programming markets from the same array of well-established and well-funded companies with which it currently competes.[229]

74. Cablevision disagrees, claiming that the combination presents horizontal concentration issues because it adds to News Corp.'s existing means of distributing Fox content—television broadcast stations. Cablevision asserts that by giving News Corp. a new outlet for its content in addition to the broadcast station outlets it already controls, the transaction will provide News Corp. with greater opportunities to leverage the power of its broad range of media assets.[230] Cablevision asserts that, for example, in the New York DMA, where it competes with DirecTV, post-transaction News Corp. will have three platforms to distribute its content—two broadcast licenses, and a DBS platform.[231] Cablevision states that if Fox denies retransmission consent for its broadcast stations to Cablevision, it will still have two different platforms—over-the-air and DBS—for reaping a return on this "must have" programming, while Cablevision will lack any means of providing this content to its subscribers.[232]

75. *Discussion.* We agree with the Applicants that the instant transaction does not present horizontal concentration issues. The Commission has previously held that broadcast television is not sufficiently substitutable with the services provided by MVPDs to constrain attempted MVPD price increases, and hence, is not in the same relevant product market.[233] The concern Cablevision raises—access to Fox network programming delivered via television broadcast stations for Cablevision's MVPD product—demonstrates that broadcast signals are an input used to produce a downstream product—MVPD service. We view access to News Corp.'s broadcast signals not as a horizontal concentration issue, but as a vertical integration issue, and we address it as part of our potential vertical harms discussion below. We therefore conclude that, because the Applicants do not offer the same products or services, the transaction does not present horizontal combination issues.[234]

[229] Applicants note that Liberty indirectly holds a controlling interest in one Ka-band satellite system. Liberty will not, however, have control over any Commission license held by any Hughes subsidiary following the transaction. Application at 46.

[230] Cablevision Comments at 12, 18-19.

[231] Cablevision Comments at 18-19.

[232] Cablevision Comments at 18-19

[233] *See Competition, Rate Deregulation, and the Commission's Policies Relating to the Provision of Cable Television Services,* 5 FCC Rcd 4962 ¶ 69 (1990); *EchoStar-DirecTV HDO* ¶¶ 109-115.

[234] The vertical nature of the proposed transaction distinguishes it from the proposed merger of EchoStar-DirecTV. The proposed acquisition of DirecTV by EchoStar presented a classic example of a horizontal merger, in which the only two existing providers of high-powered, full-CONUS DBS service sought to merge. After careful analysis of the record, we declined to approve the requested license transfers and designated the proposed transaction for hearing on analysis of the record indicating that the likelihood of the merger significantly harming competition in the MVPD market outweighed any potential merger-specific benefits alleged by the applicants. In that case, we found that such loss of competition in the MPVD market would be likely to harm consumers by: (1) eliminating an existing viable competitor in every market; (2) creating the potential for higher prices and lower service quality; and (3) negatively impacting future innovation *EchoStar-DirecTV HDO,* 17 FCC Rcd 20615-16 ¶ 138.

acquisition may increase the incentive and ability of the integrated firm to raise rivals' costs either by foreclosing supply of the input it sells downstream competitors or by raising the price at which it sells the input to competitors.[240] By doing so, the integrated firm may be able to increase its profits by raising prices in the downstream market, or increasing its market share in that market, or both.

79. The economic literature suggests that an integrated firm will engage in *permanent foreclosure* only if the present discounted value of the increased profits it earns in the downstream market as the result of foreclosure exceeds the present discounted value of the losses it incurs from reduced sales of the input in the upstream market.[241] If an integrated firm calculates that permanent foreclosure would be unprofitable, it nevertheless might find it profitable to engage in *temporary foreclosure* in certain markets. In markets exhibiting consumer inertia,[242] among other things, temporary foreclosure may be profitable even where permanent foreclosure is not, because, during the period of foreclosure, downstream customers may switch to the integrated firm's downstream product and, due to inertia, then not immediately switch back to the competitor's product once the foreclosure has ended. Consumers choosing an MVPD are subject to inertia and partial lock-in, because, among other things, there are switching costs associated with changing providers and some MVPDs, including DirecTV generally require one-year contracts.[243] Thus, temporary foreclosure may generate profits that continue for a longer period than the period of upstream losses caused by the reduction in demand for the input.

80. There is an additional reason why temporary foreclosure may be profitable. Specifically, by temporarily foreclosing supply of the input to a downstream competitor or by threatening to engage in temporary foreclosure, the integrated firm may improve its bargaining position so as to be able to extract a higher input price from the downstream competitor than it could have negotiated if it were a non-integrated input supplier. In order for an integrated firm successfully to employ temporary foreclosure or the threat of temporary foreclosure as a strategy to increase its bargaining position, the foreclosure strategy must be credible. This means that competitors must believe that temporary foreclosure is profitable (whether or not it actually is)[244] in order to extract a higher input price. For example, if the vertically integrated firm, by temporarily withholding an input from a competitor, can cause the

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[240] *See, e.g.*, Riordan & Salop, 63 ANTITRUST L J. at 527-38. *See also* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion Raising Rivals' Costs to Achieve Power over Price,* 96 YALE L. J. 209, 234-38 (1986).

[241] *See, e.g.*, Riordan & Salop, 63 ANTITRUST L. J. at 528-31 (1995).

[242] More specifically, the market must be one where consumer choice is subject to some inertia and "lock-in." *Cf.* Roy Radner, *Viscous Demand,* 112 J. ECON. THEORY 189 (2003)

[243] In contrast, temporary foreclosure would not be profitable in a market in which consumers made frequent and repeated purchases of a product and could change providers each time they made a purchase. Finally, we note that, where customers make a one-time, long-term commitment, such as by purchasing a long-lived durable good, temporary foreclosure resembles permanent foreclosure. A second requirement for temporary foreclosure to be profitable is that the withdrawal of the input (subject to foreclosure) must cause a change in the characteristics of the downstream product, such that some customers will shift to competing downstream products.

