43. Aggrieved entities can file a complaint with the Commission.[144] Remedies for violations of the rules may include the imposition of damages and the establishment of reasonable prices, terms and conditions for the sale of programming.[145] Broadcast programming is not subject to the program access rules.

44. The Commission's 2002 examination of whether the exclusivity prohibition should sunset placed substantial weight on whether, in the absence of the exclusivity prohibition, vertically integrated programmers would currently have the incentive and ability to favor their affiliated cable operators over nonaffiliated cable operators and program distributors using other technologies and, if they would, whether such behavior would result in a failure to protect and preserve competition and diversity in the distribution of video programming.[146] Commission held that access to all vertically integrated satellite cable programming continues to be necessary in order for competitive MVPDs to remain viable in the marketplace.[147] The Commission further found that an MVPD's ability to provide service that is competitive with an incumbent cable operator is significantly harmed if denied access to "must have" vertically integrated programming for which there are no good substitutes, such as regional news and sports networks.[148] The Commission also found that vertically integrated programmers retain the incentive to favor their affiliated cable operators over competing MVPDs.[149] In that regard, the Commission found that cable operators continue to dominate the MVPD marketplace and that horizontal consolidation and clustering combined with affiliation with regional programming, have contributed to cable's overall market dominance.[150] In addition, the Commission determined that an economic basis for denial of access to vertically integrated programming to competitive MVPDs continues, and that such denial would harm such competitors' ability to compete for subscribers.[151] The prohibition on exclusive contracts for satellite-delivered cable or satellite-delivered broadcast programming was therefore extended for five years, until October 5, 2007.[152]

2. **Program Carriage Rules**

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[144] 47 C.F.R. § 76.1003.

[145] 47 C.F.R. §76.1003(g) and (h).

[146] *Program Access Order*, 17 FCC Rcd at 12130 ¶15.

[147] *Id.* at 12138 ¶ 32.

[148] *Id.* at 12125 ¶ 4.

[149] *Id.* at 12143 ¶ 45.

[150] *Id.* at 12125 ¶ 4.

[151] *Id.*

[152] *Id.* at 12124 ¶ 1.

45. Our rules implementing section 616 of the 1992 Cable Act[153] *prohibit all MVPDs from: (1)* demanding a financial interest in any program service as a condition of carriage of the service on its system; (2) coercing any video programming vendor to provide exclusive rights as a condition of carriage; and (3) unreasonably restraining the ability a video programming vendor to compete fairly by discriminating on the basis of affiliation or non-affiliation of vendors in the selection, terms or conditions of carriage.[154] The program carriage rules also specify complaint procedures and remedies for violations of these requirements. Complaints may be brought by aggrieved video programmers or MVPDs.[155]

3. **Must-Carry and Retransmission Consent**

46. In adopting the mandatory carriage provisions of the 1992 Cable Act, Congress recognized the importance of local television broadcast stations as providers of free local news and public affairs programming.[156] Congress found that cable service was rapidly penetrating television households, and increasingly was competing with free over-the-air television for advertising dollars.[157] Congress recognized that television broadcast stations rely on advertising dollars to provide free over-the-air local service, and that competition from cable television posed a threat to the economic viability of television broadcast stations, and mandated cable carriage to ensure the continued economic viability of free local broadcast television.[158]

47. Pursuant to these rules, commercial television broadcast station signals are carried by their local MVPDs pursuant to either mandatory carriage or retransmission consent.[159] For cable systems, a broadcast station is entitled to mandatory carriage (*i.e.* "must-carry") on all cable systems within their local markets.[160] Where a television broadcast station has elected must-carry, the cable operator is not

[153] *See* 47 U.S.C. § 536(a). Congress enacted section 616 based on findings that some cable operators had required certain non-affiliated program vendors to grant exclusive rights to programming, a financial interest in the programming, or some other additional consideration as a condition of carriage on the cable system. *Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992,* 9 FCC Rcd 2642 ¶ 1 (1993).

[154] *See* 47 C.F.R. § 76.1301; *see also Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992,* 9 FCC Rcd 2642 (1993).

[155] Section 76.1302 authorizes video programming vendors and MVPDs to file program carriage complaints with the Commission. 47 C.F.R. § 76.1302; *see also Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992,* 9 FCC Rcd 2642 ¶ 1 (1993). On reconsideration, the Commission amended 47 C.F.R. § 76.1302 to specifically afford standing to MVPDs aggrieved by carriage agreements between other MVPDs and programming vendors that violate section 616 of the 1992 Cable Act or the Commission's rules. *Implementation of the Cable Television Consumer Protection and Competition Act of 1992,* 9 FCC Rcd 4415, 4418-19 ¶ 24 (1994).

