

**UNITED STATES OF AMERICA  
BEFORE FEDERAL TRADE COMMISSION**

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In the Matter of )  
 )  
**TIME WARNER INC.,** )  
a corporation; )  
 )  
**TURNER BROADCASTING** )  
**SYSTEM, INC.,** )  
a corporation; )  
 )  
**TELE-COMMUNICATIONS, INC.,** )  
a corporation; and )  
 )  
**LIBERTY MEDIA CORPORATION,** )  
a corporation. )

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File No. 961-0004

**AGREEMENT CONTAINING CONSENT ORDER**

The Federal Trade Commission ("Commission"), having initiated an investigation of the proposed acquisition of Turner Broadcasting System, Inc. ("Turner") by Time Warner Inc. ("Time Warner"), and Tele-Communications, Inc.'s ("TCI") and Liberty Media Corporation's ("LMC") proposed acquisitions of interests in Time Warner, and it now appearing that Time Warner, Turner, TCI, and LMC, hereinafter sometimes referred to as "proposed respondents," are willing to enter into an agreement containing an order to divest certain assets, and providing for other relief:

**IT IS HEREBY AGREED** by and between proposed respondents, by their duly authorized officers and attorneys, and counsel for the Commission that:

1. Proposed respondent Time Warner is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware with its office and principal place of business located at 75 Rockefeller Plaza, New York, New York 10019.

2. Proposed respondent Turner is a corporation organized, existing and doing business under and by virtue of the laws of the State of Georgia, with its office and principal place of business located at One CNN Center, Atlanta, Georgia 30303.
3. Proposed respondent TCI is a corporation organized, existing and doing business under and by virtue of the law of the State of Delaware, with its office and principal place of business located at 5619 DTC Parkway, Englewood, Colorado 80111.
4. Proposed respondent LMC is a corporation organized, existing and doing business under and by virtue of the law of the State of Delaware, with its office and principal place of business located at 8101 East Prentice Avenue, Englewood, Colorado 80111.
5. Proposed respondents admit all the jurisdictional facts set forth in the draft of complaint here attached for purposes of this agreement and order only.
6. Proposed respondents waive:
  - (1) any further procedural steps;
  - (2) the requirement that the Commission's decision contain a statement of findings of fact and conclusions of law;
  - (3) all rights to seek judicial review or otherwise to challenge or contest the validity of the order entered pursuant to this agreement; and
  - (4) any claim under the Equal Access to Justice Act.
7. Proposed respondents shall submit (either jointly or individually), within sixty (60) days of the date this agreement is signed by proposed respondents, an initial report or reports, pursuant to § 2.33 of the Commission's Rules, signed by the proposed respondents and setting forth in detail the manner in which the proposed respondents will comply with Paragraphs VI, VII and VIII of the order, when and if entered. Such report will not become part of the public record unless and until this agreement and order are accepted by the Commission for public comment.
8. This agreement shall not become part of the public record of the proceeding unless and until it is accepted by the Commission. If this agreement is accepted by the Commission it, together with a draft of the complaint contemplated hereby, will be placed on the public record for a period of sixty (60) days and information in respect thereto publicly released. The Commission thereafter may either withdraw its acceptance of this agreement and so notify the proposed respondents, in which event it will take such action as it may consider appropriate, or issue and serve its complaint (in such form as the circumstances may require) and decision, in disposition of the proceeding.