[244] Where downstream competitors have incomplete information about the integrated firm's revenues and costs, the integrated firm may have an incentive to engage in temporary foreclosure even where it is not profitable, because it will send a signal to downstream purchasers of the input. *See generally* Janusz A. Ordover & Garth Saloner, *Predation, Monopolization, and Antitrust* in 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 556-61 (Richard Schmalensee & Robert Willig, eds. 1989).

payment."[249] As a result, the upstream firm will likely be willing to incur any transaction costs associated with arranging such side-payments if the expected revenues from the uniform input price increase exceed the expected transaction costs of arranging the requisite side payments. If the transaction costs associated with designing the compensation scheme exceed the expected revenues from the uniform price increase, then again, it will not find it profitable to attempt such a strategy.

84. The above discussion confirms that the program access rules (and other non-discrimination safeguards) serve several useful functions with respect to the video programming subject to the vertically integrated firm's control. First, the program access rules prohibit permanent foreclosure with respect to all satellite cable programming. Second, they can prevent overt discrimination in the prices the integrated firm charges for such inputs Finally, they can also prevent uniform increases in satellite cable programming input prices where the downstream affiliate is partially owned and where the cost of compensating the affiliate exceeds the expected profits resulting from the price increase. Because, under the proposed transaction, News Corp. will acquire only a partial ownership interest in DirecTV, we believe that our program access rules and the Applicants' proposed program access commitments can help prevent permanent foreclosure, discriminatory input price increases and, in some cases, non-discriminatory uniform input price increases with respect to satellite cable programming of general interest. Conversely, the above discussion suggests that these safeguards will not prevent an upstream firm that partially owns the downstream affiliate from uniformly raising the price of its input to both its downstream affiliate and downstream competitors when it has both the economic incentive and ability to do so. Thus, the partially integrated firm may be able to execute a *uniform* input price increase without running afoul of corporate law and despite such non-discrimination safeguards especially if it is able to profitably arrange a mechanism for side-payments to occur. It would certainly be able to execute such a uniform price increase for video programming inputs not subject to such safeguards and for which it has significant market power, and may even risk shareholder litigation to do so.

85. *Roadmap and Summary of Decision.* At the outset, we note that local MVPD markets already are highly concentrated.[250] Changes in vertical relationships between a major input and output supplier in such a market can therefore have significant competitive effects. Because Applicants have asserted corporate governance and related securities laws as a global defense against all potential forms of vertical foreclosure, we address this matter at the outset of our analysis. Next, our discussion will address each relevant product market in turn and, with respect to each, the defenses raised by Applicants. For each relevant type of video programming and programming-related technologies, we will examine whether: (1) the Applicants possess market power and, if so, (2) whether the transaction increases the Applicants' incentive and ability to gain from withholding a given input, either permanently or temporarily, which could lead to increases in end user prices.[251] For markets in which we find that Applicants lack market power, we conclude that no potential public interest harms will arise with respect

[249] *See* Daniel P. O'Brien and Steven C. Salop, *Competitive Effects of Partial Ownership· Financial Interest and Corporate Control*, 67 ANTITRUST L. J. 581-582 (2000).

[250] *EchoStar-DirecTV HDO*, 17 FCC Rcd 20616 ¶ 139.

[251] We analyze the incentive and ability of the Applicants to engage in a temporary or permanent foreclosure strategy using the following methodology, described in detail in the Technical Appendix: (1) estimate the incentives to engage in foreclosure by calculating the number of consumers that must shift to the Applicants' downstream product in order to compensate for the revenues that would be lost due to foreclosure; (2) consider whether the necessary numbers of consumers are likely to switch to the Applicants' downstream product in the event of foreclosure

## 2. Role of Corporate Governance

89. *Background.* Applicants allege that corporate governance and related legal requirements will protect against all forms of vertical foreclosure alleged in the record and will guard against harmful self-dealing within the vertically integrated entity.[252] With respect to the latter, and in order to avoid a charge that they might engage in discriminatory conduct against other MVPDs, News Corp. and Hughes have hypothesized that News Corp. could employ a strategy of raising its programming prices to DirecTV which would then set a benchmark that other MVPDs would have to accept or lose the right to carry News Corp. programming.[253] To counter this hypothesis the Applicants state that, among other things, they intend to use the Audit Committee to review related-party contracts, and that the Audit Committee, in its sole discretion, will ensure that such contracts are on an arms' length basis.[254]

90. All publicly-traded corporations are required to have an audit committee comprised of at least three independent directors.[255] The proposed Hughes Amended and Restated By-Laws that will come into effect upon consummation of the transaction confirm that the Audit Committee will ". . . have the sole authority to consider and pass upon any Related Party Transaction. . ."[256]

91 *Positions of the Parties* Some commenters question the effectiveness of the Applicants' proposal. CDD suggests that the so-called independent directors will, in fact, not be independent, pointing out that the initial nominations for such directors include persons that have longstanding relationships with Mr. Murdoch or News Corp.[257] JCC contends that the Applicants purported reliance on the Sarbanes-Oxley Act[258] as providing a level of protection is misplaced. They allege that there is nothing in Sarbanes-Oxley that would prevent a controlling stockholder from exerting undue influence over the company that it controls.[259] They further suggest that the Audit Committee will not have the necessary expertise to be able to understand fully complicated programming contracts to ensure that the prices are the same as an arms' length transaction. JCC also suggest that News Corp. has offered no indication as to how the Audit Committee will function or when related-party contracts will be subject to review.[260] They conclude that, as a practical matter, independent directors are likely to be dominated and defer to the controlling stockholder and that to resist the controlling stockholder could result in a loss of a

[252] Application at 58, Applicants' Reply at 53

[253] Application at 58.

[254] Application at 59.

[255] 17 C F R. § 240.10A-3, New York Stock Exchange Rules (the "NYSE Rules") §§ 303A.06 & 07.

[256] Proposed Hughes Amended and Restated By-Laws, Article III, §3(d) filed with the SEC on June 5, 2003. A "Related Party Transaction" is defined as one that encompasses transactions between Hughes, on the one hand, and News Corp. or its subsidiaries, on the other hand.

