreover, once the strategy is shown to be only a temporary disruption, it will not work in the future against other MVPDs. Subscribers to other MVPDs,

recognizing that the disruption will be temporary as it was in the past, will act accordingly and wait out the disruption.

C. Evidence Shows that Little Switching Results from Temporary Programming Losses.

24. Empirical evidence shows that only a small amount of switching occurs when sports programming is withheld even for a considerable period of time. We examined available evidence from three such events: the YES Network's absence from Cablevision in New York and the temporary loss of News Corp. RSNs in Minnesota and Florida. These three events show that the loss of sports programming leads to relatively little switching. Consequently, there is no reason to believe that a temporary programming withdrawal would be profitable.

25. We described the YES experience in our original report. Neither EchoStar nor Cablevision licensed the YES Network, home of the New York Yankees and New Jersey Nets, during 2002. Cablevision reported losing about 30,000 New York subscribers during the period that it did not offer the YES Network, which amounted to only about one percent of its total subscribers.[5] If we assume that all the subscribers that discontinued Cablevision subscribed to DIRECTV instead, and we assume that the margins for an RSN such as the YES Network and the margins on DirectTV are the same as those used in CRA's qualitative analysis, then this strategy clearly would not have been profitable if YES had had a 34 percent interest in DIRECTV, or even a 100 percent interest.[6] The increase in DIRECTV subscribers (a maximum of the 30,000 that Cablevision reported losing) during this period was simply too small.

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5. See, <u>News: DIRECTV targets Yankees fans with Spring Campaign,</u> Cableworld, March 10, 2003 ("About 30,000 subscribers defected to satellite because of its [Cablevision's] refusal to carry YES, the company [Cablevision] said").
6. According to CRA's report, the margin (net of subscriber acquisition costs ("SAC")) on DIRECT is and the margin on News Corp. RSNs is . The total gain to DIRECTV

26. Although News Corp. has hundreds of RSN contracts with MVPDs, Professor Rogerson points to only one dispute with an MVPD in support of his temporary withholding theory. Yet even that one dispute does not support his conclusions about switching. At the end of 2002, Fox Cable Networks deauthorized signals for two Fox RSNs, Sunshine and Fox Sports Net North, for Time Warner systems serving Florida and Minnesota, respectively. From January 1, 2003 until March 13, 2003, these networks were unavailable to Time Warner cable subscribers in those areas. Data from News Corp. show that the effect on Time Warner was small.

27. In Florida, Time Warner's growth rate between the end of December 2002 and the end of February 2003 was 1.1 percent, compared with 1.2 percent in the corresponding two-month period a year earlier. DIRECTV's growth rate also was in the two years – percent during the two months of 2003 compared with percent during the two months of 2002.[7]

28. In Minnesota, Time Warner lost 0.25 percent of its subscribers between the end of December 2002 and the end of February 2003, compared with a gain of 3.6 percent during the same two-month period a year earlier. DIRECTV subscribers increased percent during the two months of 2003, compared with percent growth during the two months of 2002. Even though Time Warner may have lost subscribers, there is no evidence that this resulted in a significant increase in DIRECTV subscribers.

(...continued)

from 30,000 new subscribers would be per month, of which News Corp.'s share is , and News Corp. would earn monthly affiliate fee and advertising revenue for these additional subscribers of for a total monthly gain of .The monthly cost to News Corp. of losing three million Cablevision subscribers would be million, or times greater. Even if no SAC were required to obtain these additional subscribers, so that the DIRECTV margin was per subscriber, the gain to News Corp. would be only , still well below the loss of million.

7. The source for these subscriber numbers is News Corp.

29. Thus, this evidence suggests that temporary, or even long-lasting, withdrawals of popular regional sports programming results in little switching of subscribers among MVPDs. Professor Rogerson has provided no empirical evidence to suggest the opposite.

D. Professor Rogerson Provides No Evidence that at Least Some Customers Who Switch to DIRECTV Because of a Temporary Programming Disruption Will Not Switch Back When Programming is Restored.