[156] House Committee on Energy and Commerce, H.R.Conf.Rep. No. 102-862 ("Conference Report"), 102d Cong., 2d Sess. (1992), reprinted at 138 Cong. Rec. H8308 (Sept. 14, 1992) at 2.

[157] Conference Report at 3.

[158] Conference Report at 3.

[159] Noncommercial television stations do not have retransmission consent rights.

[160] 47 C.F.R. § 76.56.

required to compensate the broadcaster.[161] Alternatively, the station and the cable operator can negotiate the terms of carriage through retransmission consent negotiations.[162] The must-carry obligations of DBS operators differ slightly from those of cable operators. In markets where a DBS operator carries any station to subscribers within the station's local market (*i.e.*, "local-into-local" carriage), pursuant to the Statutory Copyright license all broadcast stations in the market have a right to mandatory carriage by that DBS operator (*i.e.* the "carry-one, carry-all" requirement).[163] Broadcasters also have the option of negotiating terms of retransmission with the DBS operator. Under the Act and the Commission's rules, television stations are prohibited from entering into exclusive retransmission agreements, and must negotiate in good faith with MVPDs.[164] By statute, the exclusivity and good faith negotiation requirements are effective "until January 1 2006."[165]

48. By the time Congress enacted the must-carry/retransmission consent provisions of the Satellite Home Viewer Improvement Act of 1999 ("SHVIA"), Congress had recognized the importance of local television broadcast signals not only as providers of a valuable public service, but as "must-have programming" critical to a DBS offering. By permitting DBS operators to carry local television broadcast signals, Congress sought to place DBS operators on a level playing field with their cable counterparts so that they could compete more effectively with cable operators.[166] To ensure that broadcasters negotiated fairly with these relatively new entrants into the MVPD market, Congress enacted the good faith negotiation requirement and prohibition exclusive retransmission consent agreements. Congress explicitly stated that good faith negotiation did not equate to a requirement that broadcasters grant retransmission consent on the same terms and conditions to all MVPDs.[167]

C. Relevant Markets

49. DirecTV is one of two full-CONUS DBS providers and the second largest MVPD in the U.S, providing service in all 50 states.[168] It offers more than 825 channels of sports, news, movies, and family

[161] 47 C.F.R. § 76.60.

[162] 47 C.F.R. § 76.64.

[163] 47 C.F.R. § 76.66.

[164] *See* 47 U.S.C. § 325(b)(3)(C); 47 C.F.R. § 76.65; *Implementation of Satellite Home Viewer Improvement Act of 1999, Retransmission Consent Issues: Good Faith Negotiation and Exclusivity* 15 FCC Rcd 5445, 5463 ¶ 45 ("*Good Faith Negotiation Order*").

[165] *See* 47 U.S.C. § 325(b)(3)(C). *See also,* 47 C.F.R. § 76.65(f)(good faith negotiation requirement sunsets at midnight on Dec. 31, 2005).

[166] *See* H.R. Rep. No. 106-79 at 11-15 (1999); Satellite Home Viewer Improvement Act, Pub.L. No. 106-113, 113 Stat.1501, at App. I at 1501A-523 & 544.

[167] 47 U.S.C. §325(b)(3)(C)(ii) (stating that "it shall not be a failure to negotiate in good faith if the television broadcast station enters into retransmission consent agreements containing different terms and conditions, including price terms, with different multichannel video programming distributors if such different terms and conditions are based on competitive marketplace considerations").

[168] As of the end of the third quarter, DirecTV had 11.85 million subscribers. *See Hughes Announces Third Quarter Growth of 17% in Revenues and 33% in Operating Profit Before D&A; Operating Profit Quadruples; DirecTV Adds 326,000 Owned and Operated Subscribers in the Quarter, a 58% Increase Over Last Year*, Oct. 14, 2003, (continued....)

programming, including local broadcast channels in 64 television markets, high definition and foreign-language programming to nearly 12 million customers.[169] News Corp. is a global media corporation owning a wide variety of video programming products from cable and broadcast networks to broadcast television stations which they sell to MVPDs across the country. Included in its suite of video programming products are the Fox broadcast network, one of the four major national broadcast networks, 35 owned and operated (O&O) full-power local television broadcast stations, including two stations in three of the top five and five of the top ten markets, 10 nationally distributed cable networks, 12 owned and managed regional cable networks,[170] and 171 independently owned local television stations that are affiliated with the Fox Network.[171] News Corp.'s cable programming assets include the Fox News Channel, Speedvision, FX, Fox Movie Channel, and the National Geographic Channel. News Corp. controls a wide array of regional and national sports programming channels, as well as valuable program production assets.[172] News Corps' broadcast stations carry UPN and Fox programming, which includes the World Series and other Major League Baseball post-season games, the 16 National Football Conference ("NFC") teams of the National Football League ("NFL"), and popular shows like "The Simpsons," "American Idol" and "Joe Millionaire."[173] In addition, News Corp. controls the national broadcast rights to National Association of Stock Car Auto Racing ("NASCAR") races and several major packages of college basketball and football games nationwide.[174]