[257] CDD Petition at item #5.

[258] Sarbanes-Oxley Act of 2002, 107 Pub L. No. 204, 116 Stat. 745, is a wide ranging corporate governance and accounting reform law

[259] JCC at 59.

[260] JCC at 62.

asked to undertake the additional function of passing on related-party contracts. Neither the NYSE Rules nor Hughes' proposed By-Laws state the qualifications necessary for an Audit Committee member to fulfill that function. Although there is no requirement that the member have any special expertise or even knowledge of programming contracts, the Applicants claim that this does not matter as the Audit Committee will be allowed to hire experts in order to assist it. We remain concerned, however, that, if the Audit Committee members do not have a good understanding of complicated programming contracts, they might not be aware when issues arise that require an expert's attention.[269]

94. Both the Applicants and the JCC have provided affidavits from law professors explaining Delaware law and how the Audit Committee will or will not function as an independent reviewer of related-party contracts.[270] The experts disagree about three main issues.[271] The first concerns the effect of judicial review of related-party transactions. The JCC expert asserts that "'independent' director review and approval of transactions between a controlling shareholder and a firm. . . cannot suffice to give a clean bill of health to transactions that are by their very nature tainted with conflict of interest."[272] The Applicants' expert responds that, at the very least, independent director review and approval of a related-party transaction can shift the burden of proof from the company to the stockholder challenging the transaction to establish unfairness. While we agree with the Applicants that the effect of compliance with section 144 of the Delaware General Corporation Law will be to shift the burden of proof to the complaining shareholder, we do not find that argument responsive. Independent director approval is, in no sense, determinative of the issue as a complaining stockholder would still be able to file a lawsuit and allege the transaction is unfair to the company. The Applicants further attempt to counter the JCC argument is dealt with below.

95. The second issue concerns the effectiveness and value of stockholder derivative litigation as a check on self-dealing transactions. Shareholder derivative litigation is brought on behalf of a company by a non-controlling shareholder. The Applicants allege that, for various reasons, related-party transactions would be easy to detect, and suspect transactions would be prosecuted by a "vibrant" plaintiffs' bar.[273] JCC argue that, if the plaintiffs' bar is so vibrant, "it is hard to see why such frauds and

[269] The Applicants point out that covenants in a loan agreement and public debt documents require a "fairness opinion" to be obtained concerning related-party contracts in excess of $100 million. See Applicants' Reply at 58. Accordingly, the Applicants assert that the Commission should rely on these checks to assuage any concerns that it may have. If the Applicants had included such provisions in the proposed By-Laws we might have more confidence in their assertions. The credit facility, on the other hand, could be repaid the day after closing and public debt is regularly retired If this were to happen, these checks on the Applicants behavior would be removed, rendering the value of such protections somewhat uncertain

[270] *See generally*, JCC Comments at Affidavit of Lynn A. Stout ("Stout Aff."); Applicants' Reply, Exhibit C, Affidavit of Lawrence A. Hamermesh ("Hamermesh Aff"); Letter from Christopher J. Harvie, Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, PC, to Marlene H. Dortch, Secretary, FCC (Aug. 20, 2003) ("Joint Cable Commenters Aug. 20 Ex Parte"), Attachment, Reply Affidavit of Lynn A. Stout ("Stout Reply"); Letter from William m. Wiltshire, Harris, Wiltshire & Grannis, LLP, Gary M Epstein, Latham & Watkins, and Richard E. Wiley, Wiley Rein & Fielding, to Marlene H. Dortch, Secretary, FCC (Sept. 10, 2003), Reply Declaration of Lawrence A. Hamermesh ("Hamermesh Reply Decl")

[271] Hamermesh Aff. ¶¶ 6-11

[272] Stout Aff. ¶ 23.

[273] Hamermesh Aff. ¶ 11.

that News Corp. will be considered to have *de facto* control of Hughes under Commission precedent.[283] Accordingly, we find that News Corp.'s influence is likely to be such that an independent director will be cautious before taking any step that could cause offense to News Corp. for fear that he or she might be ousted.

98. Even assuming that News Corp. will not "control" Hughes in a legal sense, it is beyond doubt that it will have enormous influence over Hughes. The Hughes board of directors will consist of 11 individuals; five appointed by the Applicants and six independent directors.[284] Applicants and the JCC discuss at length whether News Corp. will have the power to replace or dismiss an independent director that displeases it.[285] In order to do so, News Corp. would need to muster a majority of votes in support of an appropriate resolution. News Corp. will have only 34% of the votes, so, on the face of it, News Corp. would need other shareholders to cast their votes in favor of the resolution. We do not think that it is far-fetched to suggest that a sufficient number of shareholders might follow the lead of the largest single stockholder and vote the way that News Corp. voted.

99. Even if our concern about News Corp.'s influence on the board of directors is overstated, it is unlikely that related-party contracts will get the necessary scrutiny to unearth wrongful self-dealing. As a prominent corporate law treatise states, "[t]he nominations for outside directors are controlled by the nomination committee of existing directors, which may in turn be controlled . . . by outside directors who were selected by and acceptable to the insiders. Nomination of a person by the official committee virtually insures his election by the shareholders. The persons nominated are in fact often friends of the chief executive or other insiders..."[286] The treatise further points out that frequently independent directors are the corporation's bankers or lawyers and have a direct financial interest in their relationship with the corporation. Such relationships are often "controlled by the chief executive and other insiders."[287] Along these lines, CDD claims that several of the so-called independent directors have long-standing relationships with either Mr. Murdoch or News Corp.[288]

100. We therefore conclude that, notwithstanding the best intentions of the Applicants in assigning the task of related-party contract review to the Audit Committee, a significant risk remains that unfair self-dealing transactions may occur and go uncorrected. We also observe that the principal purpose of an audit committee is to protect shareholders from inappropriate management conduct -- its function is not to protect consumers. Thus, even if the Audit Committee performed its task perfectly, which, as we have noted, we do not think likely, consumers would not be protected from artificially inflated prices that are "entirely fair" to DirecTV and its shareholders but are not necessarily so to its

[283] In addition, C. Carey on behalf of News Corp., at a press conference on April 9, 2003 at 5:00 p.m., stated that by obtaining 34% of Hughes' shares it will obtain effective control of Hughes. *See* Letter from William M. Wiltshire, Harris, Wiltshire & Grannis, LLP to Marlene H. Dortch, Secretary, FCC (Nov 19, 2003), Transcript at 29

[284] Application at 13.