30. Professor Rogerson's claims depend on his assertion that customers who switch to DIRECTV because of the temporary programming disruption remain with DIRECTV permanently. This assumption likely is unjustified for two reasons.

31. Although Professor Rogerson does not explain which rival MVPD customers are most likely to switch to DIRECTV in response to the programming disruption, economic reasoning suggests that there are two kinds of customers likely to make the switch when the programming disruption occurs. The first group consists of customers with low switching costs (perhaps because they are home during the day to wait for an installer). For these customers, the temporary loss of News Corp. programming could be enough to make DIRECTV more attractive. Professor Rogerson provides no reason why this group of customers would not switch back once the disruption ends. In fact, logically it seems to us that, given that they showed a preference for their original MVPD, all else equal, many are likely to switch back rather than stay with DIRECTV, because this entails only the same low switching costs. Thus, although Professor Rogerson implies that all customers who switch do so permanently, it is more likely that many in this group of customers would not remain permanently with DIRECTV.

32. The second group of customers has high switching costs. By assumption, most customers with high switching costs likely would not switch during the temporary programming disruption, so News Corp. would not benefit from depriving them of programming. However, some customers with high switching costs may value the News Corp. programming especially

highly so that even a temporary loss of such programming may be so intolerable that it would induce them to switch. Professor Rogerson has provided no evidence about how many customers fall into this group, but empirical evidence from the YES Network disruption suggests that the group is not large.[8] Moreover, because these customers also have shown a preference for their original MVPD, all else equal, some of them likely would return to that MVPD when the disruption ends if their preference for the original MVPD is strong. Professor Rogerson's claim that these customers are highly profitable suggests that their original MVPD should be willing to make a significant "investment" to win these customers back, given the substantial profits that they contribute.

E. Professor Rogerson Ignores the Impact of Temporary Programming Disruptions on the Value of News Corp. Programming.

33. Professor Rogerson claims that the temporary programming disruption strategy will permit News Corp. to obtain higher license fees after the competing MVPD has been humbled. For reasons we have explained, we find many of the assumptions that underlie his conclusion faulty. However, even if we accept all his assumptions about switching, his analysis still fails because it ignores an important countervailing effect of the hypothesized conduct on the license fee that News Corp. could obtain.

34. The value of programming to a MVPD depends in part on its reliability. If News Corp. gets a reputation for using programming disruptions as a bargaining tool, its networks will become less valuable to its MVPD customers. An MVPD that fears that contract disputes with News Corp. will cause it to withdraw its networks will not be willing to pay as much to license

8. As we discussed earlier, Cablevision reportedly claimed that 30,000, or only about one percent, of its subscribers switched to satellite during the YES Network dispute, which removed the Yankees and other New York sports teams from cable for an entire year.

them. Moreover, some subscribers who cannot watch News Corp. programming will find viewing alternatives, and may not return to the News Corp. programming when it is restored. Thus, by implementing the bargaining strategy that Professor Rogerson hypothesizes, News Corp. will degrade the value of its networks and suffer a loss in its programming revenues from all MVPDs. This effect, ignored by Professor Rogerson, creates a further disincentive for News Corp. to engage in the behavior that Professor Rogerson hypothesizes will result from this transaction.

F. Professor Rogerson Ignores the Cost to DIRECTV of Customers it Gains only Temporarily.

35. We have explained that it is unlikely, as Professor Rogerson assumes, that all customers that switch from their current MVPD to DIRECTV in response to the temporary programming withdrawal will remain permanently with DIRECTV. Even if DIRECTV permanently gains some customers, the return to their original MVPD by some switchers could be costly for DIRECTV. We understand that new subscribers are not profitable for DIRECTV unless they remain for

36. Subscribers that remain with DIRECTV for less than one year must repay some of the upfront costs DIRECTV incurred. But customers that remain with DIRECTV for more than one year need not do so. Thus, if Professor Rogerson's speculation that all customers switch permanently is wrong, then customers who return to their original MVPD or go elsewhere within

will be unprofitable.