50. In evaluating the potential competitive effects of the transaction, it is necessary to first define the product and geographic markets.[175] A relevant market is defined as a product or group of products and a geographic area in which the product or products are produced or sold such that a hypothetical profit-maximizing monopolist would impose at least a 'small but significant and nontransitory' increase

(Continued from previous page)
available at: http://www.hughes.com/ir/releases/2003_results/q3_2003/default.asp (viewed Nov. 14, 2003). DirecTV has surpassed the total subscribers of Time Warner Cable, Inc., which had 11.4 million subscribers as of September 30, 2003. *See Time Warner Inc. Consolidated Balance Sheet,* available at: http://www.timewarner.com/investors/quarterly_earnings/2003_3q/pdf/3q2003charts.pdf (viewed Nov. 14, 2003). Thus, DirecTV is now second only to Comcast in terms of subscribership.

[169] Hughes Electronics Corporation, *General Overview* at http://www.hughes.com/ir/general/default.asp (visited Nov. 5, 2003).

[170] Since filing the application for transfer of control, News Corp. has launched an additional network, Fuel, which brings the number of nationally distributed channels to 11.

[171] *FEG 10-K 2003 Annual Report* at 7.

[172] News Corp.'s sports networks include Fox Sports World, Fox Sports en Espanol, Fox Sports Digital Networks, and 12 RSNs—Fox Sports Net Arizona, Fox Sports Net Detroit, Fox Sports Net Midwest, Fox Sports Net North, Fox Sports Net Northwest, Fox Sports Net Pittsburgh, Fox Sports Net Rocky Mountain, Fox Sports Net Southwest, Fox Sports Net West, Fox Sports Net West 2, and the Sunshine Network. *See* Application at Attachment F.

[173] Application at 47; *FEG 10-K 2003 Annual Report* at 7, 27. *See also FEG Presentation, Bear Stearns Media, Entertainment, and Information Conference,* slide 19 (Mar. 4, 2003), available at: http://www.newscorp.com/investor/download/bearstearns03/sld019.gif (visited on Dec. 12, 2003).

[174] JCC Comments at 38.

[175] *EchoStar-DirecTV HDO,* 17 FCC Rcd at 20605-06 ¶ 106; *Comcast-AT&T Order,* 17 FCC Rcd 23260-61 ¶ 42.

in price, assuming the terms of sale of all other products are held constant.[176]

1. Product Markets

51. In analyzing vertical issues in MVPD transactions, as the Applicants note, the Commission has generally examined two separate but related product markets: (1) the acquisition of programming ("the programming market"); and (2) the distribution of programming to consumers ("the distribution market").[177] We agree that the Applicants are significant participants in both of these product markets, and therefore analyze them in detail in this section.

a. MVPD Services

52. *Positions of the Parties.* The Applicants begin by observing that the Commission has previously found that DBS operators compete in a market composed of all MPVD providers,[178] and that although the Commission has considered at times that a more narrowly drawn market may be appropriate, it has continued to use the MPVD product market for its competition analysis in recent cases. Accordingly, Applicants propose that the MVPD market is the relevant product market for purposes of analyzing the issues presented by this transaction.[179] Intelsat agrees, asserting that the Commission and antitrust authorities have traditionally defined markets in a technology-neutral manner,[180] and urging the Commission to recognize the interchangeability of space and terrestrial transmission facilities when defining the appropriate product market in its analysis of the Application.[181] NRTC, on the other hand, contends that the decision of whether to consider cable systems with low channel capacities in the same product market as DBS should be determined by an administrative law judge at hearing.[182] CFA asserts that DBS and cable occupy "somewhat different product spaces" due to the lack of local channels on DBS in many markets, the unavailability of DBS in urban areas because of

[176] *DOJ/FTC Guidelines* § 1.0.

[177] Application at 47 (citing *2002 Annual Video Competition Report*, 17 FCC Rcd. at 26910 (distribution market); *id.* at 26953 (programming market); *MCIT*, 16 FCC Rcd. at 21613-14 (1999) (finding that DBS operators "compete in two product markets").

[178] Application at 44.

[179] Application at 44-45.

[180] Intelsat Comments at 2-5.

[181] Intelsat Comments at 6.