[285] Stout Aff.; Hamermesh Aff..

[286] Clarke, *Corporate Law* § 5 4 at 183

[287] *Id*

[288] CDD Petition at Issue #5.

broadcast stations.[296] CFA asserts that, although Applicants have proposed safeguards to ensure MVPD access to cable programming, they have proposed no safeguards to ensure that DirecTV does not discriminate against unaffiliated programmers.[297] CFA asserts that News Corp. also might use its bargaining power to pressure other MVPDs to discriminate against competing programming by offering MVPDs reduced prices for its affiliated programming.[298] CDD contends that, given Liberty's significant investments in News Corp., the transaction will give the two programmers the incentive and ability to place competing program suppliers at a competitive disadvantage.[299]

103. EchoStar asserts that the transaction will raise barriers for new entrants into the video programming market in two ways. First, EchoStar contends that integration of News Corp.'s programming with DirecTV's distribution will reduce or eliminate DirecTV's incentives to carry new programming that competes with News Corp.'s programming.[300] EchoStar also asserts that the transaction will foreclose an important outlet for new entrants, because DirecTV is currently the largest MVPD that is not affiliated with a programmer, and because DirecTV offers a nationwide distribution network which allows niche programming to reach a target audience that is geographically broad.[301] CDD agrees, claiming that independent producers, unaffiliated motion picture studios, and syndicators will be competitively disadvantaged by News Corp. after the transaction.[302] Victory Sports, which operates an RSN and is not vertically integrated with an MVPD, expresses concern that that the vertical integration of DirecTV's satellite distribution platform and News Corp.'s RSNs could discourage good faith negotiations for fair market value prices for independent RSN offerings.[303] Similar concerns were expressed with respect to the ability of Latino-themed English language and bilingual networks to gain access to DirecTV by the Congressional Hispanic Caucus.[304]

104. Commenters contend that News Corp.'s discrimination against unaffiliated cable networks will harm the public by reducing the diversity of programming available to viewers. NRTC is particularly concerned about the transaction's effects on viewers in rural areas. NRTC asserts that if the Application is approved, News Corp. could become an essential facility for content developers' distribution of programming to rural America.[305] According to NRTC, as one of only two MVPDs

[296] NAB Comments at 20-21, CFA Reply Comments at 3, 5; NRTC Petition at 14-15; EchoStar Petition at 39-40; CDD Petition at 3.

[297] CFA Reply Comments at 3.

[298] CFA Reply Comments at 3, 5.

[299] CDD Petition at 4.

[300] EchoStar Petition at 39.

[301] EchoStar Petition at 39-40. *See also* NRTC Petition at 14 (asserting that competing content developers may need access to the DirecTV platform to reach enough people to make distribution economically feasible).

[302] CDD Petition at 3

[303] *See* Letter from Kathleen M.H Wallman, counsel to Victory Sports, LLC, to Marlene H. Dortch, Secretary, FCC (Oct. 17, 2003).

[304] *See* Letter from Ciro Rodriguez, Chairman, Congressional Hispanic Caucus to John Ashcroft, U.S. Attorney General, U.S. Department of Justice, Michael K. Powell, Chairman, FCC and Commissioners (Dec. 9, 2003) at 2.

[305] NRTC Petition at 14.

national or regional programmers.[314] Because the Commission has previously found 20% to be well below levels of concentration at which the Commission has historically had cause for concern, Applicants argue DirecTV's 13% MVPD market share should be dispositive.[315]

**(ii) Discussion and Condition**

107. Applicants have offered that "neither News Corp. nor DirecTV will discriminate against unaffiliated programming services in the selection, price, terms or conditions of carriage." We conclude that Applicants' proposed commitment to allow unaffiliated programmers access to the DirecTV platform on nondiscriminatory terms and conditions adequately addresses concerns raised regarding unaffiliated video programmers' access to the DirecTV platform. We will therefore condition our grant of the Application on compliance with this access commitment.[316] At this time, we will not prescribe standards of conduct pursuant to which DirecTV must act to comply with this condition although we expect DirecTV to act reasonably when dealing with unaffiliated programmers. We note that Applicants' proposed commitment is not unlike the nondiscrimination requirement in the Act and our program carriage rules.[317] Similar to our treatment of the remainder of Applicants' proposed program access commitments in the following section, we clarify that aggrieved programmers and MVPDs may seek relief for any alleged violations of this condition by using the existing enforcement mechanisms found at Section 76.1003 of the Commission's rules.[318]

108. As to broadcast programming, we find it unlikely that, after the transaction, DirecTV would discriminate against competing television broadcast stations. The applicable statutory and regulatory provisions[319] thoroughly address satellite carriage of broadcast television programming. In any market in which DirecTV offers local-into-local service pursuant to the statutory copyright license, it is required to carry all television broadcast stations within that local market that request carriage.[320] The Commission's rules detail the technical terms of carriage, certain anti-discrimination provisions based on SHVIA, and the complaint process by which aggrieved parties can seek Commission redress if DirecTV has failed to meet its carriage obligations.[321] Alternatively, television broadcast stations that provide retransmission consent can negotiate the terms and conditions of carriage.[322] We reiterate that, under the

[314] Applicants' Reply at 49 (citing *EchoStar-DirecTV HDO*, 17 FCC at 20655).

[315] *Id*

[316] *See* Appendix F.

[317] We note that Applicants' proposed condition is not unlike the nondiscrimination requirement in the Act and our program carriage rules. *See* 47 U.S.C. § 536(a)(3); 47 C.F.R. § 76.1301(c).