G. Integrated Cable Companies Could Retaliate, Which Would Deter News Corp. from Engaging in such Conduct.

37. After this transaction, News Corp. will be only one of several program suppliers vertically integrated into program distribution. This suggests two issues, both ignored by Professor Rogerson. First, if the temporary disruption strategy hypothesized by Professor Rogerson were profitable, vertically integrated cable companies could have used it in the past to disadvantage satellite companies. Neither Professor Rogerson nor anyone else in this proceeding has provided evidence that this has occurred. The YES experience of temporary disruption does not support Professor Rogerson's theory, because the ultimate resolution of that dispute appears to have been more favorable to Cablevision's demands (for placement of the YES Network on a premium tier) than to the initial position taken by the YES Network (which demanded placement on a basic tier).

38. Second, if Professor Rogerson were correct that, despite the program access rules and the applicants' voluntary commitments, this strategy would be feasible and profitable for News Corp. once it is vertically integrated, then the same strategy could be used in retaliation by the vertically integrated cable companies that will be News Corp.'s hypothetical victims. The fact that these companies could retaliate makes it more costly than Professor Rogerson assumes for News Corp. to risk this strategy.

H. Conclusion.

39. Thus, Professor Rogerson's theory that News Corp. will use "temporary" withdrawals of programming as a strategy to disadvantage competing MVPDs and increase DIRECTV's subscribership is inconsistent with economic theory and unsupported and contradicted by economic evidence.

III. PROFESSOR ROGERSON'S "BARGAINING" THEORY DOES NOT RAISE SIGNIFICANT ANTICOMPETITIVE CONCERNS.

40. Above, we explained why Professor Rogerson's temporary disruption theory fails in theory and in fact. We now discuss a second, related theory proposed by Professor Rogerson, one that he describes as a "completely separate theory explaining why this transaction has the potential to raise prices" (p. 6). As summarized by Professor Rogerson, the application of this "general bargaining framework" demonstrates that News Corp. will be able to negotiate higher prices for its content if it acquires DIRECTV, because "controlling DIRECTV will increase News Corp.'s bargaining power and its concomitant *ability* to bargain for higher prices."[9] He explains further that

> [t]he transaction increases News Corp.'s bargaining power to the extent that News Corp.'s losses from withdrawing programming from rival MVPDs are partially offset by DIRECTV's increased profits. Therefore, the merger will have a significant effect on News Corp.'s bargaining power to the extent that DIRECTV's profits significantly offset News Corp.'s losses and it is NOT necessary for DIRECTV's profits to be greater than News Corp.'s losses.[10]

41. We understand Professor Rogerson's argument as follows. He claims that News Corp. will be able to negotiate higher prices after this transaction because it will have a better bargaining position. This improved position reflects the increase in News Corp.'s "threat point profit." As Professor Rogerson explains it, News Corp.'s threat point profit rises because the company recaptures through ownership of DIRECTV some of the program licensing revenue it loses if it follows through on threats to withdraw programming from other MVPDs if they refuse to pay News Corp. the license fees it demands.

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9. Rogerson, p. 6 (italics in original).
10. Rogerson, p. 7.

42. Professor Rogerson's bargaining theory reflects the same dynamic that he claims motivates the temporary programming disruption strategy – namely, the additional profits that News Corp. now earns when subscribers drop their current MVPD and switch to DIRECTV. In his model, the "threat point" changes after the transaction because the "temporary program disruption" strategy now is more profitable for News Corp. In other words, after this transaction, News Corp.'s threat to withdraw its programming is credible, where it was not before, because the strategy is profitable (by itself) or because it is less unprofitable than it was when News Corp. did not own DIRECTV. The "threat point" depends on the cost of implementing the threat, and if this becomes less costly to News Corp. then Professor Rogerson claims that it improves the company's bargaining position.