[182] NRTC Petition at 2. NRTC states that we should consider whether the "relevant geographic market" should be divided into three categories—markets not served by any cable system; markets served by low capacity cable systems; and markets served by high-capacity cable systems. *Id.* NRTC states that this determination also should factor in the number of households and subscribers in each market. *Id.* Although NRTC characterizes its concern as a definition of the relevant geographic market, it actually proposes that we consider whether to vary our analysis according to the types of products available in different markets, which concerns product markets, rather than geographic markets.

line of sight problems, and cost.[183] CFA asserts that this is best evidenced by the fact that competition from DBS has not constrained cable prices.[184] CFA does not urge the Commission to define the product market differently, but seeks to emphasize the lack of constraint on cable prices as part of its broader claim that the transaction will raise prices of DBS and cable.[185]

53. *Discussion.* In the *EchoStar-DirecTV HDO,* the Commission determined that the relevant product market that includes services offered by DBS providers was no broader than the entire MVPD market, but may well be narrower.[186] For the purpose of analyzing the competitive effects of the transaction before us we may again safely presume that the relevant downstream product market is no broader than the MVPD market. As we have noted, and our analysis below demonstrates, by purchasing Hughes and its DirecTV unit, News Corp. becomes a vertically integrated competitor to all of its MVPD programming purchasers in every MVPD market. To the degree that the transaction increases News Corp.'s incentive and ability to act anticompetitively, it does so with respect to all of its MVPD customer/competitors.

b. **Video Programming**

54. *Background.* Companies that own cable or broadcast programming networks both produce their own programming and acquire programming produced by others. Companies that own cable networks package and sell this programming as a network or networks to MVPD providers for distribution to consumers.[187] Companies that own broadcast networks distribute their programming through owned or affiliated television broadcast stations. Television broadcast stations affiliated with broadcast networks combine network programming with their own locally originated programming and/or programming secured from other sources to provide over-the-air service.[188] They redistribute such programming via cable or DBS pursuant to an election of mandatory carriage or a retransmission consent agreement.[189] MVPDs combine cable programming networks or broadcast television signals with transport on their cable, satellite, or wireless distribution networks to provide delivered multichannel video services to subscribers.[190]

[183] CFA Reply Comments at 6-8. CFA asserts that DBS is more expensive than cable, and that customers often subscribe in order to receive high-end services not provided (until the recent advent of digital cable) on cable systems, such as high-end sports packages, out of region programming, and foreign language channels. *Id.*

[184] CFA Reply Comments at 7-8.

[185] CFA Reply Comments at 2, 4-5, Attachment at 2.

[186] *EchoStar-DirecTV HDO*, 17 FCC Rcd at 20609 ¶ 115. The United States Department of Justice ("DOJ") identified this same MVPD product market in its complaint against the proposed merger of EchoStar and DIRECTV. *DOJ/EchoStar Complaint* ¶ 24.

[187] *Comcast-AT&T Order*, 17 FCC Rcd 23258 ¶ 34.

[188] *Review Of The Commission's Regulations Governing Television Broadcasting,* 10 FCC Rcd 3524 at 3545 ¶ 48 (1995).

[189] We have described the must-carry/retransmission consent provisions of the Act and our rules at Section V.B., *supra.*

[190] *Comcast-AT&T Order*, 17 FCC Rcd at 23258 ¶ 34; *EchoStar-DirecTV HDO*, 17 FCC Rcd 20653 ¶ 248.

55. Participants in the market for video programming consist of entities of various sizes, from unaffiliated packagers that own one programming network to large corporations with multiple 24-hour networks.[191] Cable programming networks sell programming to MVPDs that range in size from small "mom and pop" cable systems offering tens of channels of programming to fewer than a hundred subscribers, to large vertically integrated cable companies offering hundreds of channels of programming to tens of millions of subscribers in dozens of states. Owners of cable programming networks are compensated in part through license fees that are based on the number of subscribers served by the MVPD. These license fees are negotiated based on "rate cards"[192] that specify a top fee, but substantial discounts are negotiated based on the number of MVPD subscribers and on other factors, such as placement of the network on a particular programming tier.[193] Most cable programming networks and MVPDs also derive revenue by selling advertising time during the programming.[194]

56. Commercial local broadcast television stations elect to be carried on MVPDs pursuant to must-carry status or retransmission consent on a schedule that tracks the three-year statutory must-carry/retransmission consent election timeframe.[195] The broadcast stations most likely to elect must carry are those that are not affiliated with one of the four major networks and those in smaller markets.[196] Those stations that elect retransmission consent negotiate the terms of carriage with MVPDs. Owners of local television broadcast stations that elect retransmission consent are generally compensated by one or more of the following: (1) retransmission consent fees; (2) cable advertising availabilities; and/or (3) where the station owner also owns cable programming networks, it may grant retransmission consent rights in exchange for carriage of its cable programming networks by the MVPD.[197] At least one study finds that historically, most broadcasters have opted for (or settled for) in-kind compensation from cable operators in exchange for retransmission consent—the right to program a channel on the cable system or some cable advertising availabilities.[198] Because they are generally retransmitted in their entirety, broadcast television station signals already contain advertising sold by the station owner, the network

[191] *EchoStar-DirecTV HDO*, 17 FCC Rcd 20654 ¶ 249 (citing *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*, 16 FCC Rcd 17312, 17321-22 (2001) ("*Ownership Further Notice*")).