9. This agreement is for settlement purposes only and does not constitute an admission by proposed respondents that the law has been violated as alleged in the draft of complaint here attached, or that the facts as alleged in the draft complaint, other than jurisdictional facts, are true.
10. This agreement contemplates that, if it is accepted by the Commission, and if such acceptance is not subsequently withdrawn by the Commission pursuant to the provisions of § 2.34 of the Commission's Rules, the Commission may, without further notice to the proposed respondents, (1) issue its complaint corresponding in form and substance with the draft of complaint here attached and its decision containing the following order in disposition of the proceeding, and (2) make information public with respect thereto. When so entered, the order shall have the same force and effect and may be altered, modified or set aside in the same manner and within the same time provided by statute for other orders. The order shall become final upon service. Delivery by the U.S. Postal Service of the complaint and decision containing the agreed-to order to proposed respondents' addresses as stated in this agreement shall constitute service. Proposed respondents waive any right they may have to any other manner of service. The complaint may be used in construing the terms of the order, and no agreement, understanding, representation, or interpretation not contained in the order or the agreement may be used to vary or contradict the terms of the order.
11. Proposed respondents have read the proposed complaint and order contemplated hereby. Proposed respondents understand that once the order has been issued, they will be required to file one or more compliance reports showing that they have fully complied with the order. Proposed respondents further understand that they may be liable for civil penalties in the amount provided by law for each violation of the order after it becomes final.
12. Proposed respondents agree to be bound by all of the terms of the *Interim Agreement* attached to this agreement and made a part hereof as Appendix I, upon acceptance by the Commission of this agreement for public comment. Proposed respondents agree to notify the Commission's Bureau of Competition in writing, within 30 days of the date the Commission accepts this agreement for public comment, of any and all actions taken by the proposed respondents to comply with the *Interim Agreement* and of any ruling or decision by the Internal Revenue Service ("IRS") concerning the Distribution of The Separate Company stock to the holders of the Liberty Tracking Stock within two (2) business days after service of the IRS Ruling.
13. The order's obligations upon proposed respondents are contingent upon consummation of the Acquisition.

## **ORDER**

### **I.**

As used in this Order, the following definitions shall apply:

- A) “Acquisition” means Time Warner’s acquisition of Turner and TCI’s and LMC’s acquisition of interest in Time Warner.
- B) “Affiliated” means having an Attributable Interest in a Person.
- C) “Agent” or “Representative” means a Person that is acting in a fiduciary capacity on behalf of a principal with respect to the specific conduct or action under review or consideration.
- D) “Attributable Interest” means an interest as defined in 47 C.F.R. § 76.501 (and accompanying notes), as that rule read on July 1, 1996.
- E) “Basic Service Tier” means the Tier of video programming as defined in 47 C.F.R. § 76.901(a), as that rule read on July 1, 1996.
- F) “Buying Group” or “Purchasing Agent” means any Person representing the interests of more than one Person distributing multichannel video programming that: (1) agrees to be financially liable for any fees due pursuant to a Programming Service Agreement which it signs as a contracting party as a representative of its members, or each of whose members, as contracting parties, agrees to be liable for its portion of the fees due pursuant to the programming service agreement; (2) agrees to uniform billing and standardized contract provisions for individual members; and (3) agrees either collectively or individually on reasonable technical quality standards for the individual members of the group.
- G) “Carriage Terms” means all terms and conditions for sale, licensing or delivery to an MVPD for a Video Programming Service and includes, but is not limited to, all discounts (such as for volume, channel position and Penetration Rate), local advertising availabilities, marketing, and promotional support, and other terms and conditions.

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M) "Control," "Controlled" or "Controlled by" has the meaning set forth in 16 C.F.R. §801.1 as that regulation read on July 1, 1996, except that Time Warner's 50% interest in Comedy Central (as of the Closing Date) and TCI's 50% interests in Bresnan Communications, Intermedia Partnerships and Lenfest Communications (all as of the Closing Date) shall not be deemed sufficient standing alone to confer Control over that Person.

N) "Converted WTBS" means WTBS once converted to a Video Programming Service.

O) "Fully Diluted Equity of Time Warner" means all Time Warner common stock actually issued and outstanding plus the aggregate number of shares of Time Warner common stock that would be issued and outstanding assuming the exercise of all outstanding options, warrants and rights (excluding shares that would be issued in the event a poison pill is triggered) and the conversion of all outstanding securities that are convertible into Time Warner common stock.

P) "HBO" means the Video Programming Service Home Box Office, including multiplexed versions.

Q) "Independent Advertising-Supported News and Information Video Programming Service" means a National Video Programming Service (1) that is not owned, Controlled by, or Affiliated with Time Warner; (2) that is a 24-hour per day service consisting of current national, international, sports, financial and weather news and/or information, and other similar programming; and (3) that has national significance so that, as of February 1, 1997, it has contractual commitments to supply its service to 10 million subscribers on Unaffiliated MVPDs, or, together with the contractual commitments it will obtain from Time Warner, it has total contractual commitments to supply its service to 15 million subscribers. If no such Service has such contractual commitments, then Time Warner may choose from among the two Services with contractual commitments with Unaffiliated MVPDs for the largest number of subscribers.

