this claim is too vague to be recognized.[935] EchoStar argues that this claim rests on the earlier assumptions of increased local-into-local, HDTV, interactive services and DVRs, and that Applicants have not shown those claims to be transaction-specific. Noting that the claim relating to reduced churn is based in part on BSkyB's low churn rate, EchoStar further argues that that News Corp. faces different MVPD competitors in the U.K., and it points out that News Corp. has not specified how they will reduce churn for DirecTV.[936]

347. *Discussion.* As various opponents of the transaction suggest, this claimed benefit, to a large extent, duplicates portions of previous claims, including claims that the proposed transaction will allow News Corp. to: (1) introduce more innovative services; (2) provide more local-into-local and HDTV; and (3) take advantage of economies of scale and scope. To the extent that this claimed benefit is duplicative of other claimed benefits, the benefits should not be counted twice. On the other hand, to the extent that the earlier benefits are cognizable, it is appropriate, in evaluating the earlier claims, to consider not only the cost savings, but also the demand response to any resulting decrease in price.

348. To the extent that the earlier benefits would reduce churn, that reduction would be a cognizable component of those benefits, provided that the earlier benefits are found to be transaction-specific. Applicants have not attempted to quantify these potential consumer benefits, however, but have only estimated the potential revenue gain to the merged entity of between $450 million and $525 million by 2006. When we balance potential harms and benefits of the transaction, however, we will not give significant weight to the Applicants' estimate because it is not clear whether some benefits are counted twice and because there is no attempt to quantify the benefits that might flow through to consumers.

6. Improved Capital Structure

349. *Positions of the Parties.* Applicants claim that, because Hughes is a wholly owned and controlled subsidiary of GM and currently has only a tracking stock, it is limited in its ability to pursue outside financing. The proposed transaction, Applicants claim, will eliminate this problem. ACA responds that DirecTV, while under the control of General Motors, attracted substantial investment, including a $1.5 billion investment from AOL. ACA further argues that GM's decision on how much to invest in Hughes should have no bearing on the public interest.[937]

350. *Discussion.* Although the proposed transaction may improve Hughes' access to capital, as Applicants contend, we do not believe this to be a transaction-specific benefit. Rather, the gist of Applicants' argument is that DirecTV cannot obtain direct access to the capital markets (because it only has a tracking stock) and that General Motors has no significant interest in further significant investments in this business. To the extent that access to capital is a problem, however, it could be ameliorated through other means that pose fewer competitive risks than the proposed transaction, such as spinning off DirecTV so that it has its own traded stock. Thus, since the capital structure could be improved through other means that pose fewer competitive risks, this claimed benefit is not transaction-specific.

7. Reduction in Double Marginalization

[935] JCC Comments at 70-71.

[936] EchoStar Petition at 44-45.

[937] ACA Comments at 27-28.

351. Applicants claim that the reduction in "double marginalization" which results from vertical integration "will create a downward incentive for News Corp.'s programming prices."[938] As discussed in greater detail above, we agree that vertical integration can reduce prices by reducing double marginalization.[939] Nevertheless, because Applicants have neither attempted to quantify this benefit nor provided sufficient information for the Commission to quantify the benefit, we will not take it into account when weighing the potential harms and benefits of the proposed transaction.

8. **Increased Program and Employment Diversity**

352. *Positions of the Parties.* Applicants contend that the transaction will benefit the public by increasing programming geared to linguistic, ethnic, and cultural minorities, and by promoting employment diversity.[940] These claims are summarized and discussed below.

353. Applicants assert that the proposed transaction would increase program diversity because the transaction will bring News Corp.'s "deep commitment" to diversity to Hughes, resulting in DirecTV's carriage of more programming targeted at culturally, ethnically, and linguistically diverse audiences.[941] In support of this claim, News Corp. cites several examples of its commitment to diversity in programming, including television programming and films with prominent minority cast members and minority directors.[942] Applicants assert that the nationwide reach of DBS service will allow News Corp. to efficiently aggregate and reach niche audiences. In response to these claims, as with other diversity benefits claimed by Applicants, commenters contend that Applicants have failed to show that there is anything lacking in DirecTV's commitment to diverse programming.[943] Moreover, several commenters contend that the transaction poses potential harms to program diversity.[944]

354. The Commission has traditionally sought to increase employment of women and minorities by broadcasters and MVPDs through its equal employment opportunity ("EEO") rules and policies.[945] The Commission's rules prohibit discrimination in hiring and employment. In addition, FCC EEO outreach rules require broadcasters and MVPDs to: provide wide dissemination of job vacancies; undertake initiatives such as jobs fairs and internships to assist jobseekers develop skills and training;

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[938] Applicants' Sept. 22, 2003 Ex Parte at 12. *See also* Applicants' Reply, Lexecon Report at 6; Applicants' Reply, CRA Analysis at 10-12 & Appendix B.

[939] *See* Section VI.C.4.b.iii, *supra.*

[940] Application at 39-43.

[941] Application at 42.

[942] *Id.*; Applicants' Sept. 11 Ex Parte at 3-4.

[943] ACA Comments at 28; JCC Comments at 72.

[944] ACA Comments at 3, 7, 16, 29; Cablevision Comments at 23-29; CDD Petition at 2-3; CFA Reply Comments at 9-12; EchoStar Petition at 39-40; NRTC Petition at 9-16. Commenters' concerns about potential harms to program diversity are discussed at section VII.A.2 above. There, we conclude that the transaction is unlikely to reduce program diversity.

[945] *See* 47 CFR §73.2080 (Broadcast EEO Rule); 47 CFR §76.75 (Cable EEO Rule).

and evaluate regularly the efficacy of these efforts.[946]

355. Applicants contend that the proposed transaction will serve the public interest by promoting employment diversity.[947] Applicants submit that News Corp. is a leader in promoting employment diversity, and that its commitment to such diversity will be expanded to DirecTV as a result of the proposed transaction.[948] Applicants cite several News Corp. EEO initiatives, including its Diversity Development Department, which is focused on ensuring a diverse workforce as well as diversity in procurement.[949] Applicants report that News Corp.'s efforts have resulted in increased opportunities for writers, directors, producers and actors from diverse backgrounds.[950] Applicants also cite News Corp.'s internship and apprenticeship programs,[951] a Fox mentoring program for minority film and television entrepreneurs,[952] and the fact that the Fox group of companies now has a much more diverse group of suppliers.[953] Applicants assert that, after consummating the transaction, it will: (1) launch a mentoring program for female and minority entrepreneurs who seek to launch niche cable channels; (2) recruit and/or seek to promote women and minorities into leadership positions at Hughes; (3) implement an internship program at Hughes designed to attract diverse candidates; (4) evaluate and/or modify Hughes' procurement programs to ensure that they provide opportunities for minorities; and (5) upgrade Hughes' internal and external communications to facilitate diversity initiatives.[954]

356. As with Applicants' program diversity claims, commenters contend that these claimed benefits are not transaction-specific. More specifically, they argue Applicants have not shown that DirecTV is any less committed to diversity than is News Corp.[955]

357. *Discussion.* We agree with commenters that Applicants have failed to demonstrate that either the claimed program diversity or employment diversity benefits are transaction-specific. Applicants have described several News Corp. initiatives, which are much like those we seek to promote

[946] In 2000, the Commission adopted EEO rules subsequently invalidated by the US Court of Appeals for the District of Columbia Circuit. *MD/DC/DE Broadcasters Association v. FCC,* 236 F.3d 13 (D.C. Cir. 2001), *rehearing denied* 253 F.3d 732 (D.C. Cir. 2001), *cert. denied,* 122 S.Ct. 920 (2002). The Commission adopted its current broadcast and MVPD EEO rules pursuant to a further rulemaking proceeding. *Review of the Commission's Broadcast and Cable Equal Employment Opportunity Rules and Policies,* 17 FCC Rcd 24018 (2002) (*"EEO Second Report and Order").*

[947] Application at 39-43.