[192] Such rate cards are not publicly available.

[193] *EchoStar-DirecTV HDO,* 17 FCC Rcd 20654 17 FCC Rcd 20654 ¶ 249 (citing *Ownership Further Notice*, 16 FCC Rcd at 17322).

[194] *EchoStar-DirecTV HDO*, 17 FCC Rcd 20654 ¶ 249 (citing *Ownership Further Notice*, 16 FCC Rcd at 17322).

[195] Broadcasters must elect either must-carry or retransmission consent every three years (except for the very first DBS carriage election cycle, which commenced in 2001 and ends on Dec. 31, 2005). *See* 47 C.F.R. §§ 76.64(f), 76.66(c). The most recent cable carriage election was made on Oct. 1, 2002, became effective on Jan. 1, 2003, and the election cycle will end on Dec. 31, 2005. 47 C.F.R. § 76.64(f).

[196] *Carriage of the Transmissions of Digital Television Broadcast Stations*, 13 FCC Rcd 15092 at 15110 (1998) ("*DTV Must-Carry Notice*"). As we explain above, electing must-carry entitles a station to carriage but not compensation. *See* Section V.B.3., *supra.*

[197] FCC, OPP Working Paper #37, *Broadcast Television: Survivor in a Sea of Competition* at 29.

[198] FCC, OPP Working Paper #37, *Broadcast Television: Survivor in a Sea of Competition* at 29.

with which the station is affiliated (if any), or other program suppliers.[199]

57. Some cable programming networks offer programming of broad interest and depend on a large, nationwide audience for profitability; others also seek large nationwide audiences but offer content that is more focused in subject; yet others still seek nationwide distribution, but offer narrowly tailored programming, focusing on a "niche within a niche."[200] Some cable programming networks do not seek a national audience but are regional or even local in scope, including RSNs and local or regional news networks. Some cable programming networks likely can survive with distribution to a few million subscribers within a certain region, while others may need nationwide distribution in order to remain viable.[201]

58. *Positions of the Parties.* Applicants describe the video programming market as national or international in geographic scope, although they do not offer a product market definition.[202] EchoStar complains that Applicants "postulate a single product market encompassing all programming" but offer no economic evidence to support this view.[203] Commenters identify and discuss various segments of the video programming market, including broadcast network programming and RSN programming. Several commenters contend that News Corp. has market power in some or all segments of the video programming market.[204]

59. *Discussion.* The record in this proceeding makes clear that the video programming networks offered to MVPDs differ significantly in their characteristics, focus and subject matter. Thus, for example, there are over-the-air broadcast stations, national cable networks, including news, entertainment and hobby networks, as well as various regional networks, including, in particular, regional sports networks. The record further makes clear that these various networks are not viewed as perfect substitutes by either MVPDs or their subscribers.[205] Accordingly, we find that the market(s) that include

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[199] FCC, OPP Working Paper #37, *Broadcast Television: Survivor in a Sea of Competition* at 11 (broadcast networks, broadcast stations, and syndicators sell time to national advertisers; broadcast stations also sell time to local advertisers).

[200] *EchoStar-DirecTV HDO,* 17 FCC Rcd 20654 ¶ 250 (citing *Ownership Further Notice,* 16 FCC Rcd at 17322-23. Examples of the first type of programming include TNT and USA; examples of the second type include ESPN for sports and CNN for news; and examples of this third type of programming include Discovery Health, the Golf Network, and Home and Garden. *Id.*

[201] *EchoStar-DirecTV HDO,* 17 FCC Rcd 20654 ¶ 250 (citing *Ownership Further Notice,* 16 FCC Rcd at 17323); *Comcast-AT&T Order,* 17 FCC Rcd at 23258 ¶ 35.

[202] Application at 45.

[203] EchoStar Petition at 31.

[204] *See, e.g.,* EchoStar Petition at 31 (News Corp. has market power in "a number of relevant segments of the programming market, including regional sports and [broadcast] network programming"); CFA at 4-5 ("One of News Corp./Fox's most important weapons is significant control over regional and national sports programming."); Cablevision Comments at 12-17 (discussing News Corp.'s market power in the broadcast network programming segment).