R) "Independent Third Party" means (1) a Person that does not own, Control, and is not Affiliated with or has a share of voting power, or an Ownership Interest in, greater than 1% of any of the following: TCI, LMC, or the Kearns-Tribune Corporation; or (2) a Person which none of TCI, LMC, or the TCI Control Shareholders owns, Controls, is Affiliated with, or in which any of them has a share of voting power, or an Ownership Interest in, greater than 1%. *Provided, however, that* an Independent Third Party shall not lose such status if, as a result of a transaction between an Independent Third Party and The Separate Company, such Independent Third Party becomes a successor to The Separate Company and the TCI Control Shareholders collectively hold an Ownership Interest of 5% or less and collectively hold a share of voting power of 1% or less in that successor company.

S) "LMC" means Liberty Media Corporation, all of its directors, officers, employees, Agents, and Representatives, and also includes (1) all of its predecessors, successors, assigns, subsidiaries, and divisions, all of their respective directors, officers, employees, Agents, and Representatives, and the respective successors and assigns of any of the foregoing; and (2)

partnerships, joint ventures, and affiliates that Liberty Media Corporation Controls, directly or indirectly.

T) “The Liberty Tracking Stock” means Tele-Communications, Inc. Series A Liberty Media Group Common Stock and Tele-Communications, Inc. Series B Liberty Media Group Common Stock.

U) “Multichannel Video Programming Distributor” or “MVPD” means a Person providing multiple channels of video programming to subscribers in the United States for which a fee is charged, by any of various methods including, but not limited to, cable, satellite master antenna television, multichannel multipoint distribution, direct-to-home satellite (C-band, Ku-band, direct broadcast satellite), ultra high-frequency microwave systems (sometimes called

Rate(s) as the Competing MVPD makes available nationally.

DD) "TCI" means Tele-Communications, Inc., all of its directors, officers, employees, Agents, and Representatives, and also includes (1) all of its predecessors, successors, assigns, subsidiaries, and divisions, all of their respective directors, officers, employees, Agents, and Representatives, and the respective successors and assigns of any of the foregoing; and (2) partnerships, joint ventures, and affiliates that Tele-Communications, Inc. Controls, directly or indirectly. TCI acknowledges that the obligations of subparagraphs (C)(6), (8)-(9), (D)(1)-(2) of Paragraph II and of Paragraph III of this order extend to actions by Bob Magness and John C. Malone, taken in an individual capacity as well as in a capacity as an officer or director, and agrees to be liable for such actions.

EE) "TCI Control Shareholders" means the following Persons, individually as well as collectively: Bob Magness, John C. Malone, and the Kearns-Tribune Corporation, its Agents and Representatives, and the respective successors and assigns of any of the foregoing.

FF) "TCI's and LMC's Interest in Time Warner" means all the Ownership Interest in Time Warner to be acquired by TCI and LMC, including the right of first refusal with respect to Time Warner stock to be held by R. E. Turner, III, pursuant to the Shareholders Agreement dated September 22, 1995 with LMC or any successor agreement.

GG) "TCI's and LMC's Turner-Related Businesses" means the businesses conducted by Southern Satellite Systems, Inc., a subsidiary of TCI which is principally in the business of distributing WTBS to MVPDs.

HH) "Tier" means a grouping of Video Programming Services offered by an MVPD to subscribers for one package price.

II) "Time Warner" means Time Warner Inc., all of its directors, officers, employees, Agents, and Representatives, and also includes (1) all of its predecessors, successors, assigns, subsidiaries, and divisions, including, but not limited to, Turner after the Closing Date., all of their respective directors, officers, employees, Agents, and Representatives, and the respective successors and assigns of any of the foregoing; and (2) partnerships, joint ventures, and affiliates that Time Warner Inc. Controls, directly or indirectly. Time Warner shall, except for the purposes of definitions OO and PP, include Time Warner Entertainment Company, L.P., so long as it falls within this definition.