[948] Application at 39.

[949] Application at 40.

[950] Application at 40-41.

[951] *Id.* at 41; Applicants' Sept. 11 Ex Parte at 4-7.

[952] Application at 42.

[953] Application at 42; Applicants' Sept. 11 Ex Parte at 7-9.

[954] Application at 42-43.

[955] ACA Comments at 28; JCC Comments at 72.

through our EEO rules.[956] They have also identified a significant amount of News Corp. programming developed by production staff from diverse backgrounds which is targeted to diverse viewing audiences. In addition, News Corp. contends that it has taken steps to create a more diverse base of suppliers of equipment and services. These data may very well evidence high levels of program diversity and successful EEO policies at News Corp. However, Applicants have not demonstrated that DirecTV would not adopt similarly effective EEO initiatives or provide similarly diverse programming absent the transaction. As several commenters note, there is no evidence in the record that DirecTV's current programming is not diverse, or that its EEO polices need improvement. Thus, we cannot find that these claimed diversity benefits are transaction specific.

IX. BALANCING POTENTIAL PUBLIC INTEREST HARMS AND BENEFITS

358. Our task under the Communications Act is to determine whether the "public interest, convenience and necessity will be served" by the granting of the Application.[957] The public interest standard involves a balancing of potential public interest harms of the proposed transaction and the potential public interest benefits.[958] The Applicants bear the burden of proving, by a preponderance of the evidence that the proposed transaction, on balance, serves the public interest.[959] Our options at this stage are to approve the application without conditions, approve it with conditions, or hold a hearing if we are unable to make the findings required for approval.[960] The Application and the substantial record before us make clear that, on balance, the public interest will be served by approval of the application as amended by the conditions that we impose herein.

359. The proposed transaction would combine News Corp., a major supplier of, *inter alia,* video programming, including one of four national broadcast networks, 35 owned and operated local broadcast television stations as well as various cable programming program networks, with Direct TV, the second largest MVPD and one of the two incumbent nationwide DBS providers. Integration of programming with distribution is not new in the media industry. Broadcasters, cable operators and DBS providers are all permitted to own programming assets, although the terms and conditions of the sale of vertically integrated satellite cable programming to rival distribution networks is subject to certain rules

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[956] We note also the presentation at the inaugural meeting on September 29, 2003, of the Advisory Committee on Diversity for Communications in the Digital Age of Mitsy Wilson, Senior Vice President, Fox Entertainment Group, News Corp. Ms. Wilson described diversity initiatives at Fox. The Federal Advisory Committee on Diversity was established by Chairman Powell in May 2003 to bring together experts from the communications, financial, and technology communities to develop recommendations to identify potential regulatory actions and education initiatives that can promote and enhance opportunities for minorities and women.

[957] *See* 47 U.S.C. §§ 310(d), 309(a)&(d).

[958] *See, e.g., AT&T-Comcast Order,* 17 FCC Rcd at 23255 ¶ 26; *EchoStar-DirecTV Order,* 17 FCC Rcd at 205784 ¶ 25.

[959] See *id.*

[960] If we are unable to find that the proposed transaction serves the public interest for any reason, or if the record presents a substantial and material question of fact, Section 309(e) of the Act requires that we designate the application for hearing. 47 U.S.C. §309(e).

to ensure that vertical integration does not cause anticompetitive outcomes.[961]

360. The potential harms of the combination of News Corp. and Hughes' assets are in many respects those inherent in such supplier/distributor integration, and in balancing the potential public interest harms and benefits, we take into account how such potential harms have been dealt with in related contexts. On the one hand, certain of the potential competitive harms inherent in vertically integrated programming/MVPD providers have been recognized as requiring special remedies to prevent potential abuses. On the other hand, the remedies chosen, at least in recent years, have not generally been structural remedies, such as prohibitions on common ownership of programming and distribution assets, but behavioral remedies, such as requirements for program access and nondiscrimination.[962] This choice reflects the general recognition that vertical integration is less likely than horizontal integration to have anticompetitive effects and is more likely to promote efficiency.[963]

361. There are, of course, obvious differences among broadcast television, cable, and direct broadcast satellite distribution systems. Full-CONUS direct broadcast satellite distribution systems, such as DirecTV's, are both multichannel and nationwide in scope, and this transaction will result in an unprecedented level of integration of both broadcast and cable programming assets with an incumbent nationwide DBS provider. At the same time, while the two primary incumbent DBS competitors have attracted enough subscribers nationwide to rank them among the largest MVPDs, they rank far behind cable operators in most local markets, including all the most populous urban areas.[964] Cable remains the predominant provider of MVPD services in these markets.

362. We must choose the action on the pending application that will serve the public interest with due attention to the context and structure of the current marketplace. Our primary objective is to promote the interest of the consumer of video programming—to maximize the variety, quality and innovation of available programming and minimize its price where possible. The mechanism of choice to achieve this goal is generally to encourage a competitive marketplace.

363. The proposed transaction will shift control of one of the two incumbent full-CONUS DBS providers from a non-media owner who has made no secret of its desire to exit the business in recent years to a media company that has a proven record of innovation and success in providing satellite television services (and, incidentally, competing with cable distribution systems) in other markets throughout the world. As indicated above, we find that the potential improvement in DirecTV's service offerings under News Corp.'s innovative and aggressively competitive management, while inherently difficult to quantify precisely, would be a major public interest benefit. Another tangible benefit that we can ensure will be realized is News Corp.'s commitment to achieve the important public interest benefit of increased local channel service offerings to all regions of the country.

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[961] *See, e.g.*, Section 628 of the Communications Act of 1934, as amended, 47 U.S.C. § 548.

[962] *See, e.g.*, 47 C.F.R. § 76.100, *et seq.*; *Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act*, 17 FCC Rcd 12124 (2002).

[963] *See* para. 155, note 458, and para. 353, *supra*.

[964] *See 2002 Video Competition Report*, 17 FCC Rcd at 26903 ¶¶ 4-7, 26929-31 ¶ 58-60.

364. Based on our review of the record, we have found that where Applicants lack market power, such as in the programming-related technologies and fixed satellite services markets, no potential public interest harms will arise.[965] At the same time, we also have found that the proposed transaction would create the potential for competitive and other public interest harms in areas in which the Applicants have market power and the transaction would increase their incentive and ability to exercise that market power to the detriment of the public. We reiterate that because local MVPD markets already are highly concentrated,[966] changes in vertical relationships between a major input and output supplier in such a market can have significant competitive effects.

365. Applicants themselves have suggested conditions, analogous to those applicable to vertically integrated cable companies, to mitigate potential harms. We accept these proposed conditions as sufficient, together with our existing program access rules, to protect against any potential competitive harms with respect to ensuring non-discriminatory access to the DirecTV platform for unaffiliated programming providers and for ensuring non-discriminatory access to national and non-sports regional programming for rival MVPDs. Consequently, we impose no additional remedial actions with respect to these video programming products beyond those offered by the Applicants.

366. In contrast, based on our review of the record, we find substantial evidence that competitive and consumer harms would likely result from the increase in News Corp.'s ability to leverage its market power with respect to both regional sports networks and local broadcast television once it acquires control of DirecTV. The record indicates that temporary withdrawal of regional sports programming networks and local broadcast television station signals during disputed carriage negotiations will 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 prices and/or obtain other carriage concessions through temporary foreclosure would likely lead to higher prices to MVPD consumers 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.