[205] *See, e.g.,* JCC Comments at 20, 36 (discussing lack of substitutes for Fox broadcast programming and sports programming).

video programming networks are classic differentiated product markets.[206] As discussed in greater detail below, the record further indicates that at least a certain proportion of MVPD subscribers view certain types of programming as so critical or desirable that they are willing to change MVPD providers in order to gain or retain access to that programming.[207]

60. Nothing in the record suggests a need for us to define rigorously all the possible relevant product markets for video programming networks; the primary alleged harm involves a unilateral vertical restraint, and there is sufficient data in the record for us to analyze the potential profitability of News Corp.'s engaging in such temporary foreclosure with respect to certain of its video programming products. For purposes of this analysis, we will separate the video programming products offered by News Corp. into three broad categories: (1) national and non-sports regional cable programming networks;[208] (2) regional sports cable networks;[209] and (3) local broadcast television programming.[210]

61. *Other Relevant Product Markets.* News Corp. also owns substantial interests in firms selling programming-related technologies. As with the video programming products, there is no need to engage in a rigorous market definition in order to analyze the potential anticompetitive effects of the transaction. Rather, we will separate these products into three programming-related technologies product categories: (1) electronic and interactive program guides; (2) interactive television programming and associated technologies; and (3) conditional access technologies. We address issues arising from News Corp.'s acquisition of an interest in PanAmSat in Section VI.C.4.e., *infra.*

2. Relevant Geographic Markets

a. MVPD Services

62. Applicants assert that the Commission has consistently found that the geographic scope of the multichannel video programming distribution market is local or regional.[211] Cablevision and

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[206] Differentiated products are products whose characteristics differ and which are viewed as imperfect substitutes by consumers. *See* Dennis W. Carlton & Jeffrey M. Perloff, MODERN INDUSTRIAL ORGANIZATION 281 (2d ed. 1991).

[207] **[REDACTED]** Technical Appendix Sections A.3 and B.3, **[REDACTED]**.

[208] The national and non-sports regional cable programming network category includes 11 nationally distributed networks owned and managed by News Corp. These networks are Fox News Channel, FX, National Geographic Channel, Speed Channel, Fox Movie Channel, Fox Sports World, Fox Sports en Espanol, Fox Sports Digital Networks, TV Guide Channel, TV Games Channel, and Fuel.

[209] The regional sports cable networks category includes the 12 RSNs owned and managed by News Corp. These networks are Fox Sports Net Arizona, Fox Sports Net Detroit, Fox Sports Net Midwest, Fox Sports Net North, Fox Sports Net Northwest, Fox Sports Net Pittsburgh, Fox Sports Net Rocky Mountain, Fox Sports Net Southwest, Fox Sports Net West, Fox Sports Net West 2, and the Sunshine Network.

[210] The broadcast television programming category includes the 35 O&Os and the 171 Fox affiliates. *See supra* n.171.

[211] Application at 44 (citing 2002 *Video Competition Report,* 17 FCC Rcd at 26852-55; *Comcast-AT&T Order,* 17 FCC Rcd at 23282; *MCIT,* 16 FCC Rcd at 21613-14).

EchoStar assert that the proper geographic market is local.[212] In the past, we have concluded that the relevant geographic market for MVPD services is local[213] because consumers make decisions based on the MVPD choices available to them at their residences and are unlikely to change residences to avoid a small but significant increase in the price of MVPD service. In order to simplify the analysis, we have aggregated consumers that face the same choice in MVPD products into a larger, more manageable relevant geographic market. We find it appropriate to continue this approach here. Because the major MVPD competitors in many cases are the local cable company and the two DBS providers, we find that the franchise area of the local cable company can be used as the relevant geographic market for purposes of this analysis.

b. **Video Programming**

63. Applicants assert that the geographic scope of the video programming market is national and possibly international. The Applicants do not divide the video programming market into different types of video programming, and therefore do not provide geographic definitions for different types of programming. EchoStar critiques Applicants' failure to identify or analyze various segments of the video programming market.[214] Although they do not provide detailed descriptions of how the geographic markets for each programming segment should be defined for purposes of our analysis, MVPD commenters identify at least two segments of the video programming market that have a geographic scope narrower than the "national or international" scope of the programming market described by Applicants. MVPDs contend that access to one or both of these segments is critical to their ability to compete within the geographic areas where such programming is popular: broadcast network programming delivered by free over-the-air television stations (within a Nielsen Designated Market Area ("DMA")); and RSN programming (within the region where the sporting events featured on the RSN take place).[215]

64. Because video programming is a non-rival good[216] that can be distributed large distances at relatively little cost, the relevant geographic market potentially could be the national or international in scope. As a practical matter, however, demand for particular types of programming varies from region to region. Moreover, owners of programming have the right to decide in which areas to license the programming for distribution, and they generally limit distribution to smaller areas where the demand for programming is greatest. Given this, we find it reasonable to approximate the relevant geographic market for video programming by looking to the area in which the program owner is licensing the programming.