JJ) "Time Warner CATV" means a CATV which is owned or Controlled by Time Warner. "Non-Time Warner CATV" means a CATV which is not owned or Controlled by Time Warner. Obligations in this order applicable to Time Warner CATVs shall not survive the disposition of Time Warner's Control over them.

KK) "Time Warner National Video Programming Vendor" means a Video Programming Vendor providing a National Video Programming Service which is owned or Controlled by

Time Warner. Likewise, “Non-Time Warner National Video Programming Vendor” means a Video Programming Vendor providing a National Video Programming Service which is not owned or Controlled by Time Warner.

LL) “TNT” means the Video Programming Service Turner Network Television.

MM) “Total Subscribers” means the total number of subscribers to an MVPD other than subscribers only to the Basic Service Tier.

NN) “Turner” means Turner Broadcasting System, Inc., all of its directors, officers, employees, Agents, and Representatives, and also includes (1) all of its predecessors, successors (except Time Warner), assigns (except Time Warner), subsidiaries, and divisions; and (2) partnerships, joint ventures, and affiliates that Turner Broadcasting System, Inc., Controls, directly or indirectly.

OO) “Turner Video Programming Services” means each Video Programming Service owned or Controlled by Turner on the Closing Date, and includes (1) WTBS, (2) any such Video Programming Service and WTBS that is transferred after the Closing Date to another part of Time Warner (including TWE), and (3) any Video Programming Service created after the Closing Date that Time Warner owns or Controls that is not owned or Controlled by TWE, for so long as the Video Programming Service remains owned or Controlled by Time Warner.

PP) “Turner-Affiliated Video Programming Services” means each Video Programming Service, whether or not satellite-delivered, that is owned, Controlled by, or Affiliated with Turner on the Closing Date, and includes (1) WTBS, (2) any such Video Programming Service and WTBS that is transferred after the Closing Date to another part of Time Warner (including TWE), and (3) any Video Programming Service created after the Closing Date that Time Warner owns, Controls or is Affiliated with that is not owned, Controlled by, or Affiliated with TWE, for so long as the Video Programming Service remains owned, Controlled by, or affiliated with Time Warner.

QQ) “TWE” means Time Warner Entertainment Company, L.P., all of its officers, employees, Agents, Representatives, and also includes (1) all of its predecessors, successors, assigns, subsidiaries, divisions, including, but not limited to, Time Warner Cable, and the respective successors and assigns of any of the foregoing, but excluding Turner; and (2) partnerships, joint ventures, and affiliates that Time Warner Entertainment Company, L.P., Controls, directly or indirectly.

RR) “TWE’s Management Committee” means the Management Committee established in Section 8 of the Admission Agreement dated May 16, 1993, between TWE and U S West, Inc., and any successor thereof, and includes any management committee in any successor agreement that provides for membership on the management committee for non-Time Warner individuals.



SS) “TWE Video Programming Services” means each Video Programming Service owned or Controlled by TWE on the Closing Date, and includes (1) any such Video Programming Service transferred after the Closing Date to another part of Time Warner and (2) any Video Programming Service created after the Closing Date that TWE owns or Controls, for so long as the Video Programming Service remains owned or Controlled by TWE.

TT) “TWE-Affiliated Video Programming Services” means each Video Programming Service, whether or not satellite-delivered, that is owned, Controlled by, or Affiliated with TWE, and includes (1) any such Video Programming Service transferred after the Closing Date to another part of Time Warner and (2) any Video Programming Service created after the Closing Date that TWE owns or Controls, or is Affiliated with, for so long as the Video Programming Service remains owned, Controlled by, or Affiliated with TWE.

VV) “Unaffiliated MVPD” means an MVPD which is not owned, Controlled by, or

(1) combining TCI's and LMC's Interest in Time Warner Inc. and TCI's and LMC's Turner-Related Businesses in The Separate Company;

(2) distributing The Separate Company stock to the holders of Liberty Tracking Stock ("Distribution"); and

(3) using their best efforts to ensure that The Separate Company's stock is registered or listed for trading on the Nasdaq Stock Market or the New York Stock Exchange or the American Stock Exchange.