367. In addition, we have found that the increase in News Corp.'s market power with respect to its RSN and local broadcast station programming would likely, if not checked, permit News Corp. to inflict additional collateral damage on rival MVPDs. For example, the incremental increase in News

[965] *See* Sections VI.C.4.d (Electronic Programming Guides and Interactive Television Markets) and VI.C.4.e (Fixed Satellite Services), *supra*.

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

Corp.'s market power resulting from its acquisition of control of DirecTV could be used to force MVPDs to carry or use technologies such as its electronic and interactive programming guides as conditions of accessing its "must have" programming. We also found that this same potential for increased use of temporary foreclosure would reduce program diversity on a short term basis because consumers lack access to the foreclosed programming and that, in the long run, the increased costs paid by MVPDs to News Corp. would also likely reduce program diversity because absent these increased costs, the MVPD might have elected to carry a new niche network that would have expanded the types of programming available to its subscribers. We made similar findings with respect to the impact of the transaction on viewpoint diversity.

368. To mitigate the increased market power the transaction provides to News Corp. with respect to carriage negotiations for RSN and local broadcast station signals, we impose the additional conditions described above and set forth in Appendix F below. With respect to local television broadcast stations on whose behalf News Corp. negotiates retransmission consent, we extend the good faith and exclusivity requirements of SHVIA beyond their scheduled sunset date to run concurrently with the program access rules applicable to satellite cable programming. In addition, we extend News Corp.'s proposed non-discrimination safeguards to its broadcast programming, so that News Corp. must make its programming subject to retransmission consent available to all MVPDs on a non-discriminatory basis. To deter the more frequent use of temporary foreclosure strategies following News Corp.'s acquisition of control of DirecTV, the principal harm associated with vertical integration identified in the record, we direct News Corp. to submit carriage disputes over RSNs and local broadcast stations, at an MVPD's request, to commercial arbitration. Our commercial arbitration remedy is intended to provide a neutral backstop mechanism for the MVPD if commercial negotiations fail to produce a carriage agreement that is mutually satisfactory to News Corp. and the MVPD. Under our condition, an MVPD purchasing News Corp. RSN programming or negotiating a retransmission consent agreement may elect to send its dispute to commercial arbitration with a right of appeal to the Commission. In connection with the election of arbitration, we limit the power of News Corp. to withdraw its broadcast and RSN networks pending resolution of the carriage dispute by the arbitrator. In addition, cable operators with fewer than 5000 subscribers, for whom arbitration would be unreasonably expensive, are given special relief with respect to retransmission consent, and those with fewer than 400,000 subscribers are permitted to bargain collectively and collectively avail themselves of the arbitration remedy for both RSN and broadcast programming.

369. In assessing the potential harms and benefits of the proposed transaction, we note that the major benefit—improved service offerings under News Corp.'s innovative and aggressive management—while adequately supported under the rather unique circumstances of this case, is inherently difficult to quantify. Other claimed benefits, such as merger-related efficiencies, that are not so difficult to quantify have not been adequately supported by Applicants on the record here. Finally, consistent with our commitment to localism and as a tangible confirmation of the benefits of the proposed transaction, we adopt, as a condition of our approval, the requirement that, by year end 2004, DirecTV will offer local channel service in an additional 30 DMAs.

370. With these conditions to mitigate the potential harms and confirm the potential benefits, a fair and balanced assessment of the proposed transaction demonstrates that News Corp.'s acquisition of a controlling interest in Hughes will, as required by the Communications Act, serve "the public interest,

convenience, and necessity."[967]

X. CONCLUSION

371. We conclude that the positive public interest benefits promised by this transaction are sufficient to support the Commission's approval of GM's, Hughes', and News Corp.'s Application, under the public interest balancing test of section 310(d) of the Communications Act, subject to the conditions specified in this Order.

XI. ORDERING CLAUSES

372. Accordingly, having reviewed the Application and the record in this matter, IT IS ORDERED, pursuant to Sections 4(i) and (j), 214(a), 214(c), 309, and 310(d) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 214(a), 214(c), 309, 310(d), that the application for consent to transfer control to The News Corporation Ltd., News Publishing Australia Limited, and Fox Entertainment Group, Inc., various Commission authorizations as set forth in Appendix G, including DBS and fixed satellite space station authorizations, earth station authorizations, and other related authorizations, held by wholly- or majority-owned subsidiaries of General Motors Corporation and Hughes Electronics Corporation IS GRANTED subject to the conditions stated below.

373. IT IS FURTHER ORDERED that as a condition of this grant The News Corporation Ltd., its wholly- and majority-owned subsidiaries, and Hughes Electronics Corporation shall comply with the conditions set forth in Appendix F of this Order.

374. IT IS FURTHER ORDERED that, pursuant to sections 4(i) and (j), 309 and 310(b) and (d) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i) and (j), 309, 310(b) and (d), that the Petition to Adopt Conditions to Authorization and Licenses filed by the U.S. Department of Justice and Federal Bureau of Investigation, on November 25, 2003, IS GRANTED, and that the authorizations and licenses related thereto which are to be assigned or transferred as a result of this Order are subject to compliance with provisions of the Agreement between General Motors Corporation, Hughes Electronics Corporation, and The News Corporation Limited on the one hand, and the U.S. Department of Justice and the Federal Bureau of Investigation on the other, as further set forth in Paragraph 38 and Appendix E of this Order, which Agreement is designed to address the national security, law enforcement, and public safety concerns of the U.S. Department of Justice and the Federal Bureau of Investigation regarding the authority granted herein, is fully binding upon General Motors Corporation, Hughes Electronics Corporation, and The News Corporation Limited and those subsidiaries, successors and assigns of both companies that provide telecommunications services within the United States. Nothing in the Agreement is intended to limit any obligation imposed by Federal law or regulation.

375. IT IS FURTHER ORDERED, pursuant to Sections 4(i) and (j), 214(a), 214(c), 309, and 310(d) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 214(a), 214(c), 309, 310(d), that the Petitions to Deny filed by EchoStar Corporation, Center for Digital Democracy, and National Hispanic Media Coalition and all similar petitions ARE DENIED.

[967] See 47 U.S.C. §§ 309(a) and 310(d).

376. IT IS FURTHER ORDERED that the Petition to Condition the Transfer of Control filed by Wyser-Pratte Management Co., Inc., and the Petition to Designate the Application for Hearing filed by National Rural Telecommunications Cooperative ARE DENIED.

377. IT IS FURTHER ORDERED that this Memorandum Opinion and Order SHALL BE EFFECTIVE on December 19, 2003,[968] in accordance with Section 1.103 of the Commission's rules, 47 C.F.R. § 1.103.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

[968] On December 19, 2003, the Commission released a public notice announcing the Commission's adoption of this *Order*. Public Notice, "Subject to Conditions, Commission Approves Transaction Between General Motors Corporation, Hughes Electronics Corporation and The News Corporation Limited," FCC 03-328 (rel. Dec. 19, 2003).