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212 Cablevision Comments at 12, n.22; EchoStar Petition at 12.

213 *EchoStar-DirecTV HDO*, 17 FCC Rcd 20610 ¶ 119; *Comcast-AT&T Order*, 17 FCC Rcd at 23282 ¶ 90.

214 EchoStar Petition at 31.

215 *See, e.g.*, JCC at 41-43 (discussing the effects of temporary withholding of RSN programming from cable operators on the relevant system and competitors serving the same region); EchoStar at 15 (discussing the effects on EchoStar's penetration rates in DMAs where it lacked access to the signals of all four major network affiliated stations).

216 A good is said to be "non-rival" if one individual's consumption of the good does not diminish the supply of the good to other individuals. *See* THE MIT DICTIONARY OF MODERN ECONOMICS 308 (David W. Pearce, ed., 4th ed. 1999).

65. Applying this approach, we conclude that in the case of broadcast television programming, it is reasonable to use DMAs to define the relevant geographic market for each individual broadcast station. Contracts between broadcast stations and the providers of programming, as well as FCC regulations and broadcasting technology, limit the extent to which broadcast station signals can be distributed outside of the assigned market area.[217] DMAs are widely used to represent these areas, so we will use them as reasonable approximations.

66. With respect to national cable programming networks the relevant geographic market is at least national in scope. These networks are generally licensed to MVPDs nationwide, and in some cases they are licensed internationally. The widespread demand that is evidenced for such programming and the corresponding widespread distribution suggests that the relevant geographic market is at least national in scope. In contrast, with respect to RSNs, we conclude, as we did in the Comcast-AT&T merger, that the relevant geographic market for RSNs is regional.[218] In general, contracts between sports teams and RSNs limit the distribution of the content to a specific "distribution footprint," usually the area in which there is significant demand for the specific teams whose games are being transmitted.[219] MVPD subscribers outside the footprint thus are unable to view many of the sporting events that are among the most popular programming offered by RSNs. We thus find it reasonable to define the relevant geographic market as the "distribution footprint" established by the owner of the programming.

67. Finally, we find that the geographic market for programming-related technologies is at least national in scope, and possibly international. These technologies are composed of software and hardware components which have high value and low transportation costs and can be easily delivered and are delivered to many widespread locations in the U.S. and the world.

VI. ANALYSIS OF POTENTIAL HARMS IN THE RELEVANT MARKETS

A. Introduction

68. In this section, we consider the potential harms of the proposed transaction in the relevant product markets that include video programming and MVPD services. In particular, we consider whether, as a result of the transaction, the post-transaction entity 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. Where we find that the proposed transaction is likely to result in anticompetitive harms, we also analyze and explain our decision to impose conditions that are narrowly targeted to address those harms.

69. Transactions involving the acquisition of a full or partial interest in another company may give rise to concerns regarding "horizontal" concentration and/or "vertical" integration, depending on the lines of business engaged in by the two firms. A transaction is said to be horizontal when the firms in the

[217] Broadcasters have the right to prevent cable operators from carrying certain programming from the signals of broadcast stations from other markets. *See* 47 C.F.R. §§76.92-76.95 (network non-duplication rule); 47 C.F.R. §§ 76.101-76.110 (syndicated exclusivity rule).

[218] *Comcast-AT&T Order*, 17 FCC Rcd at 23267 ¶ 59.

[219] DirecTV, *Blackout Information* at http://www.directvsports.com/Blackout_Info/ (visited Oct. 3, 2003).

transaction sell products that are in the same relevant markets and are therefore viewed as reasonable substitutes by purchasers of the products. Horizontal transactions are of antitrust concern because they eliminate competition between the firms and increase concentration in the relevant markets.[220] The reduction in overall competition in the relevant markets may lead to substantial increases in prices paid by purchasers of products in the markets.