(B) TCI and LMC shall make all regulatory filings, including, but not limited to, filings with the Federal Communications Commission and the Securities and Exchange Commission that are necessary to accomplish the requirements of Paragraph II(A).

(C) TCI, LMC, and The Separate Company shall ensure that:

(1) The Separate Company's by-laws obligate The Separate Company to be bound by this order and contain provisions ensuring compliance with this order;

(2) The Separate Company's board of directors at the time of the Distribution are subject to the prior approval of the Commission;

(3) The Separate Company shall, within six (6) months of the Distribution, call a shareholder's meeting for the purpose of electing directors;

(4) No member of the board of directors of The Separate Company, both at the time of the Distribution and pursuant to any election now or at any time in the future, shall, at the time of his or her election or while serving as a director of The Separate Company, be an officer, director, or employee of TCI or LMC or shall hold, or have under his or her direction or Control, greater than one-tenth of one percent (0.1%) of the voting power of TCI and one-tenth of one percent (0.1%) of the Ownership Interest in TCI or greater than one-tenth of one percent (0.1%) of the voting power of LMC and one-tenth of one percent (0.1%) of the Ownership Interest in LMC;

(5) No officer, director or employee of TCI or LMC shall concurrently serve as an officer or employee of The Separate Company. *Provided further, that* TCI or LMC employees who are not TCI Control Shareholders or directors or officers of either Tele-Communications, Inc. or Liberty Media Corporation may provide to The Separate Company services contemplated by the attached Transition Services Agreement;

(6) The TCI Control Shareholders shall promptly exchange the shares of stock received by them in the Distribution for shares of one or more classes or series of convertible preferred stock of The Separate Company that shall be entitled to vote only on the following issues on which a vote of the shareholders of The Separate Company

is required: a proposed merger; consolidation or stock exchange involving The Separate Company; the sale, lease, exchange or other disposition of all or substantially all of The Separate Company's assets; the dissolution or winding up of The Separate Company; proposed amendments to the corporate charter or bylaws of The Separate Company; proposed changes in the terms of such classes or series; or any other matters on which their vote is required as a matter of law (except that, for such other matters, The Separate Company and the TCI Control Shareholders shall ensure that the TCI Control Shareholders' votes are apportioned in the exact ratio as the votes of the rest of the shareholders);

(7) No vote on any of the proposals listed in subparagraph (6) shall be successful unless a majority of shareholders other than the TCI Control Shareholders vote in favor of such proposal;

(8) After the Distribution, the TCI Control Shareholders shall not seek to influence, or attempt to control by proxy or otherwise, any other Person's vote of The Separate Company stock;

(9) After the Distribution, no officer, director or employee of TCI or LMC, or any of the TCI Control Shareholders shall communicate, directly or indirectly, with any officer, director, or employee of The Separate Company. *Provided, however, that* the TCI Control Shareholders may communicate with an officer, director or employee of The Separate Company when the subject is one of the issues listed in subparagraph 6 on which TCI Control Shareholders are permitted to vote, except that, when a TCI Control Shareholder seeks to initiate action on a subject listed in subparagraph 6 on which the TCI Control Shareholders are permitted to vote, the initial proposal for such action shall be made in writing. *Provided further, that* this provision does not apply to communications by TCI or LMC employees who are not TCI Control Shareholders or directors or officers of either Tele-Communications, Inc. or Liberty Media Corporation in the context of providing to The Separate Company services contemplated by the attached Transition Services Agreement or to communications relating to the possible purchase of services from TCI's and LMC's Turner-Related Businesses;

(10) The Separate Company shall not acquire or hold greater than 14.99% of the Fully Diluted Equity of Time Warner. *Provided, however, that*, if the TCI Control Shareholders reduce their collective holdings in The Separate Company to no more than one-tenth of one percent (0.1%) of the voting power of The Separate Company and one-tenth of one percent (0.1%) of the Ownership Interest in The Separate Company or reduce their collective holdings in TCI and LMC to no more than one-tenth of one percent (0.1%)