APPENDIX A

LIST OF COMMENTERS

Petitions To Deny

Center for Digital Democracy ("CDD")
EchoStar Satellite Corporation ("EchoStar")
National Hispanic Media Coalition ("NHMC")
National Rural Telecommunications Cooperative ("NRTC")

Initial Comments

Advance/Newhouse Communications, Cable One, Cox Communications & Insight Communications ("JCC")
American Cable Association ("ACA")
Association of Public Television Stations and the Public Broadcasting Service ("APTS")
Cablevision Systems Corporation ("Cablevision")
Intelsat Global Service Corporation ("Intelsat")
Johnson Broadcasting of Dallas, Inc. ("Johnson")
Maranatha Broadcasting Company, Inc. ("Maranatha")
Microcom ("Microcom")
National Association of Broadcasters ("NAB")
RCN Telecom Services, Inc. ("RCN")

Opposition and Reply Comments

General Motors, Hughes Electronics Corporation and The News Corporation Limited ("Applicants")

Reply Comments

Advance/Newhouse Communications, Cable One, Cox Communications & Insight Communications ("JCC")
American Cable Association ("ACA")
Cablevision Systems Corporation ("Cablevision")
Consumer Federation of America, Consumers Union, Center for Digital Democracy & Media Access Project ("CFA")
Maranatha Broadcasting Company, Inc. ("Maranatha") (late-filed)
National Hispanic Media Coalition ("NHMC") (late-filed)

APPENDIX B

MODIFICATIONS TO RULES FOR ARBITRATION INVOLVING REGIONAL SPORTS NETWORKS

1. We modify the Rules in several respects as they apply to arbitration involving regional sports networks.

2. **Initiation of Arbitration.** Arbitration shall be initiated as provided in Rule R-4 except that, under Rule R-4 (a) (ii) the MVPD shall not be required to submit copies of the arbitration provisions of the contract, but shall instead refer to this Order in the demand for arbitration. Such reference shall be sufficient for the AAA to take jurisdiction.

3. **Appointment of the Arbitrator.** Appointment of an arbitrator shall be in accordance with rule E-4 of the Rules. Arbitrators included on the list referred to in rule E-4 (a) of the Rules shall be selected from a panel jointly developed by the American Arbitration Association and the Commission and will be based on the following criteria:

The arbitrator shall be a lawyer admitted to the bar of a state of the United States;

The arbitrator shall have been practicing law for at least 10 years;

The arbitrator shall have prior experience in mediating or arbitrating disputes concerning media programming contracts;

The arbitrator shall have negotiated or have knowledge of the terms of comparable cable programming network contracts.

4. **Exchange of Information.** At the request of any party, or at the discretion of the arbitrator, the arbitrator may direct the production of current and previous contracts between either of the parties and MVPDs, broadcast stations, video programming networks, and sports teams, leagues, and organizations as well as any additional information that is considered relevant in determining the value of the programming to the parties. Parties may request that access to information of a commercially sensitive nature be restricted to the arbitrator and outside counsel and experts of the opposing party.

5. **Administrative Fees and Expenses.** If the arbitrator finds that one parties' conduct, during the course of the arbitration, has been unreasonable, the arbitrator may assess all or a portion of the other parties costs and expenses (including reasonable attorneys' fees) against the offending party.

6. **Locale**. In the absence of agreement between the parties, the arbitration shall be held in the city that contains the headquarters of the MVPD.

7. **Form of Award.** The arbitrator shall render a written award containing the arbitrator's findings of fact and reasons supporting the award. If the award contains confidential information, the arbitrator shall compile two versions of the award; one containing the confidential information and one with such information redacted. The version of the award containing the confidential information shall only be disclosed to persons bound by the Protective Order issued in connection with the arbitration. The parties shall include such confidential version in the record of any review of the arbitrator's

decision by the Commission.

APPENDIX C

MODIFICATIONS TO RULES FOR ARBITRATION INVOLVING RETRANSMISSION CONSENT

1. We modify the Rules in several respects as they apply to arbitration over retransmission consent.

2. **Initiation of Arbitration.** Arbitration shall be initiated as provided in Rule R-4 except that, under Rule R-4 (a) (ii) the MVPD shall not be required to submit copies of the arbitration provisions of the contract, but shall instead refer to this Order in the demand for arbitration. Such reference shall be sufficient for the AAA to take jurisdiction

3. **Appointment of the Arbitrator.** Appointment of an arbitrator shall be in accordance with rule E-4 of the Rules. Arbitrators included on the list referred to in rule E-4 (a) of the Rules shall be selected from a panel jointly developed by the American Arbitration Association and the Commission and will be based on the following criteria:

a. The arbitrator shall be a lawyer admitted to the bar of a state of the United States;

b. The arbitrator shall have been practicing law for at least 10 years;

c. The arbitrator shall have prior experience in mediating or arbitrating disputes concerning media programming contracts;

d. The arbitrator shall have negotiated or have knowledge of the terms of retransmission contracts.

4. **Exchange of Information.** At the request of any party, or at the discretion of the arbitrator, the arbitrator may direct the production of current and previous contracts between either of the parties and MVPDs and broadcast stations as well as any additional information that is considered relevant in determining the value of the programming to the parties. Parties may request that access to information of a commercially sensitive nature be restricted to the arbitrator and outside counsel and experts of the opposing party.

5. **Administrative Fees and Expenses.** If the arbitrator finds that one parties' conduct, during the course of the arbitration, has been unreasonable, the arbitrator may assess all or a portion of the other parties costs and expenses (including reasonable attorneys' fees) against the offending party.

6. **Locale**. In the absence of agreement between the parties, the arbitration shall be held in the city that contains the headquarters of the MVPD.

7. **Form of Award.** The arbitrator shall render a written award containing the arbitrator's findings of fact and reasons supporting the award. If the award contains confidential information, the arbitrator shall compile two versions of the award; one containing the confidential information and one with such information redacted. The version of the award containing the confidential information shall only be disclosed to persons bound by the Protective Order issued in connection with the arbitration. The parties shall include such confidential version in the record of any review of the arbitrator's

decision by the Commission.

APPENDIX D

TECHNICAL APPENDIX

I. STAFF ANALYSIS OF THE LIKELIHOOD OF FORECLOSURE IN THE BROADCAST TELEVISION PROGRAMMING MARKET

1. The two primary scenarios of competitive harm that have been alleged are: (1) permanent foreclosure, where the broadcast signal is permanently removed from rival MVPDs and (2) temporary foreclosure, where the broadcast signal is removed for a brief period, possibly during the negotiations for retransmission consent. We first analyze the allegations that following the transaction Applicants will have an incentive to permanently withhold consent to retransmit the local broadcast signal from rival MVPDs. While Cablevision and JCC believe that temporary foreclosure is much more likely in this situation,[1] other commenters argue that permanent foreclosure is also a legitimate concern.[2] Our analysis is similar for both forms of the alleged harm. We determine the number of consumers that must switch to DirecTV to compensate News Corp. for the loss in revenue that occurs when the signal is removed from rival MVPDs. We refer to this as the critical value. If more than this number of customers are likely to switch to DirecTV following the withdrawal of the local broadcast signal, then News Corp. would find it profitable to withhold the local broadcast signal from a rival MVPD.

A. Permanent Withdrawal of the Broadcast Signal from Rival MVPDs

2. Concerned parties in this proceeding have alleged that the transaction will give News Corp. an increased incentive and ability to profitably withhold consent to retransmit broadcast television signals from rival MVPDs.[3] Applicants argue that permanently withholding the right to retransmit the signals of News Corp. owned and operated ("O&O") broadcast television stations would not be profitable given the likely reactions of consumers.[4] Applicants estimate that DirecTV would need to increase its market share from 13% to between 44% and 53%, depending on the assumptions used.[5] We analyze the incentives to engage in permanent withdrawal of the broadcast signal from rival MVPDs weighing the arguments of the parties over the various methods and assumptions used in the analysis.[6] In addition to analyzing the incentives to withhold the signals of News Corp.'s owned and operated stations, we analyze the incentives to withhold the local broadcast signals of independently owned affiliates. We perform this calculation because evidence in the record indicates that **[REDACTED]**.[7] We begin with determining the loss News Corp. will suffer if it permanently removes its local broadcast

[1] JCC Aug. 4 Ex Parte, Rogerson Analysis II at 15; Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 6.

[2] EchoStar Petition at 14-15; ACA Comments at 10-11.

[3] *Id.*

[4] Applicants' Reply at 39.

[5] Applicant's Reply, CRA Analysis, ¶ 71 and ¶ 73.