43. Professor Rogerson claims that the threat point improves even if the temporary programming disruption strategy is, by itself, unprofitable because it becomes a more likely strategy the smaller the loss of profit. Assume that, before the acquisition, News Corp. would lose $1 million a month in licensing profits if it temporarily withdrew a network from a cable system. Assume further that this would cause enough subscribers to switch from cable to DIRECTV to raise DIRECTV's profits by $500,000 per month. Then, after this transaction, News Corp.'s loss is reduced by 34 percent of the $500,000 gain to DIRECTV, or by $170,000. This means that the temporary programming disruption strategy now costs News Corp. only $830,000, and not $1 million. Professor Rogerson argues that the fact that News Corp.'s loss from implementing the strategy is smaller means that its bargaining partners are more likely to accede to its demands.

44. As we now explain, Professor Rogerson's theory has many flaws. Moreover, he offers no support for the empirical requirements of the theory and the available empirical evidence is inconsistent with his hypothesized harm.

A Threat May Not be Credible if it is Not in the Party's Interest to Implement it.

45. We explained above why Professor Rogerson errs in claiming that a temporary programming disruption strategy would be profitable for News Corp. after this transaction. There is no evidence that News Corp.'s profits would increase as a result, because gains to DIRECTV from a temporary disruption likely would not outweigh the losses in programming revenue. Put simply, our analysis shows that temporary disruptions likely would result in little switching to DIRECTV, and that there is no reason to believe that all who switch would do so permanently.

46. Thus, the only part of Professor Rogerson's bargaining theory we have not already addressed is his claim that the "threat point" changes because a temporary programming disruption, although still unprofitable, is <u>less unprofitable</u> after this transaction because DIRECTV's subscriber gains from a temporary programming disruption would "*significantly offset* News Corp.'s programming losses" (p. 16, emphasis in original). Professor Rogerson does not clarify how much offset is required, nor does he attempt to determine from empirical evidence how large such an offset is likely to be.

47. We already explained why available evidence suggests such an offset likely is small. But even if it were "significant," the fact remains that the strategy, by itself, remains unprofitable for News Corp. If News Corp.'s programming customers know that News Corp. will lose money if it carries out its threat to withhold programming, then it is by no means certain that their willingness to accept News Corp's demands will be affected. In other words, using the stylized example presented above, the fact that News Corp. threatens to impose on itself losses of $870,000 per month, rather than $1 million per month, does not alter the fact that News Corp. loses money if it carries out its threat.

48. Professor Rogerson claims that economic theory supports his conclusion that the bargaining outcome changes when the unprofitability of a strategy is reduced. However, while some theoretical models of bargaining imply that a change in the value of a non-credible threat will affect the price at which a bargain is struck, other models do not.[11] Professor Rogerson's argument implies that a first-round NFL draft pick with a college degree will obtain a higher salary contract than would a first-round draft pick with only one year of college, because the former could earn more in alternative employment. Neither common sense, nor economic theory, shows that this is an unambiguous result. Professor Rogerson presents no empirical support from real-world experience in the MVPD or any other industry that a change in the value of a non-credible threat caused by vertical integration (or, indeed, by any other event) has affected the price at which a bargain was made.[12]

B. Available Evidence Suggests that the Offset Would be Small.

49. Professor Rogerson claims that, after this transaction, News Corp.'s profits from increased DIRECTV subscribers will be a "significant offset" to the lost programming revenue from a temporary programming disruption. The offset would occur if subscribers switch to DIRECTV from their current MVPD during a temporary loss of News Corp. programming.

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11. *See*, Baird, Gertner and Picker, Game Theory and the Law (1995), pp. 226-230 and Ariel Rubinstein, "Perfect Equilibrium in a Bargaining Model," 50 Econometrica 97 (1982).