(11) The Separate Company shall not acquire or hold, directly or indirectly, any Ownership Interest in Time Warner that is entitled to exercise voting power except (a) a vote of one-one hundredth (1/100) of a vote per share owned, voting with the outstanding common stock, with respect to the election of directors and (b) with respect to proposed changes in the charter of Time Warner Inc. or of the instrument creating such securities that would (i) adversely change any of the terms of such securities or (ii) adversely affect the rights, power, or preferences of such securities. *Provided, however, that* any portion of The Separate Company's stock in Time Warner that is sold to an Independent Third Party may be converted into voting stock of Time Warner. *Provided, further, that*, if the TCI Control Shareholders reduce their collective holdings in The Separate Company to no more than one-tenth of one percent (0.1%) of the voting power of The Separate Company and one-tenth of one percent (0.1%) of the Ownership Interest in The Separate Company or reduce their collective holdings in both TCI and LMC to no more than one-tenth of one percent (0.1%) of the voting power of TCI and one-tenth of one percent (0.1%) of the Ownership Interest in TCI and one-tenth of one percent (0.1%) of the voting power of LMC and one-tenth of one percent (0.1%) of the Ownership Interest in LMC, The Separate Company's Time Warner stock may be converted into voting stock of Time Warner.

(D) TCI and LMC shall use their best efforts to obtain a private letter ruling from the Internal Revenue Service to the effect that the Distribution will be generally tax-free to both the Liberty Tracking Stock holders and to TCI under Section 355 of the Internal Revenue Code of 1986, as amended ("IRS Ruling"). Upon receipt of the IRS Ruling, TCI and LMC shall have thirty (30) days (excluding time needed to comply with the requirements of any federal securities and communications laws and regulations, provided that TCI and LMC shall use their best efforts to comply with all such laws and regulations) to carry out the requirements of Paragraph II(A) and (B). Pending the IRS Ruling, or in the event that TCI and LMC are unable to obtain the IRS Ruling,

(1) TCI, LMC, Bob Magness and John C. Malone, collectively or individually, shall not acquire or hold, directly or indirectly, an Ownership Interest that is more than the lesser of 9.2% of the Fully Diluted Equity of Time Warner or 12.4% of the actual issued and outstanding common stock of Time Warner, as determined by generally accepted accounting principles. *Provided, however, that* day-to-day market price changes that cause any such holding to exceed the latter threshold shall not be deemed to cause the parties to be in violation of this subparagraph; and

(2) TCI, LMC and the TCI Control Shareholders shall not acquire or hold any Ownership Interest in Time Warner that is entitled to exercise voting power except (a) a vote of one-one hundredth (1/100) of a vote per share owned, voting with the outstanding common stock, with respect to the election of directors and (b) with respect to proposed changes in the charter of Time Warner Inc. or of the instrument creating such securities that would (i) adversely change any of the terms of such securities or

(ii) adversely affect the rights, power, or preferences of such securities. *Provided, however, that* any portion of TCI's and LMC's Interest in Time Warner that is sold to an Independent Third Party may be converted into voting stock of Time Warner.

In the event that TCI and LMC are unable to obtain the IRS Ruling, TCI and LMC shall be relieved of the obligations set forth in subparagraphs (A), (B) and (C).

### III.

**IT IS FURTHER ORDERED** that

After the Distribution, TCI, LMC, Bob Magness and John C. Malone, collectively or individually, shall not acquire or hold, directly or indirectly, any voting power of, or other Ownership Interest in, Time Warner that is more than the lesser of 1% of the Fully Diluted Equity of Time Warner or 1.35% of the actual issued and outstanding common stock of Time Warner, as determined by generally accepted accounting principles (provided, however, that such interest shall not vote except as provided in Paragraph II(D)(2)), without the prior approval of the Commission. *Provided, further, that* day-to-day market price changes that cause any such holding to exceed the latter threshold shall not be deemed to cause the parties to be in violation of this Paragraph.

### IV.

**IT IS FURTHER ORDERED** that

(A) For six months after the Closing Date, TCI and Time Warner shall not enter into any new Programming Service Agreement that requires carriage of any Turner Video Programming Service on any analog Tier of TCI's CATVs.