[6] Many of the values used in analyzing the situation of temporary withdrawal are also used in analyzing a situation of permanent withdrawal, we will discuss some of the values proposed by the parties for use in the analysis of temporary withdrawal as they arise in our analysis of permanent withdrawal.

[7] **[REDACTED]**.

signal from rival MVPDs. If News Corp. removes its signal from rival MVPDs it stands to lose the advertising revenues from those consumers that remain with the rival MVPDs but no longer receive the local broadcast station's signal. Since the signal remains available over the air, some fraction of the rival MVPD viewers will continue to watch News Corp. broadcast programming, therefore reducing the economic loss suffered by News Corp. News Corp. stands to gain a share of the additional profits DirecTV will earn from the consumers that switch from rival MVPDs as well as the advertising revenues those new subscribers generate for the local broadcast station. Our critical value is then the number of rival MVPD subscribers that must switch to DirecTV in order for the revenue loss from the foreclosure to equal the revenue gain to News Corp.[8]

3. The analysis requires a number of values to complete the calculation. News Corp. has provided information on the advertising revenues earned by each of its broadcast stations and the Fox broadcast network, and in the absence of any objections from commenters, we accept these values as presented.[9] In addition, we use information on the advertising revenues of independently owned local affiliates from the BIA Master Access Database. Applicants also have presented calculations on the additional profit, or profit margin, DirecTV earns on each additional subscriber. Applicants use a value of **[REDACTED]** before factoring in a subscriber acquisition cost of **[REDACTED]** per subscriber.[10] Cablevision questions the values used by Applicants, and instead suggests that a more reasonable value would be $29.84 prior to factoring in subscriber acquisition costs.[11] They base their proposal on an unexplained analysis of SEC filings. We find Applicants' detailed documentation of DirecTV revenues, variable costs, and subscriber acquisition costs convincing, and will use these values in our analysis. We also must account for the fact that subscriber acquisition costs are a one-time expense associated with the acquisition of a new customer. To do this we follow the standard method, used by both Applicants and commenters, of amortizing those costs over the length of time that the subscriber is expected to stay with DirecTV.[12] To perform the amortization, two values are required, the average tenure of a subscriber and an appropriate discount, or interest, rate to use in spreading out the one-time cost over the tenure of the subscriber. Cablevision assumes the average tenure of a subscriber to be 60 months based on an analyst's report,[13] while Applicants report that the actual value for DirecTV subscribers is **[REDACTED]** months.[14] We will use an average subscriber tenure of **[REDACTED]** months since DirecTV is likely to have more accurate information regarding its subscribers than is an unaffiliated analyst, though we note that the difference between these two values is relatively minor.

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[8] Mathematically, the critical value is $\left[\dfrac{(1-a)\bullet(Ad\ Revenue)\bullet(RivalMVPDSubs)}{s\bullet(DTV\ Profits)+(Ad\ Revenue)}\right]$, where 'a' represents the fraction of rival MVPD subscribers that obtain the News Corp. broadcast programming off of the air and 's' represents the share of DirecTV profits that will accrue to News Corp.

[9] News Corp. July 28, 2003 Response **[REDACTED]** and Applicants' Reply, CRA Analysis ¶ 70.

[10] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 23 and DirecTV July 30, 2003 Response **[REDACTED]**.

[11] Cablevision Sept. 25 Ex Parte, Rubinfeld Analysis II at 11-12.

[12] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 23; Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 29.

[13] Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 16, citing SG Cowen, *DBS Sector Upgrade.*

[14] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 23.

The difference between the discount rates used by Applicants and JCC in their analyses is more substantial. Applicants use a rate of **[REDACTED]**, based on the so-called hurdle rate used by DirecTV in its planning processes,[15] and Cablevision offers a range of between 5% and 10% with a stated preference for using News Corp.'s weighted average cost of capital of 8%.[16]

4. We find that the use of the hurdle rate would be an inappropriate value to use for discounting cash flows. The hurdle rate is "the rate of interest in a capital budgeting study that a proposed project must exceed before it can be regarded as worthy of consideration."[17] "The hurdle rate is often based on the cost of capital or the weighted average cost of capital, adjusted by a factor to represent the risk characteristics of the projects under consideration."[18] We prefer to use a more objective measure of the opportunity cost of capital to the firm such as the weighted average cost of capital.[19] However, we note that News Corp.'s weighted average cost of capital is unusually low when compared with MVPDs.[20] We will use 10% as our discount rate, this is a reasonable compromise between News Corp.'s weighted average cost of capital, which does not include the impact of MVPD operations, and the weighted average cost of capital of firms in the MVPD industry.

5. The previous discussion focused on determining the profit margin on customers serviced by DirecTV. However, not all customers receiving DirecTV services are serviced by DirecTV; some are serviced by the National Rural Telecommunications Cooperative (NRTC). Some of the customers that shift to DirecTV service in the event of a permanent withdrawal of a broadcast station signal will be serviced by NRTC rather than DirecTV. DirecTV earns a substantially lower margin on these customers. Applicants estimate that this value is less than **[REDACTED]** per NRTC subscriber per month.[21] Absent any further data, we will use this value as the profit margin on DirecTV customers serviced by NRTC in our analysis. We will assume that the customers switching to DirecTV after a permanent withdrawal will be serviced by DirecTV and NRTC in the same proportion as existing customers in the DMA.

6. Before performing the calculation we must identify reasonable values for the share of

[15] *Id.*

[16] Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 13. Estimates of Fox Entertainment Group's weighted average cost of capital range between 8.8% and 9.7%. JP Morgan Securities, *Media & Entertainment: December 2002Quarterly Review and Outlook*, Feb. 24, 2003 at 28; Bank of America Securities, *Entertainment Industry Overview*, July 2003 at 163.

[17] *A Dictionary of Finance and Banking 2nd Edition*, Oxford University Press, 1997 at 167.

[18] *Id.*

[19] "The WACC is a company cost of capital. Strictly speaking, it works only for projects that are carbon copies of the firm's existing assets, in both business risk and financing. Often it is used as a companywide benchmark discount rate; the benchmark is adjusted upward for unusually risky projects and downward for unusually safe ones." Richard A. Brealey and Stewart C. Myers, *Principles of Corporate Finance, 5th Edition*, McGraw-Hill, 1996 at 523.

[20] See for example Morgan Stanley, *The Copernicus Theorem*, July 2, 2003 which reports weighted average costs of capital for the major firms in the MVPD industry ranging from 10.0% to 11.25%.

[21] Applicants' Reply, CRA Analysis at fn. 39.

rival MVPD customers that will use over-the-air reception to obtain the broadcast signal. Applicants, in their analysis, use the figure of 33%.[22] Cablevision assumes values of 33% and 50% and JCC use the complete range of possible values.[23] No one has presented any evidence to indicate what an appropriate value should be. We will use a value of 33%, since in our judgment it is a reasonable approximation, being twice the fraction of television households that currently receive video programming only via broadcast reception.[24]

7. We also need to determine the allocation of the additional profits that would be generated by the withholding of programming. Applicants have suggested the use of two different figures: 34%, representing the fraction of Hughes Electronics that would be acquired by News Corp. pursuant to the transaction documents as well as 50%, representing the fraction of Hughes that News Corp. is permitted to acquire without further approval by Hughes stockholders.[25] Cablevision and JCC argue that a value of 100% is more appropriate and would be consistent with joint profit maximization.[26] News Corp. counters that there are strong checks on News Corp.'s ability to engage in self-dealing, including an independent audit committee.[27] Cablevision and JCC argue that the harms being analyzed result from the joint profit maximizing behavior of both firms and that "News Corp. and DirecTV would simply strike a bargain that maximized their joint profits and then distribute the gains so that everyone would be better off."[28] We reject the 34% value since the new Hughes certificate of incorporation allows News Corp. to acquire up to 50% ownership without further approval by Hughes stockholders.[29] We instead analyze the transaction's effects assuming a 50% division of the additional joint profits earned through the withdrawal of programming, as well as 100%. We analyze the worst-case scenario where News Corp. obtains 100% of the additional joint profits generated by a foreclosure strategy for several reasons. As our discussion of corporate governance has pointed out, the incentive and ability of DirecTV's audit committee to ensure arms-length contracting between News Corp. and DirecTV is limited.[30] In addition, we note that any split of the additional profits in excess of News Corp.'s ownership share would not make Hughes stockholders worse off. This is because any DirecTV profits achieved through foreclosure would result directly from the actions of News Corp., and those profits would not otherwise be available to Hughes stockholders. The proposed joint endeavors between News Corp. and DirecTV that are a basis for many of the Applicant's claimed benefits provide ample opportunities to compensate News Corp. for the losses in programming revenue associated with foreclosure and make the strategy profitable for both firms and their stockholders.