12. Professor Rogerson ignores the symmetric improvement in the relative bargaining position of other vertically integrated MVPDs. Today, News Corp. has no vertical relationship with other program suppliers but after this transaction, through its DIRECTV ownership, it will become a purchaser of programming. Thus, if News Corp. threatens to withdraw its programming if a vertically integrated MVPD does not agree to higher rates, that MVPD can threaten to punish News Corp. by withholding programming from DIRECTV. Professor Rogerson fails to analyze the negative impact such a retaliatory action would have in driving down News Corp.'s "threat point." Moreover, the FCC's non-discrimination rules mean that unintegrated MVPDs stand to benefit from the ability of integrated MVPDs to threaten News Corp.

Professor Rogerson has not explained how much switching to DIRECTV is necessary, under his theory, for the offset effect to change the threat point significantly, and he has made no attempt to determine whether the amount of switching likely to occur is substantial enough to cause a meaningful change in the threat point. The historical evidence we examined above from episodes of temporary programming disruptions shows that little switching occurs so that there likely would be no significant offset to News Corp.'s losses.

C. Professor Rogerson's Theory Would Apply to all Vertical and Horizontal Mergers.

50. In describing his bargaining theory of harm, Professor Rogerson claims that "this merger raises an entirely new and different potential cause for concern, which I do not believe the Commission has ever explicitly addressed before."[13] He recommends that "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." However, Professor Rogerson identifies no unique aspects of this transaction to warrant such special concern.

51. The relationship that Professor Rogerson finds troubling – namely, a supplier vertically integrating with only one of its many distributors – is the typical vertical transaction. Thus, according to Professor Rogerson's theory, a firm always would raise the price of the product or service it supplies to unaffiliated distributors if it vertically integrates. Certainly, if Professor Rogerson's theory has merit, it would apply to any vertical merger in the cable industry, of which there have been many. Yet, as far as we know, and as Professor Rogerson claims, this "bargaining theory" is "a more novel issue that I do not believe the Commission has

13. Original Rogerson Report, p. 25.

ever explicitly addressed before in its evaluation of the competitive harms of vertical integration."[14]

52. Moreover, even if this concern has not been raised in the past, Professor Rogerson's "bargaining" analysis implies that these prior vertical mergers should have resulted in price increases to unaffiliated MVPDs, because these prior transactions would have affected the "threat point profits" of the merging firms. Yet Professor Rogerson provides no evidence of such an effect. In fact, he ignores completely a prior event that provides an empirical test of his conclusions – the period from July 1999 through December 2001 during which News Corp. held an interest in EchoStar, a situation corresponding to the proposed transaction. Professor Rogerson provides no indication that he attempted to determine whether News Corp. raised its prices or engaged in the opportunistic, short-term withdrawals of programming that he claims will occur if this transaction is approved. We are aware of no such effects.

53. Finally, the hypothesized effect that concerns Professor Rogerson is not limited to vertical transactions. Rather, the effect would arise from any horizontal merger between a vertically integrated cable company and another cable company. Such a merger would increase the "offset" by enlarging the potential offsetting benefit from any temporary programming disruption aimed at DIRECTV or EchoStar. For example, if this concern were valid, it would have arisen in connection with the merger of Advance/Newhouse and Time Warner. Professor Rogerson's theory implies that this merger would have reduced the cost of temporarily withdrawing a Time Warner network from DIRECTV or EchoStar, because the size of the affiliated cable franchise areas increased (to include those served by both Advance/Newhouse and Time Warner), thereby increasing the number of potential subscribers able to switch from the DBS operators. Thus, Professor Rogerson's bargaining "theory" would have provided a

14. Original Rogerson Report, page 4.

basis for prohibiting previous mergers among vertically integrated cable companies that the FCC found untroubling.