[318] *See* 47 C.F.R. § 76.1003.

[319] *See, e g.*, Satellite Home Viewer Improvement Act of 1999, PL 106-113, 113 Stat. 1501, Appendix I (1999).

[320] 47 C.F.R. § 76.66(b)(1).

[321] *See* 47 C.F.R. § 76 66(i) (channel position); 47 C.F.R. § 76 66(j) (manner of carriage) 47 C.F.R. § 76.66(m) (remedies)

[322] 47 C.F.R. § 76 65.

SHVIA, we will, in reviewing carriage complaints against any MVPD, consider any unreasonable terms or conditions or negotiating procedures.[323]

#### 4. Discrimination Against Unaffiliated MVPDs

##### a. Access to National and Non-Sports Regional Cable Programming Networks

###### (i) Position of Parties

109 News Corp. has interests in several satellite cable programming networks, including national programming networks offering sports, news, or general entertainment,[324] and regional programming networks that do not offer sports.[325] Applicants acknowledge that a vertical relationship could lead to anti-competitive results in the distribution market if a programmer discriminated against or refused to sell to unaffiliated MVPDs in order to gain competitive advantage for its affiliated MVPD. Applicants claim, however, that any such concern would be extremely attenuated in this case for five principal reasons: (1) News Corp. has no market power in the sale of video programming that would enable it to carry out such a strategy; (2) it would be commercially irrational for News Corp. and DirecTV to attempt foreclosure; (3) the program access rules prohibit News Corp. from engaging in such discriminatory conduct; (4) the parties are willing to accept a series of program access-like undertakings that will remain enforceable even if News Corp. ceases to be subject to the Commission's program access rules; and (5) vertical foreclosure strategies that involve News Corp. attempting to force its "sophisticated partners", including Hughes and the various co-owners of many News Corp. programming networks, to act against their self-interests, would not work because such self-dealing behavior is adequately protected against by "existing corporate governance and legal requirements."[326]

110. Applicants maintain that News Corp's affiliates' combined share of the programming market is too small for News Corp to be able to exercise any type of market power. They cite prior Commission findings that the programming supply market is extremely competitive, with the growth rate of new programmers outpacing the growth of new channels on MVPD systems,[327] and they state that News Corp 's share of national video programming services is relatively small (3.9%, or 10 of 257

[323] *Implementation of the Satellite Home Viewer Improvement Act of 1999 Retransmission Consent Issues*, 16 FCC Rcd 1918, 1928 (2000) In addition, as discussed in Section VI.C.4.c., below, we extend the good faith and non-exclusivity provisions of SHVIA as a condition of license transfer approval for so long as the program access rules are also in effect.

[324] The following is a list of national programming networks affiliated with News Corp. (News Corp.'s ownership share appears in parentheses only if it is less than 100%) Fox News Channel; FX; National Geographic Channel (66 2/3%, remaining 33 1/3% National Geographic Society); Speed Channel; Fox Movie Channel; Fox Sports World; Fox Sports en Espanol (37 8%, remaining 62% Liberty (10 6%) and Hicks Muse (51.6%)); Fox Sports Digital Networks; TV Guide Channel (42.9% indirectly owned through Gemstar, which owns 100%); TV Games Network (42.9% indirectly owned through Gemstar, which owns 100%) *See* Application at Attachment F.

[325] The following is a list of non-sports regional programming networks affiliated with News Corp. News Corp. holds a 40% interest in each network, while the remaining interest is held by Rainbow. MSG Metro Guide; MSG Metro Learning, MSG Traffic and Weather *See* Application at Attachment F.

[326] Application at 54, Reply at 59

[327] Application at 54, (citing *Cable Horizontal Order,* 14 FCC Rcd at 19104).

serving un-cabled rural areas and the only such MVPD with programming holdings, News Corp. could control the programming available in rural areas by denying distribution to competing content providers.[306] CDD asserts that if the transaction is approved, certain safeguards must be imposed to ensure that unaffiliated programmers have access to DirecTV's platform, including requiring Applicants to make "channel and related capacity" available on a non-discriminatory basis to unaffiliated programmers that lack market power; requiring that non-broadcast local (commercial and non-commercial) programmers have access to Applicants' spot-beam capacity; and requiring Applicants to increase the amount of national footprint capacity available to non-commercial entities beyond what is required by our public interest obligations for DBS licensees.[307]

105. NAB asserts that the transaction will give DirecTV the incentive and ability to discriminate against broadcast stations other than Fox O&Os.[308] NRTC asserts that News Corp. will have less economic incentive to deliver local signals in markets where it does not have an O&O or an affiliate.[309] NAB and NRTC claim that consumers will be harmed by the resulting reduction in programming, particularly local programming and programming available to rural consumers. Commenters contend that News Corp.'s discrimination against competing television broadcast stations will harm the public by reducing the diversity of programming available to viewers and by limiting viewer access to local programming.[310] With respect to the Applicants proposed condition that the merged entity will not discriminate against "unaffiliated programming vendors with respect to price, terms, or conditions of carriage on the DirecTV platform,"[311] NAB contends the proposed condition is inadequate because it does not address potential discrimination against broadcasters, and urges the Commission to expand this condition to prohibit discrimination against broadcast stations as well as cable programmers.[312]

106. Applicants respond that these claims of vertical foreclosure against unaffiliated programmers are flawed because DirecTV simply lacks a large enough share of the MVPD market to foreclose an unaffiliated programmer. Such programmers would still be able to sell to MVPDs serving approximately 87% of subscribers nationwide. Moreover, such a strategy would only hurt DirecTV by reducing the attractiveness of its channel lineup. DirecTV's refusal to carry programming valued by consumers, regardless of its source, would only drive subscribers to competing MVPDs.[313] Applicants note that, even where this issue has arisen in the context of an MVPD with much higher market share – as in the proposed EchoStar-DirecTV merger, where the combined market share would have been about 20%—the Commission concluded that the transaction would not create purchasing market power over

[306] NRTC Petition at 14.