[22] Applicants' Reply, CRA Analysis ¶ 73.

[23] Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 13; JCC Aug. 4 Ex Parte, Rogerson Analysis II at 54.

[24] *2002 Annual Video Competition Report* ¶ 4.

[25] Applicants' Reply, CRA Analysis at 52.

[26] JCC Aug. 4 Ex Parte, Rogerson Analysis II at 11; Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 18.

[27] Applicants' Reply, CRA Analysis at 53.

[28] JCC Aug. 4 Ex Parte, Rogerson Analysis II at 11.

[29] Hughes Electronics Corporation, SEC Form S-4, June 5, 2003 at 26.

[30] *See* Section IV.C.2.

8. Applicants calculate the critical value based on the average advertising revenues of all News Corp. owned and operated stations as well as average market shares of cable and DBS in the United States.[31] Applicants find that on average, it would not be profitable to engage in permanent foreclosure. We find this analysis incomplete and suffering from the "fallacy of division."[32] Accordingly, we will calculate the critical values that would make permanent foreclosure of broadcast station's programming at the smallest geographic level possible. Ideally that would be at the level of a cable franchise within a Nielsen Designated Market Area ("DMA"). However, we do not have reliable figures on cable subscribers by franchise in a DMA. We do have estimates of the cable and DirecTV households in a DMA.[33] Therefore we perform our calculations at the DMA level and assume that the programming is withdrawn from all competing MVPDs within the DMA. We find this a reasonable assumption and a feasible strategy since **[REDACTED]**.[34]

9. Our analysis of the incentives for News Corp. to permanently withhold retransmission consent of broadcast signals from rival MVPDs indicates that this strategy is unlikely to be profitable to News Corp. and its affiliates. If News Corp. could claim 50% of joint profits of a withdrawal strategy, it would find a withdrawal of the local broadcast station from rival MVPDs to be profitable if, depending on the broadcast station, between **[REDACTED]** and **[REDACTED]** of cable customers switched to a DBS provider. If News Corp. receives 100% of the joint profits from the strategy, the percentage of rival MVPD customers that must switch to make temporary foreclosure profitable is between **[REDACTED]** and **[REDACTED]** for the various local broadcast stations. Table A-1 presents the percentage of all rival MVPD subscribers that reside in areas where News Corp. would find it profitable to permanently withdraw the local broadcast signal. This value will depend on the percent of rival MVPD subscribers that shift in response to the removal of the local broadcast station from their chosen MVPD. We hypothesize a range of values from **[REDACTED]** to **[REDACTED]**. If we can expect **[REDACTED]** of rival MVPD customers to defect to DirecTV following a withdrawal of the broadcast station, News Corp. would find the withdrawal a profitable endeavor against companies serving **[REDACTED]** of all rival MVPD subscribers if News Corp. can lay claim to 50% of the additional joint profits. If News Corp. gains 100% of the additional joint profits, **[REDACTED]** of all rival MVPD subscribers would be at risk from suffering under a permanent withdrawal of the programming.

10. Table A-1. Percentage of Rival MVPD Subscribers at Risk of a Permanent Withdrawal of their Local Broadcast Signal.**[REDACTED]**

B. Temporary Withdrawal of the Broadcast Signal from Rival MVPDs

11. Commenters raise the concern that the more likely harm to rivals will occur from the

[31] Applicants' Reply, CRA Analysis ¶ 73.

[32] The "fallacy of division" occurs when one argues that what is true for the whole is also true for the parts. In this context, News Corp. argues that since it would not be profitable to permanently withhold retransmission consent of all of its owned and operated stations, it would also be true that it is not profitable to withhold consent for any single station.

[33] DirecTV July 30, 2003 Response **[REDACTED]**; BIA MasterAccess Database of Television Stations. We assume that the number of subscribers to EchoStar is proportional to DirecTV's share in the DMA in the same proportion as the two firms' market shares nationally.

[34] News Corp. July 28, 2003 Response **[REDACTED]**.

temporary withdrawal of the broadcast signal from rival MVPDs, rather than permanent withdrawal. Cablevision estimates that DirecTV need only add between 0.7 and 1.4 points to its market share for temporary withholding of the broadcast signal to be profitable.[35] Applicants argue that using more appropriate assumptions, DirecTV would need to increase its market share by **[REDACTED]** points.[36] In our analysis of the incentives to engage in temporary foreclosure, we build upon the assumptions evaluated in our permanent withholding analysis, and examine several new factors.

12. The possibility of temporary foreclosure presents a different risk of competitive harms. Under this strategy, News Corp. would remove its broadcast signal from rival MVPDs for a short period of time, thereby limiting the loss in advertising revenues it incurs. JCC point out that this withdrawal benefits Applicants in two ways.[37] The first benefit is the same as that analyzed under the hypothesis of permanent foreclosure where the additional customers switching to DirecTV generate profits that accrue to DirecTV and are shared with News Corp. The second benefit accrues solely to News Corp. That benefit is the increased compensation for retransmission consent that News Corp. will be able to extract from MVPDs due to the reduction in the costs of withholding retransmission consent and the greater credibility that the threat of withholding carries. Our analysis of the incentives to temporarily foreclose the local broadcast signals from rival MVPDs is only able to measure the effect of the first benefit, the additional profits that are earned when consumers switch to DirecTV. The effect of the increased credibility of withholding of retransmission on the compensation for retransmission of the local broadcast station's signal is difficult to quantify. As JCC point out, the effect of this increased credibility can have a substantial effect on compensation, even when the profits that accrue from switching subscribers cannot compensate for the advertising revenues lost due to foreclosure.[38] However, the extent of the effect depends on the relative strengths of the bargaining positions of News Corp. and MVPDs. There is no evidence in the record regarding the relative strengths of News Corp. and MVPDs in this area, therefore we are unable to estimate the full magnitude of the increase in the incentive and ability to obtain additional compensation in return for granting retransmission consent. Our analysis will provide an estimate of increased incentive and ability that is likely to occur due to the additional profit News Corp. earns when consumers switch from rival MVPDs to DirecTV, as such it is an estimate of the *minimum* increase in incentive and ability to obtain additional compensation from MVPDs.

13. Unlike the case of permanent foreclosure, with temporary foreclosure, the timing of the various effects becomes important. Because some of the consumers that switch to DirecTV will return to their previous MVPD after the period of withdrawal, we must account for the timing of the subscriber acquisition costs as well as the timing of consumers' return to their original MVPD. We adopt a discounted cash flow approach to allow us to compare these benefits and costs over time.[39] DirecTV

[35] Cablevision Sept. 25 Ex Parte, Rubinfeld Analysis II at 13.

[36] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 24.

[37] JCC Sept. 23 Ex Parte, Rogerson Analysis III at 2.

[38] JCC Sept. 23 Ex Parte, Rogerson Analysis III at 7-9.