D. Professor Rogerson's Claims are Refuted by the Absence of Contracts to Achieve the Same Result

54. In analyzing the likelihood of speculative harm from vertical mergers, economists first consider whether the hypothesized anticompetitive conduct could be achieved today through contract if it were in the parties' interests to do so. Even if a contract cannot perfectly duplicate vertical integration, we expect that, if the strategy that Professor Rogerson hypothesizes were very profitable, then there would be some attempt to obtain those profits by contract, even if imperfectly. This is an important reality check, because it is easy to speculate about various anticompetitive scenarios in the absence of any need to verify the harm empirically. If, however, the anticompetitive conduct that is claimed likely to result from a merger could be achieved through contract without merging, yet such contracts do not exist, then, absent special circumstances, that is powerful evidence that the speculative concerns are unfounded.[15]

55. In this case, Professor Rogerson claims that a temporary disruption in programming provided by News Corp. to a cable company would increase News Corp.'s and DIRECTV's combined profits, although it would not be profitable to News Corp. alone. If this were true, then it would have been in the parties' interests to negotiate a contract in which DIRECTV shares some of its benefits with News Corp. Professor Rogerson claims that such a

15. Professor Rogerson suggests that there is a tension between our argument here and our claim that efficiencies are likely from the merger. Professor Rogerson argues that we must expect no efficiencies because, if there were some, they could have been obtained by contract. This is not so – as we explain in our original report, it is well recognized that the transfer of expertise between companies may be better achieved through common ownership that permits incentives to be aligned and prevents opportunistic conduct, rather than through contract. See Carlton and Perloff, chapter 12.

contract could not be written – that "DIRECTV and News Corp. could not enter into arms length contracts that would increase News Corp.'s *bargaining power* with respect to rival MVPDs" (p. 24, emphasis in original). However, this conclusion is wrong.

56. Ignoring, as Professor Rogerson does, the constraints imposed by the program access rules (which he claims are ineffective), contracts that increase bargaining power could be written between News Corp. and an unaffiliated DIRECTV. News Corp. could write a contract with DIRECTV under which the price News Corp. is paid by DIRECTV depends on DIRECTV's share of MVPD subscribers. This would change News Corp.'s "threat point" with other MVPDs, since those MVPDs would know that a temporary withdrawal of News Corp. programming from them would increase News Corp.'s revenue from DIRECTV. Contracts where payment terms depend on a firm's share of sales are used in other industries.

IV. PROFESSOR ROGERSON'S ANALYSIS OF "BARRIERS TO ENTRY" INTO RSNS IS FLAWED.

57. Professor Rogerson claims that "the evidence that does exist suggests that barriers to entry into the regional sports network industry may be more substantial than Lexecon asserts" (p. 34). As support, he cites examples of failed RSNs and notes that, according to one trade article, "it is by no means a sure or simple process for a new regional network to gain carriage on a sufficiently large number of MVPDs" (p. 34).

58. Professor Rogerson argues that it may be difficult to start a successful RSN. Yet some firms have succeeded in doing so, including the YES Network we discussed above. The fact that some attempts at establishing RSNs have failed, including the examples Professor Rogerson cites, does not prove that there are barriers to entry that protect the Fox RSNs from competitive pressures. Rather, the firms that have tried and failed to enter successfully may have been unlucky or have followed poor business plans – perhaps not realizing that "launching a

successful regional sports network with only one team" has a low probability of success (as an article that Professor Rogerson cites explains).

59. Moreover, the fact that the regional sports network business is "*not trivial to enter*," as another article cited by Professor Rogerson notes (emphasis in original), is not valid evidence of barriers to entry; exit and entry are common in most industries and the fact that requirements for entry are "not trivial" hardly proves that there are significant barriers to entry that protect incumbents. For example, many, if not most, restaurants fail, and those that succeed may need an advantage that distinguishes them from incumbents. Yet, the frequency of restaurant failures does not imply that there are barriers to entry into the restaurant industry. Professor Rogerson ignores the ability of teams and/or cable operators to acquire sports rights for MVPD exhibition. Examples of successful entry into RSNs include the YES Network, Turner South, Comcast Sports Southeast and Royals Television Network.[16]

60. Finally, Professor Rogerson's analysis of barriers to entry ignores the fact that, as we explained in our prior report, sports-team owners – not News Corp. – have the ultimate power to control sports programming. If News Corp. were to attempt to take advantage of the teams that are essential to its success, these teams could retaliate by establishing a new sports network. They likely would obtain the support of MVPDs in their region if News Corp. were systematically engaging in the temporary programming disruption strategy, to the detriment of both the teams and the MVPDs, that Professor Rogerson fears.