[307] CDD Nov. 7, 2003 Ex Parte at 3. *See also* 47 CFR § 100.5

[308] NAB Comments at 20-24. NAB asserts that News Corp. will have the ability and incentive to act as a gatekeeper to the detriment of unaffiliated content providers, including broadcast stations. *Id.*

[309] NRTC Petition at 15.

[310] NAB Comments at 20-24, NRTC Petition at 15.

[311] NAB Comments at 26.

[312] NAB Comments at 26.

[313] Applicants' Reply at 49.

customers.[289] We therefore discount the likelihood that corporate governance, corporate law or securities laws in general may be relied upon to adequately protect MVPD and video programming competitors from potential anti-competitive vertical foreclosure behavior on the part of Applicants.

### 3. Discrimination Against Unaffiliated Programming

#### (i) Positions of the Parties

101. Applicants acknowledge that competitive concerns could arise if a transaction were to create an entity with sufficient market power in the distribution of programming that it would have the incentive and ability to foreclose access to its distribution network by refusing to buy programming that viewers' desire from unaffiliated programmers.[290] Applicants assert, however, that DirecTV's post-transaction ability and incentive to engage in such conduct is significantly constrained by DirecTV's small share of the MVPD market. Applicants assert that DirecTV's share of the national MVPD market—13%—is too low for the transaction to result in harm to unaffiliated cable networks,[291] and they note that, in every local market, DirecTV competes against a "dominant" cable operator, as well as EchoStar.[292] Applicants maintain that the primary purchasers of video programming are cable operators, including Comcast, which alone controls 29% of the MVPD market.[293] Applicants claim that it would be economically irrational for DirecTV to refuse to carry attractive unaffiliated programming in favor of programming produced by its new affiliate, News Corp. They claim that it is DirecTV's primary economic incentive to increase subscribership by distributing the widest possible variety of content to the widest possible audience, and thus it has no incentive to discriminate against unaffiliated content providers, either now or after consummation of the transaction. Nonetheless, Applicants state, "if the Commission deems it necessary," News Corp. and Hughes have agreed to accept the following enforceable undertaking as a condition of grant of their Application:

> Neither News Corp. nor DirecTV will discriminate against unaffiliated programming services in the selection, price, terms or conditions of carriage.[294]

With respect to potential discrimination against broadcast stations, Applicants point to statutory mandatory carriage requirements, which would prevent them from engaging in such a strategy, even if they had the incentive to do so.[295]

102. Several commenters contend that the transaction would give DirecTV the incentive and ability to favor News Corp.'s content and discriminate against competing cable networks and television

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[289] Consumers Union Comments at 5, and Stout Reply Aff. ¶ 16.

[290] Application at 49.

[291] Application at 48-52.

[292] Application at 49.

[293] Application at 49

[294] Application at 53, Attachment G.

[295] Applicants' Reply at 63.

violations still occur."[274] We agree with the JCC on this issue. Not all violations will be detected, even by an alert plaintiffs' bar. Moreover, litigation may not be brought for a variety of reasons that have nothing to do with the merits of the case. In the final analysis, this Commission, not the private bar, is the guardian of the public interest in these matters

96. The final and most contentious disagreement concerns the extent to which and independent director is actually "independent." The Applicants contend that Delaware corporate law, the federal securities laws, the NYSE Rules, and other federal statutes will ensure that independent directors will be effective in reviewing the fairness of related-party contracts to Hughes and to all of its shareholders and thus, ultimately, to the public. We disagree. As we have already discussed, the Delaware Law provides a safe harbor for companies entering into related-party contracts.[275] Further, although federal securities laws provide that material contracts must be disclosed, they do not bar such contracts from being entered into in the first place.[276] On the Applicants' own admission, the Sarbanes-Oxley Act does not operate "to protect consumers from alleged controlling shareholder self-dealing."[277] Finally, the NYSE Rules set forth the requirements of an audit committee and define who is eligible to be a member of the committee. As we have already discussed, the requirements set forth in the NYSE Rules consist of matters relating to the company's outside auditors, they do not consist of requirements concerning related-party contract review.

97. The NYSE Rules also provide a definition of an independent director.[278] JCC argue that, while Delaware law, the Sarbanes-Oxley Act and the NYSE Rules set forth requirements that are designed to ensure that independent directors are independent from the firm's management in transactions involving the company and its management, such provisions do not deal with the situation presented by the instant transaction, namely, the independent directors' independence from the company's controlling shareholder.[279] Applicants argue that News Corp. is not a controlling shareholder, with the consequence that News Corp. cannot influence the choice and election of the independent directors.[280] Applicants attempt to distinguish between Delaware law, which they assert presumes that shareholders owning less than a majority of a company's shares do not control a company, and Commission precedent.[281] Applicants state that the presumption could be overcome only "if it were supported by specific facts of record that overcome the Delaware law presumption against non-majority stockholder control."[282] We believe that there is sufficient evidence in the record to overcome the presumption. Indeed, Applicants implicitly concede, by having filed the Application presently before us,

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[274] Stout Aff. ¶ 15.

[275] *See* note 266, *supra*

[276] Hamermesh Aff. ¶ 11.

[277] Applicants' Jul. 28 Response at I.6.

[278] *See* note 267, *supra*

[279] Stout Reply Aff. ¶ 3.

[280] Hamermesh Aff. ¶ 8(b); Hamermesh Reply Decl ¶¶ 3-5.