[39] The discounted cash flow analysis is the method used by both Cablevision (Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis) and Applicants (Applicants' Sept. 8 Ex Parte, CRA Analysis II) when examining the incentives to engage in temporary withholding of programming. It is the standard method for comparing flows of costs and benefits that vary over time. See for example Richard A. Brealey and Stewart C. Myers, *Principles of Corporate Finance, 5th Edition,* McGraw-Hill, 1996, Chapter 3.

requires that customers agree to purchase 12 months of programming before DirecTV will provide free or subsidized equipment and installation.[40] Because **[REDACTED]**, we assume that all of the customers that switch to DirecTV agree to purchase twelve months of programming.[41] After that period of time, a number will return to their previous MVPD. Applicants report that **[REDACTED]** of new DirecTV customers drop service over the course of one year.[42] They believe that a larger fraction of the customers induced to switch because of the temporary withholding will leave and consequently assume that **[REDACTED]** customers will leave after the first year.[43] Following the initial churn of these new customers, Applicants assume that these new customers will exit at DirecTV's average churn rate of **[REDACTED]** per month.[44] Cablevision and JCC argue that customers who switched to DirecTV due to the temporary withdrawal are, if anything, less likely to churn than the average DirecTV customer.[45] We assume this initial churn rate is **[REDACTED]**, which is **[REDACTED]** the normal 12 month churn rate of DirecTV. We base this value on the regression analysis described later in this appendix where we analyze the impact on DirecTV customer disconnects of the introduction of the YES cable network on Cablevision cable systems in New York, which signaled the return of New York Yankees baseball games to those systems. Our analysis also indicates that **[REDACTED]**. Therefore, following the initial churn of these new customers, we assume that the continuing churn rate of these new customers will be equal to **[REDACTED]** per month.

14. Cablevision suggests that an additional adjustment should be made to account for the positive impact the temporary foreclosure would have on the future growth rate of DirecTV.[46] We reject this proposed adjustment. In Section I.C of this appendix we examine the effects of the temporary withdrawal of a local broadcast station signal from one of DirecTV's competitors and **[REDACTED]**.

15. With these assumptions, as well as those discussed in analyzing the impact of permanent withholding of the local broadcast station's signal, the losses and gains from a temporary foreclosure can be calculated. Applicants, as well as Cablevision, propose that the calculation for the withholding of retransmission rights for a local broadcast station be based upon a one month withholding.[47] We will adopt this assumption as well. In the first period News Corp. will suffer the loss of a month's worth of advertising revenue. In the succeeding month, the temporary foreclosure will have ended and News Corp. will no longer suffer the loss associated with it and is assumed to earn the same advertising revenue and compensation from retransmission consent as it did prior to the withholding. The gain experienced by News Corp. will be its share of the profit margin from each new customer that arrives from a rival MVPD. News Corp. also will be assessed its share of the one-time subscriber acquisition

[40] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 12.

[41] DirecTV July 30, 2003 Response **[REDACTED]**.

[42] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 15

[43] *Id.*

[44] *Id.*

[45] JCC Sept. 23 Ex Parte, Rogerson Analysis III at 14; Cablevision Sept. 25 Ex Parte, Rubinfeld Analysis II at 9.

[46] Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 14.

[47] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 23; Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 6.

costs associated with each new subscriber. For 11 successive months, News Corp. will earn its share of the profit margin on the customers that shifted due to the temporary foreclosure. It continues to receive these profits because these customers, in order to receive free installation and equipment, have committed to purchase 12 months of DirecTV programming. However, in the thirteenth month, when the new customers' commitments expire, DirecTV will lose **[REDACTED]** of the customers it acquired due to the temporary foreclosure. In each continuing month, DirecTV will lose **[REDACTED]** of the remaining customers. Given this monthly pattern of gains and losses, we discount the earnings of future periods using a discount rate of 10%. We calculate the number of rival MVPD customers that must switch to DirecTV for the one month withdrawal to be profitable to News Corp. and DirecTV for each owned and operated broadcast station as well as independently owned affiliates of the Fox Broadcast Network.

16. Our analysis indicates that a temporary withdrawal of local broadcast signals from rival MVPDs is a credible negotiating tactic. It demonstrates that in most areas of the country, following the transaction, News Corp. can earn additional profits based on the consumers that switch to DirecTV when the local broadcast signal is withheld from rival MVPDs. Rival MVPDs facing this situation during retransmission consent negotiations will have two choices, either give News Corp. additional considerations for retransmission consent or have News Corp. earn those additional profits through the mechanism of temporary withholding. If News Corp. could claim 50% of joint profits of a withdrawal strategy, it would find a withdrawal of the local broadcast station's signal from rival MVPDs to be profitable if, depending on the broadcast station, between **[REDACTED]** and **[REDACTED]** of cable customers switched to DirecTV. If News Corp. receives 100% of the joint profits from the strategy, the percentage of rival MVPD customers that must switch to make temporary foreclosure profitable is between **[REDACTED]** and **[REDACTED]** for the various broadcast stations. Table A-2 presents the percentage of rival MVPD subscribers that reside in areas where News Corp. would find it profitable to temporarily withhold the local broadcast signal. This value depends on the percent of subscribers to rival MVPDs that shift in response to the one month withdrawal of the local broadcast station from their MVPD. We examine the extent of the profitability of temporary withholding for a range of values of the consumer response. If **[REDACTED]** of rival MVPD customers defect to DirecTV following a withdrawal of the local broadcast station, News Corp. would find the withdrawal profitable in areas with **[REDACTED]** of rival MVPD subscribers if News Corp. can lay claim to 50% of the joint profits. If News Corp. gains 100% of the joint profits, **[REDACTED]** of rival MVPD subscribers are at risk from suffering under a temporary withdrawal of the programming.

17. Table A-2. Percentage of Rival MVPD Subscribers at Risk of a Temporary Withdrawal of their Local Broadcast Signal.**[REDACTED]**

C. Estimation of the Impact of the Withdrawal of a Broadcast Station from Rival MVPDs on DirecTV

18. The preceding analysis of the incentives to either permanently or temporarily withhold a broadcast signal from a rival MVPD informs us about the necessary responses from consumers to make the hypothesized harms real. Cablevision has analyzed the results of a retransmission consent dispute between Time Warner and the ABC owned and operated broadcast television station in Houston.[48] Based on their early analysis, they believe that as many as 3% of Time Warner's subscribers may have

[48] Cablevision Aug. 20 Ex Parte, Rubinfeld Analysis at 3-5.

switched to DirecTV. Subsequent econometric analysis led to a refinement in their conclusion. Cablevision argues that DirecTV **[REDACTED]** of MVPD subscribers in the Houston DMA.[49] Applicants argue that the situation in Houston is not relevant since it involved a case of a cable company removing the broadcast signal from its system rather than a broadcaster withholding the signal from a cable company.[50] We disagree with the Applicant's position. The value of the Houston incident is not in determining which firm found it more advantageous to carry through on the removal or withholding of the signal. The value is in analyzing how Time Warner customers reacted when the signal was no longer available on the cable system. To that extent, Applicants have not convinced us that the specific details in Houston bias estimates of consumer reactions to the withdrawal of a broadcast signal from a cable system.

19. We approach the problem from the standpoint of researchers estimating the impact of a policy. We obtain data from two separate groups. A control group which is unaffected by the policy for the entire period under observation, and a treatment group, that for some period of time has the policy applied to them. In the case at hand, the policy or treatment is the removal of the ABC affiliate from the Time Warner cable system. Our treatment group consists of those ZIP codes within the Houston DMA that where Time Warner offers service to at least 75% of the households. For our control group we use those ZIP codes within the Houston DMA where Classic Cable or Northwoods Cable offer service to at least 75% of the households.[51] Both firms in the control group carried the ABC affiliate on an uninterrupted basis during 2000. We measure the effect of these events on the growth rate in DirecTV subscribers for each month between December 1999 and July 2000.