16. For other successful entrants, *see* General Motors Corp., *et al.*, Opposition to Petitions to Deny and Reply Comments, MB Docket No. 03-124, at pp. 21-22 (filed July 1, 2003).

V. PROFESSOR RUBINFELD AND DR. CAMERON RAISE NO NEW ISSUES AND THEIR EMPIRICAL EVIDENCE DOES NOT SUPPORT THEIR CONCERNS.

61. Professor Rubinfeld and Dr. Cameron claim that "[t]he proposed transaction is likely to create or enhance incentives for News Corp to withhold Fox Network programming from cable operators because News Corp's investment in DIRECTV will reduce its cost of withholding transmission consent." Unlike Professor Rogerson, Professor Rubinfeld and Dr. Cameron raise no concern about possible withholding of the Fox RSNs.

62. Most of Professor Rubinfeld's and Dr. Cameron's comments concern the foreclosure methodology presented in CRA's report, to which CRA is responding. Our comments are limited to two parts of their presentation: the discussion that they title "Temporary Withholding has Occurred" and the criticism of our claim that the alleged anticompetitive conduct could already occur by contract if such conduct were in the parties' interest.

A. Professor Rubinfeld and Dr. Cameron Mischaracterize the Implications of the Disney/ABC and Time Warner-Houston *Incident*

63. Professor Rubinfeld and Dr. Cameron claim that a retransmission consent dispute between Disney/ABC and Time Warner in May 2000 provides evidence that News Corp. is likely to pursue a temporary withholding strategy after it acquires DIRECTV. In that episode, the ABC network signal was unavailable on the Time Warner cable systems in Houston and several other cities for 39 hours on May 1 and 2. Professor Rubinfeld and Dr. Cameron conclude that "the Houston episode therefore may have cost Time Warner over $65 million, while costing Disney/ABC virtually nothing." They imply that, after this transaction, News Corp. will be in an equivalent position to engage in temporary withdrawals of retransmission consent to impose enormous costs on DIRECTV's competitors, without incurring any significant costs itself.

64. Based on our understanding, this episode provides no support for the conclusion that the authors draw. First, the episode was not a temporary "withholding" of programming imposed by Disney/ABC, but rather a blackout imposed by Time Warner, the alleged victim. In fact, ABC had offered Time Warner an extension of retransmission consent, but Time Warner nonetheless refused to carry the signal. Therefore, far from providing evidence that a company like News Corp. can improve its bargaining position through vertical integration, this example shows that the cable systems that would be News Corp.'s alleged victims can use the threat to drop even popular programming as a bargaining tool. Professor Rubinfeld and Dr. Cameron fail to note that the dispute was resolved when the FCC, at Disney's request, ordered Time Warner (the alleged "victim") to restore the ABC signal.[17] We understand that at no time during this dispute did Disney refuse to permit Time Warner to broadcast the ABC signal.

65. Second, this episode clearly supports our argument that MVPDs wield considerable power over programmers. Time Warner chose to drop the ABC signal at the beginning of a "sweeps" month in order to impose the maximum financial harm on Disney. MVPDs have many tools with which to impose financial harm on programmers if those programmers attempt to engage in the temporary withdrawal strategy that the critics allege will occur after this transaction.