(B) Any Programming Service Agreement entered into thereafter that requires carriage of any Turner Video Programming Service on TCI's CATVs on an analog Tier shall be limited in effective duration to five (5) years, except that such agreements may give TCI the unilateral right(s) to renew such agreements for one or more five-year periods.

(C) Notwithstanding the foregoing, Time Warner, Turner and TCI may enter into, prior to the Closing Date, agreements that require carriage on an analog Tier by TCI for no more than five years for each of WTBS (with the five year period to commence at the time of WTBS' conversion to Converted WTBS) and Headline News, and such agreements may give TCI the unilateral right(s) to renew such agreements for one or more five-year periods.

### V.

**IT IS FURTHER ORDERED** that

Time Warner shall not, expressly or impliedly:

(A) refuse to make available or condition the availability of HBO to any MVPD on whether that MVPD or any other MVPD agrees to carry any Turner-Affiliated Video Programming Service;

(B) condition any Carriage Terms for HBO to any MVPD on whether that MVPD or any other MVPD agrees to carry any Turner-Affiliated Video Programming Service;

(C) refuse to make available or condition the availability of each of CNN, WTBS, or TNT to any MVPD on whether that MVPD or any other MVPD agrees to carry any TWE-Affiliated Video Programming Service; or

(D) condition any Carriage Terms for each of CNN, WTBS, or TNT to any MVPD on whether that MVPD or any other MVPD agrees to carry any TWE-Affiliated Video Programming Service.

## VI.

**IT IS FURTHER ORDERED** that

(A) For subscribers that a Competing MVPD services in the Service Area Overlap, Time Warner shall provide, upon request, any Turner Video Programming Service to that Competing MVPD at Carriage Terms no less favorable, relative to the Carriage Terms then offered by Time Warner for that Service to the three MVPDs with the greatest number of subscribers, than the Carriage Terms offered by Turner to Similarly Situated MVPDs relative to the Carriage Terms offered by Turner to the three MVPDs with the greatest number of subscribers for that Service on July 30, 1996. For Turner Video Programming Services not in existence on July 30, 1996, the pre-Closing Date comparison will be to relative Carriage Terms offered with respect to any Turner Video Programming Service existing as of July 30, 1996.

(B) Time Warner shall be in violation of this Paragraph if the Carriage Terms it offers to the Competing MVPD for those subscribers outside the Service Area Overlap are set at a higher

(B) Time Warner shall not coerce any National Video Programming Vendor to provide, or retaliate against such a Vendor for failing to provide exclusive rights against any other MVPD as a condition for carriage on one or more Time Warner CATVs.

(C) Time Warner shall not engage in conduct the effect of which is to unreasonably restrain the ability of a Non-Time Warner National Video Programming Vendor to compete fairly by discriminating in video programming distribution on the basis of affiliation or nonaffiliation of Vendors in the selection, terms, or conditions for carriage of video programming provided by such Vendors.

## **VIII.**

### **IT IS FURTHER ORDERED** that

(A) Time Warner shall collect the following information, on a quarterly basis:

(1) for any and all offers made to Time Warner's corporate office by a Non-Time Warner National Video Programming Vendor to enter into or to modify any Programming Service Agreement for carriage on an Time Warner CATV, in that quarter:

a) the identity of the National Video Programming Vendor;

b) a description of the type of programming;

c) any and all Carriage Terms as finally agreed to or, when there is no final agreement but the Vendor's initial offer is more than three months old, the last offer of each side;

d) any and all commitment(s) to a roll-out schedule, if applicable, as finally agreed to or, when there is no final agreement but the Vendor's initial offer is more than three months old, the last offer of each side;

e) a copy of any and all Programming Service Agreement(s) as finally agreed to or, when there is no final agreement but the Vendor's initial offer is more than three months old, the last offer of each side; and

(2) on an annual basis for each National Video Programming Service on Time Warner CATVs, the actual carriage rates on Time Warner CATVs and

(a) the average carriage rates on all Non-Time Warner CATVs for each National Video Programming Service that has publicly-available information from which Penetration Rates can be derived; and

(b) the carriage rates on each of the fifty (50) largest (in total number of subscribers) Non-Time Warner CATVs for each National Video Programming Service that has publicly-available information from which Penetration Rates can be derived.