[281] *Id*

[282] Hamermesh Reply Decl ¶ 5.

board seat.[261]

92. Applicants respond that the GM stockholders would not affirmatively vote to approve the transaction if the commenters' allegations were true. Applicants argue that the claimed vagueness of the By-Laws is actually a strength, as the Audit Committee will have the flexibility to respond to changing conditions and areas of concern that could not have been predicted when the By-Laws were adopted.[262] Responding to allegations that the Audit Committee lacks the expertise to properly review related-party contracts, the Applicants assert that the Audit Committee can retain experts, counsel and consultants to assist it with its task.[263] They further note that, as a public company, Hughes will be subject to extensive disclosure obligations under federal securities laws, including disclosure requirements relating to related-party contracts.[264] Finally, they contend that Hughes' non-controlling shareholders will be able to bring derivative shareholder suits against the company if self-dealing is suspected; that covenants contained in certain of Hughes' debt agreements require that a related-party transaction be on an arms' length basis; and that certain transactions, in addition, require an independent fairness opinion from an outside financial advisor.[265]

93. *Discussion* Applicants contend that, because the Audit Committee will have the sole power to pass upon related-party contracts, any attempt by News Corp. or its programming subsidiaries to compel Hughes to accept anything other than an entirely fair contract for the carriage of Fox programming would be unsuccessful. This in turn would result in the protection of both the non-controlling shareholders of Hughes and, ultimately, protecting Hughes' consumers from higher prices.[266] The NYSE Rules state that an audit committee must consist of at least three directors each of whom must be "independent."[267] As set forth in the NYSE Rules, an audit committee's responsibility is to select and oversee the company's outside auditors.[268] In the case of Hughes, however, the Audit Committee will be

[261] JCC at 62-3 (citing to Stout Aff.)

[262] Applicants' Reply at 55.

[263] Applicants' Reply at 56

[264] Applicants' Reply at 56.

[265] Applicants' Reply at 57-58

[266] Application at 58-59. It should be noted that Hughes is a Delaware corporation and is therefore subject to the General Corporation Law of the State, 56 Del. Laws, c. 50 ("DGCL"). Under section 144 of the DGCL, a contract between a corporation and another corporation that share one or more officers or directors in common is not void or voidable solely due to that fact, provided that the contract is fair as to the corporation as of the time it is authorized, approved or ratified by the board of directors, a committee or the shareholders (§ 144(a) DGCL) Thus, while the DGCL does not require a contract between related-parties to be approved, it would be a reasonable thing for a corporation to do as it provides a level of protection for the corporation should the contract be challenged. In a similar fashion, the Applicants have stated that the Audit Committee will have the sole power to pass on a related-party contract. As with the DCGL, the Audit Committee may give its approval either before or after the fact (By-Laws, Article III 3 (d)) At bottom, therefore, it appears that the Applicants are offering only to comply with a discretionary provision of the DGCL that would be prudent for them to follow in any event.

[267] To be "independent," *inter alia*, the board of directors must affirmatively determine that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company). NYSE Rules § 303A.02.

[268] NYSE Rules § 303A.07.

to that market. For markets in which the Applicants have market power, we will analyze whether the transaction increases Applicants' incentive and ability to withhold a given input. Based on our review and analysis of the record, we do not agree with Applicants that the proposed transaction will result in no public interest harms in any of these areas absent appropriate conditions.

86. Our review of the record, using the approach described above, demonstrates that, with respect to national and non-sports regional cable programming, the program access rules, together with the Applicants' program access-like commitments should adequately protect against permanent foreclosure and overt price discrimination. Further, there is no evidence in the record that significant numbers of customers will shift MVPDs if such programming is temporarily withdrawn from their current MVPD. This suggests that temporary foreclosure will not significantly increase downstream profits of DirecTV or that this increase in profits will exceed the sum of the loss in revenues in the upstream market plus the transaction costs associated with arranging compensation for DirecTV's other shareholders. As a result, we find it unlikely that News Corp. will have an incentive to temporarily withhold such programming in an effort to secure a uniform increase in the price of its general interest cable programming.

87. In contrast, we find substantial evidence in the record that a temporary withdrawal of regional sports programming networks and local broadcast television station signals would cause a significant number of customers to shift from their current MVPD, which is subject to the foreclosure, to DirecTV. In addition, there is significant evidence in the record that the per-subscriber profits generated by each additional DirecTV subscriber are sufficiently large that the increased downstream revenues resulting from temporary foreclosure are likely to exceed the costs of foreclosure in many local markets. Accordingly, we find that, as a result of the transaction, the increased profits accruing to DirecTV and News Corp. as a result of the temporary withdrawal of regional sports programming and broadcast signals will give News Corp. an increased incentive to adopt a strategy of temporary foreclosure in order to uniformly raise the price of its broadcast television and regional sports programming and/or obtain other carriage concessions. News Corp.'s post-transaction ability to act anti-competitively to increase its competitors' programming costs is greater than it would otherwise be due to News Corp.'s post-transaction ability to off-set temporary revenue losses arising from foreclosure with increased profits accruing to DirecTV as subscribers drop the affected MVPD and subscribe to News Corp's affiliated MVPD. This increased ability and incentive to seek and obtain higher programming rates through unilateral temporary foreclosure would likely lead to higher prices to MVPD consumers than would otherwise occur and thereby harm the public interest. To avoid public interest harms that would result from such conduct, we impose several conditions to maintain the balance of bargaining power between News Corp. and other MVPDs at roughly pre-transaction levels.

88. In this section, we first address Applicants' claims with respect to the role of corporate governance and associated legal requirements in protecting against anticompetitive harms. We next examine, sequentially, concerns raised in the record with respect to the potential for Applicants to discriminate against or foreclose access to unaffiliated programming on the DirecTV platform and their potential for discrimination against or foreclosure of unaffiliated rivals in the video programming and MPVD markets, as appropriate, with respect to access to Applicants': (a) national and non-sports regional cable programming networks; (b) regional sports cable programming networks; (c) local broadcast television stations signals; (d) programming-related technologies; and (e) fixed satellite services.

competitor to lose sufficient revenue or suffer other competitive harms, the competitor might agree to pay a higher price for the input, which could lead to higher prices for the output, thus injuring consumers. Even if the vertically integrated firm suffered a loss in profits from engaging in a specific instance of temporary foreclosure, it might nevertheless find it to be a profitable strategy over the longer run. Specifically, if by temporarily foreclosing certain competitors, the vertically integrated firm may signal to other downstream competitors its willingness to foreclose, which may cause other downstream competitors to agree to a higher price without the vertically integrated firm's having to actually engage in repeated foreclosures.[245] Temporary foreclosure may result in a widespread increase in the input price and thus upstream profits in the longer-run. In addition, if the increase in the input price affects the marginal cost of producing the downstream product, prices in the downstream market will rise as well.