70. Vertical transactions raise slightly different competitive concerns. At the outset, it is important to note that antitrust law and economic analysis have viewed vertical transactions more favorably in part because vertical mergers, standing alone, do not increase concentration in either the upstream or downstream markets.[221] In addition, vertical mergers may generate significant efficiencies. For example, a vertical transaction may produce a more efficient organization form, which can reduce transaction costs, limit free-riding by internalizing incentives, and take advantage of technological economies.[222] Where both the upstream and downstream firms possess enough market power to set prices above marginal costs, a vertical transaction also may reduce prices through the elimination of this "double marginalization." The reduction occurs because the integrated firm, in determining the costs of producing the downstream product and consequently the final price charged to consumers, will consider the real economic cost of the input rather than the higher price (including the upstream profit margin) previously charged by the unintegrated upstream firm.[223]

71. Nevertheless, as discussed in greater detail below, vertical transactions also have the potential for anticompetitive effects. In particular, a vertically integrated firm that competes both in an upstream input market and a downstream output market, such as post-transaction News Corp., may have the incentive and ability to: (1) discriminate against particular rivals in either the upstream or downstream markets (*e.g.,* by foreclosing rivals from inputs or customers); or (2) raise the costs to rivals generally in either of the markets. We first address potential horizontal harms and then analyze, with respect to each affected product and geographic market, potential vertical harms arising from the

[220] 4 AREEDA & HOVEMKAMP 5-6; *see also* 1 ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS 317 (4th ed. 1997) (hereinafter ANTITRUST LAW DEVELOPMENTS); KIP VISCUSI, JOHN M. VERNON & JOSEPH E. HARRINGTON, JR., ECONOMICS OF REGULATION AND ANTITRUST 192 (3d ed. 2000) ("VISCUSI ET AL.").

[221] In the simple case where there are two levels of production, an upstream market is a market for inputs, while a downstream market is a market for end-user outputs. We will sometimes refer to the upstream and downstream markets as the input and output markets.

[222] VISCUSI ET AL. at 219-221; Michael H. Riordan and Steven Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST L. J. 513, 523-26 (1995) ("Riordan & Salop").

[223] Double marginalization occurs when an upstream firm sells an input to a downstream firm at a price that exceeds marginal cost, and the downstream firm then sells its product in the downstream market at a price that exceeds its marginal cost. The margin charged by the upstream firm increases the marginal cost of the downstream firm, which results in a higher end-user price than would occur if the input had been priced at marginal cost. Vertical integration in theory reduces the problem of double marginalization because the integrated firm, in determining the uniform price at which it will sell the downstream product, will consider the real economic cost of producing the input. Because vertical integration effectively reduces the marginal cost of the input, it is likely to result in the integrated firm's setting a lower price for the downstream product, which will benefit consumers. The extent of this benefit, however, will depend crucially on the elasticity of demand for the downstream product. The less elastic is the demand, the greater is the benefit. JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION (MIT Press 1988) at 174-75; Riordan & Salop, 63 ANTITRUST L. J. at 526-27.

proposed transaction.

B. Potential Horizontal Harms

72. *Positions of the Parties.* Applicants explain that the satellite assets of Hughes and its subsidiaries in the United States complement the non-U.S. satellite interests of News Corp., completing News Corp.'s global network for the distribution of programming without creating any domestic overlap of satellite assets or MVPD participation.[224] In contrast with the failed EchoStar-DirecTV merger, this transaction, Applicants aver, does not involve the affiliation of two domestic MVPD systems.[225] Similarly, they allege that there is no effect on potential competition because News Corp. has no plans for independently entering the domestic distribution market.[226] Following the transaction, DirecTV will continue to face competition from cable operators in most local markets, as well as continued competition from EchoStar in every local market.[227]

73. Nor does the proposed transaction create horizontal overlap in programming, according to the Applicants, because DirecTV does not produce or own any programming (beyond Hughes' 5% passive equity interest in the Hallmark Channel), and has no plans to expand its programming interests.[228] For its part, News Corp. will continue to face competition in regional, national, and international 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"

[224] Application at 45.

[225] Application at 45.

[226] Application at 46.

[227] Application at 46.

[228] Application at 46.

[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.

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]

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

[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.

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

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 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

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[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.

[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).

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 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

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[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).

[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).

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-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-

[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.

[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).

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 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.

[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.

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.

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]

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

[253] Application at 58.

[254] Application at 59.

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 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

[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.

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

[262] Applicants' Reply at 55.

[263] Applicants' Reply at 56.

[264] Applicants' Reply at 56.

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 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

[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.

[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.

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 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

[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.

[274] Stout Aff. ¶ 15.

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

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, 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

[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.

[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.

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 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-

[285] Stout Aff.; Hamermesh Aff..

[286] Clarke, *Corporate Law* § 5.4 at 183.

[287] *Id.*

[288] CDD Petition at Issue #5.

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

[290] Application at 49.

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 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]

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[291] Application at 48-52.

[292] Application at 49.

[293] Application at 49.

[294] Application at 53, Attachment G.

[295] Applicants' Reply at 63.

[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.