66. Third, the arrangements between Disney and DIRECTV provide strong support for our argument that firms could achieve by contract the type of exclusivity or preference that Professor Rubinfeld and Dr. Cameron, as well as Professor Rogerson, claim is anticompetitive, if it were in their interests to do so. As noted by Professor Rubinfeld and Dr. Cameron, in connection with its dispute with Time Warner, Disney (a programmer) entered into an arrangement with DIRECTV to subsidize subscribers that cancelled their Time Warner cable

17. *See Time Warner Cable*, 15 FCC Rcd. 7882 (Cable Svc. Bur. 2000).

service and subscribed to DIRECTV instead. This is exactly the kind of contractual arrangement that we argue could accomplish the alleged goals of the "foreclosure" or "temporary programming disruption" strategy that the economist critics claim will follow from News Corp.'s acquisition of DIRECTV. We reiterate our previous conclusion – that vertical integration will not result in competitive harm if the same alleged anticompetitive conduct could be achieved through contract without merger, and yet was not.

B. Professor Rubinfeld's and Dr. Cameron's Criticism of our Contracting Analysis is Wrong.

67. Professor Rubinfeld and Dr. Cameron claim that there is an inconsistency between our argument that "the efficiencies claimed to be associated with the transaction are merger-specific" and our argument that "foreclosure must not be a profitable strategy, otherwise content sellers would have been able to capture the benefits of exclusivity through contracts to sell programming exclusively" (p. 25). We disagree.

68. First, the efficiencies that the parties expect to achieve largely involve the transfer of expertise from News Corp. to DIRECTV. As we have noted before, it is well known that vertical integration can be the best way to avoid the opportunistic conduct that frequently attends the use of contracts in these circumstances.

69. Second, as we explained above, evidence presented by Professor Rubinfeld and Dr. Cameron support our contention that firms can contract to achieve the benefits of exclusivity or favoritism. Thus, market evidence shows that firms could achieve through contract the benefits of the conduct that Professor Rubinfeld and Dr. Cameron claim will result from this transaction, if it were in their interests to do so. The rarity of such contracting suggests that such conduct is not likely to result from the proposed transaction.

VI. CONCLUSION.

70. In his two reports, Professor Rogerson has offered various speculations about how News Corp. could injure competition after the acquisition of DIRECTV. Yet his theories of economic harm are unsupported by any empirical evidence. Economists who have studied the conditions under which a vertical transaction can lead to anticompetitive outcomes recognize that many, if not most, vertical transactions are procompetitive and that only when certain specific conditions are present (conditions not shown by critics to apply here) is there a risk of competitive harm. Thus, in considering theories such as those offered by Professor Rogerson, it is essential to analyze available empirical evidence to see whether it supports the theoretical concerns he raises.

71. Professor Rogerson has not subjected his theories to empirical evaluation, but we have done so. The empirical evidence clearly shows that Professor Rogerson's concerns are unfounded and his theories of anticompetitive effects from the transaction are without basis in theory or fact. Rather, the empirical evidence supports the conclusion we presented in our original report, and that we reiterate here – that the transaction will not lead to consumer harm. This evidence includes

- Short, or even quite long, programming disruptions have not resulted in substantial switching by subscribers among MVPDs;
- Exclusives, which could be achieved through contract today, are rare and so are unlikely to be in the parties' interests;
- Contracts to achieve the strategy that Professor Rogerson claims is anticompetitive could be used today, but are not;

- Professor Rogerson and Professor Rubinfeld and Dr. Cameron fail to cite evidence that prior vertical and horizontal mergers in the MVPD industry resulted in the type of strategic conduct that they claim will result from this transaction.

72. We also note that Professor Rogerson's analysis ignores the efficiencies that will result from the proposed transaction. He claims that the efficiencies that News Corp. expects will result from the acquisition are largely "the more generic sort of efficiencies that are generally also raised in the context of horizontal mergers" (p. 37). Yet, even he does not dispute the parties' claim that the proposed transaction will generate such efficiencies

73. Finally, our review of Professor Rubinfeld's and Dr. Cameron's arguments shows that the empirical evidence that they cite provides support for our arguments that the transaction will not reduce competition, and no support for their concern about a temporary disruption strategy.