81. The underlying purpose of temporary foreclosure generally is to extract a higher price for the integrated firm's upstream input and thus raise its downstream rivals' costs. It is recognized that this raising rivals' costs strategy may take two forms. First, an integrated firm, if it can, will generally seek to discriminate in the price it charges downstream rivals for its upstream input. Specifically, it will have an incentive to charge a higher input price to its downstream competitors than it charges itself or non-competing firms in ancillary markets.[246] In many cases, however, either legal or regulatory constraints or market forces will limit the ability of the integrated firm to engage in price discrimination.

82. Where the downstream affiliate is wholly owned, the integrated firm can always raise the internal transfer price of an input so that it equals the price charged to downstream competitors. Under these conditions, however, the increase in the internal transfer price is not particularly meaningful, since the integrated firm in making business decisions will consider the real economic cost of the input and not its nominal transfer price.[247] Thus, in the case of a wholly owned downstream affiliate, it may be difficult to detect if price discrimination is occurring and anti-discrimination rules may not function effectively.

83. Where, as in this case, the upstream input supplier holds only a *partial ownership interest* in the downstream firm, matters become even more complicated. The Applicants note that corporate law generally requires that the transfer price not be set in a manner that disadvantages the other shareholders of the downstream firm.[248] As our discussion of corporate governance in the following section demonstrates, the protections afforded by corporate law are neither absolute nor omniscient. Even when corporate law effectively limits the ability of the upstream firm to enter into arrangements that disadvantage the minority shareholders of the downstream firm, it is equally true that the upstream firm can circumvent this problem if it can effectively compensate the downstream firm and its shareholders for any increase in the transfer price of the input. This compensation is frequently referred to as a "side-

[245] The analysis of the incentives to engage in temporary foreclosure is similar to the incentive for union to engage in the temporary withholding of labor in the economic analysis of strikes. *See, e.g.,* Peter Cramton and Joe Tracy *Strikes and Holdouts in Wage Bargaining Theory and Data* , AMERICAN ECONOMIC REVIEW Vol. 82 at 100-121 (Mar. 1992).

[246] *Cf* Riordan & Salop, 63 ANTITRUST L J at 535-38 (discussing the incentive of an integrated firm to discriminate and charge higher prices to its direct rivals).

[247] We ignore for purposes of this discussion other regulations that may constrain the setting of transfer prices.

[248] In Section VI C.2. we analyze the likelihood that internal controls and corporate law will limit the ability of News Corp. to set transfer prices that disadvantage the remaining Hughes shareholders.

## C. Potential Vertical Harms

### 1. Background

76. *Background* In this section, we consider the potential vertical harms of the proposed transaction. In particular, we consider whether, as a result of the transaction, Applicants will have an increased incentive and ability to engage in anticompetitive foreclosure strategies with respect to national and non-sports regional cable programming networks, regional sports cable programming networks, broadcast television station signals, programming-related technologies, including electronic and interactive programming guides and fixed satellite services

77. Applicants present a series of economic and legal arguments in support of their overall claim that the proposed transaction poses no competitive harms in the affected markets. In general, they contend that: (1) economic forces are sufficient to ensure that the proposed transaction will have no anticompetitive effect in any relevant market; (2) neither News Corp. nor Hughes has sufficient power in any relevant market that would give it the ability or incentive to pursue a vertical foreclosure strategy; and (3) even if this were not true, structural corporate governance checks and regulatory constraints, including their proposed program access conditions, would safeguard against such conduct.[235] Most commenters and opponents of the transaction argue that News Corp. will use its control of DirecTV to disadvantage its MVPD rivals and harm consumers.[236] Commenters and opponents of the transaction assert that the transaction poses a significant likelihood that News Corp. will use its control of Hughes and DirecTV to disadvantage its MVPD competitors and ultimately harm consumers in several relevant product markets.[237] In particular, several opponents of the transaction contend that consumer demand for local broadcast television station signals and regional sports network programming is so strong as to make profitable a strategy of temporary vertical foreclosure in order to drive up prices for those programming packages.[238]

78. With respect to vertical foreclosure, which is the main harm alleged in the record, a vertically integrated firm, as the result of a transaction, may have the incentive and ability (or an increased incentive and ability) to foreclose downstream competitors from important inputs.[239] That is, where a firm that has market power in an input market acquires a firm in the downstream output market, the

[235] Application at 47-48; Applicants' Reply at iii-iv

[236] *See, e.g.*, ACA Comments at 7-23; Cablevision Comments at 8-30; CDD Comments; CFA Reply Comments at 3-12; Consumers Union Sept. 23, 2003 Ex Parte; EchoStar Petition at 11-39, 58-67; JCC Comments at 13-65; NAB Comments at 5-9, 15-26; NRTC Petition at 7-15; RCN Comments at 4-11; Pegasus Comments.

[237] *See, e.g.*, ACA Comments at 7-23; Cablevision Comments at 8-30; CDD Comments; CFA Reply Comments at 3-12, Consumers Union Sept. 23, 2003 Ex Parte; EchoStar Petition at 11-39, 58-67; JCC Comments at 13-65; NAB Comments at 5-9, 15-26, NRTC Petition at 7-15; RCN Comments at 4-11; Pegasus Comments.

[238] *See, e.g.* EchoStar Petition at 22-24, 30-32; JCC Comments at 15-44; Pegasus Dec.16, 2003 Ex Parte; RCN Dec. 18, 2003 Ex Parte.

[239] A vertically integrated firm also may attempt to foreclose upstream competitors from the vertically integrated firm's downstream affiliate in order to reduce the competitors' customer base. If the downstream affiliate had previously purchased significant amounts of inputs from other independent suppliers, this foreclosure could raise the costs of upstream rivals and possibly cause them to exit the market *See, e.g.*, Riordan & Salop, 63 ANTITRUST L. J. at 519