20. We use an econometric method known as "fixed effects estimation."[52] This method estimates DirecTV's subscriber growth rate in a ZIP code as depending on a ZIP code-specific effect, which varies across ZIP codes, but does not vary over time, and a time-specific effect which varies over time, but is the same across all ZIP codes. The treatment effect is measured by indicator variables for the Time Warner ZIP codes for each month between December of 1999 and July of 2000. These indicator variables will measure the difference between DirecTV's growth in Time Warner ZIP codes and in the Classic and Northwoods ZIP codes after accounting for the factors that are due either to constant characteristics of the ZIP code, such as household income, population density, and consumer preferences, or effects at one point in time that affect both sets of ZIP codes equally, such as changes in DirecTV programming.

21. The estimated monthly difference in DirecTV's growth rate in areas served by Time

[49] Letter from Tara Corvo, , Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, PC, to Marlene H. Dortch, Secretary, FCC (Nov. 20, 2003), Daniel L. Rubinfeld and Duncan Cameron, Estimating the Effect on MVPD Subscribership of the May 2000 Withholding of ABC Network Retransmissions from Time Warner Houston Cable Subscribers at 11.

[50] Applicants' Sept. 8 Ex Parte, CRA Analysis II ¶ 21-22.

[51] To make a determination of which ZIP codes and the fraction of households that fall within the service areas of the firms we use the May 2003 GDT Dynamap 2000 ZIP code boundaries, 3rd Quarter 2002 incumbent cable operator service territories from MediaPrints™, ©Warren Communications News Inc. and The Janus Group, and 2000 Census Summary File 1.

[52] See Jeffrey Wooldridge, *Econometric Analysis of Cross Section and Panel Data*, The MIT Press, 2002, Chapter 10.

Warner as compared to the control group that was not in a retransmission consent dispute is given in table A-3. The results indicate a statistically significant increase in the growth rate of DirecTV in the ZIP codes where consumers were continually being told that they were likely to be losing access to the ABC affiliate on the incumbent cable operator.[53]

22. Table A-3. Additional DirecTV Subscriber Growth in Houston due to Retransmission Consent Dispute between ABC and Time Warner. **[REDACTED]**

23. We can calculate the impact of the warnings and actual withdrawal of the ABC affiliate from Time Warner cable systems in Houston by applying the excess growth rates **[REDACTED]**.[54] **[REDACTED]** Therefore, we estimate that the effect on DirecTV of the withdrawal of broadcast programming from the rival cable operator was an additional **[REDACTED]** subscribers. We estimate that because of the 39-hour withdrawal of the ABC affiliate Time Warner lost **[REDACTED]** of its customer base to DirecTV. If we assume that EchoStar gained customers at a rate equivalent to its market share relative to DirecTV, Time Warner would have lost a further **[REDACTED]** of its customer base to EchoStar.

24. We would like to verify our assumptions about the churn rate of DirecTV customers following the return of the signal, but are unable to do so, because the churn resulting from this incident would not evidence itself until 2001 when the 1-year contracts signed by consumers expired. The data submitted by DirecTV exhibits a discontinuity between 2000 and 2001 due to the acquisition and conversion of PrimeStar customers. Consequently, we must rely on our analysis of churn following the return of withdrawn regional sports programming.

II. STAFF ANALYSIS OF THE LIKELIHOOD OF FORECLOSURE IN THE REGIONAL SPORTS NETWORK MARKET

25. The analysis of the incentive and ability of News Corp. to withhold carriage of regional sports networks (RSNs) from DirecTV's competitors in the MVPD market closely follows the methods used in the analysis of the same issue in the local broadcast programming market. We calculate the number of consumers that must switch to DirecTV to compensate for the loss in revenue when a cable system no longer carries the RSN. As with our analysis of the withholding of broadcast television station signals, we consider cases of permanent and temporary withholding.

A. Permanent Withdrawal of the Regional Sports Network from Rival MVPDs

26. The case of permanent foreclosure differs slightly from that examined in the local broadcast station segment since RSN programming is generally not available over the air. If News Corp. removes its RSN from a rival MVPD it loses the advertising revenues associated with all of those subscribers, not just a fraction as was the case with the local broadcast station. In addition to a loss in advertising revenue, there is also the loss in the affiliate fees paid by the rival MVPD for the right to

[53] See for example, Mike McDaniel, *Picture Looking Dark in TV Feud, Channel 13 May Go Off Cable Tonight*, HOUSTON CHRONICLE, March 9, 2000.

[54] This estimate is based upon DirecTV October 24, 2003 Response to the Commission's Second Information and Document Request **[REDACTED]** as well as GDT ZIP code boundaries and MediaPrints™ cable system boundaries.

carry the RSN. The gain to News Corp. of a permanent withholding strategy is its share of the joint profits earned from the consumers that switch from the rival MVPD, as well as the affiliate fees and advertising revenues those consumers bring with them.

27. Applicants assert that permanent withholding of a RSN from a rival MVPD is not a rational economic act.[55] Their analysis, using the same method as they employed in analyzing the permanent withholding of a broadcast station, indicates that for the strategy to be profitable DirecTV's market share must increase between 93% and 128%.[56]

28. News Corp. has provided the affiliation revenue and subscriber counts of each MVPD distributing a RSN it manages, as well as the aggregate advertising revenues for each network.[57] From these data we calculate the average advertising revenue per subscriber for each RSN. We also calculate the average revenue per subscriber for each RSN carried by each MVPD. In association with subscriber counts, these are the costs of removing a RSN from a rival MVPD.

29. A portion of the benefits of removing a RSN from a rival MVPD are the additional profits that accrue from those customers that switch to DirecTV service. We use the same value we used when calculating the critical values for the withholding of a broadcast station signal. News Corp. also receives the RSN affiliate fees and advertising revenue the switching customers generate. We make one significant modification from the analysis of permanent withholding of broadcast station signals. We assume that the RSN is withdrawn from the competing cable company, but not from EchoStar. We make this assumption because **[REDACTED]**.[58] The effect of this assumption is to reduce the number of cable subscribers defecting to DirecTV following the withdrawal of the RSN from the rival cable provider. Since EchoStar also carries the RSNs, some of the defecting cable subscribers will choose to purchase service from EchoStar rather than DirecTV. News Corp. will not share in any of the additional profit EchoStar earns from those customers, but it will receive advertising revenues as well as affiliate fees. We assume that switching cable subscribers go to the two DBS companies in the same proportion as the firms' national market shares, 42% will go to EchoStar and 58% will go to DirecTV.[59] As in the previous analysis, we calculate the critical values for situations where News Corp. can lay claim to 50% and 100% of the joint profits generated by the withdrawal of the RSN.[60]

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[55] Applicants' Reply at 27-36.

[56] Applicants' Reply, CRA Analysis at 51.

[57] News Corp. July 28, 2003 Response **[REDACTED]**.

[58] See News Corp. July 28, 2003 Response **[REDACTED]**.

[59] Applicants' Reply, CRA Analysis ¶ 32.

[60] The critical value is

$$\left[\frac{(Ad\,\mathrm{Re}\,venue + CableAffiliateFee) \bullet (RivalCableSubs)}{\alpha \bullet (s \bullet (DTV\,\mathrm{Pr}\,ofits) + DTVAffiliateFee) + (1-\alpha) \bullet EchoAffiliateFee + Ad\,\mathrm{Re}\,venue}\right]$$, where

's' represents the share of the joint profits that will accrue to News Corp. and 'α' is the fraction of subscribers leaving cable that shift to DirecTV.