(B) The information collected pursuant to subparagraph (A) shall be provided to each member of TWE's Management Committee on the last day of March, June, September and December of each year. *Provided, however, that*, in the event TWE's Management Committee ceases to exist, the disclosures required in this Paragraph shall be made to any and all partners in TWE; or, if there are no partners in TWE, then the disclosures required in this Paragraph shall be made to the Audit Committee of Time Warner.

(C) The General Counsel within TWE who is responsible for CATV shall annually certify to the Commission that it believes that Time Warner is in compliance with Paragraph VII of this order.

(D) Time Warner shall retain all of the information collected as required by subparagraph (A), including information on when and to whom such information was communicated as required herein in subparagraph (B), for a period of five (5) years.

## **IX.**

### **IT IS FURTHER ORDERED** that

(A) By February 1, 1997, Time Warner shall execute a Programming Service Agreement with at least one Independent Advertising-Supported News and Information National Video Programming Service, unless the Commission determines, upon a showing by Time Warner, that



(a) By July 30, 1997, so that it is available to 10% of the Total Subscribers of all Time Warner CATVs at that time;

(b) By July 30, 1999, so that it is available to 30% of the Total Subscribers of all Time Warner CATVs at that time; and

(c) By July 30, 2001, so that it is available to 50% of the Total Subscribers of all Time Warner CATVs at that time.

(C) If, for any reason, the Independent Advertising-Supported News and Information National Video Programming Service chosen by Time Warner ceases operating or is in material breach of its Programming Service Agreement with Time Warner at any time before July 30, 2001, Time Warner shall, within six months of the date that such Service ceased operation or the date of termination of the Agreement because of the material breach, enter into a replacement Programming Service Agreement with a replacement Independent Advertising-Supported News and Information National Video Programming Service so that replacement Service is available pursuant to subparagraph (B) within three months of the execution of the replacement Programming Service Agreement, unless the Commission determines, upon a showing by Time Warner, that none of the Carriage Terms offered are commercially reasonable. Such replacement Service shall have, six months after the date the first Service ceased operation or the date of termination of the first Agreement because of the material breach, contractual commitments to supply its Service to at least 10 million subscribers on Unaffiliated MVPDs, or, together with the contractual commitments it will obtain from Time Warner, total contractual commitments to supply its Service to 15 million subscribers; if no such Service has such contractual commitments, then Time Warner may choose from among the two Services with contractual commitments with Unaffiliated MVPDs for the largest number of subscribers.

## **X.**

### **IT IS FURTHER ORDERED** that:

(A) Within sixty (60) days after the date this order becomes final and every sixty (60) days thereafter until respondents have fully complied with the provisions of Paragraphs IV(A) and IX(A) of this order and, with respect to Paragraph II, until the Distribution, respondents shall submit jointly or individually to the Commission a verified written report or reports setting forth in detail the manner and form in which they intend to comply, are complying, and have complied with Paragraphs II, IV(A) and IX(A) of this order.

(B) One year (1) from the date this order becomes final, annually for the next nine (9) years on the anniversary of the date this order becomes final, and at other times as the Commission may require, respondents shall file jointly or individually a verified written report or reports with the Commission setting forth in detail the manner and form in which they have complied and are complying with each Paragraph of this order.

**XI.**

**IT IS FURTHER ORDERED** that respondents shall notify the Commission at least thirty (30) days prior to any proposed change in respondents (other than this Acquisition) such as dissolution, assignment, sale resulting in the emergence of a successor corporation, or the creation or dissolution of subsidiaries or any other change in the corporation that may affect compliance obligations arising out of the order.

**XII.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this order, and subject to any legally recognized privilege, upon written request, respondents shall permit any duly authorized representative of the Commission:

1. Access, during regular business hours upon reasonable notice and in the presence of counsel for respondents, to inspect and copy all books, ledgers, accounts, correspondence, memoranda and other records and documents in the possession or under the control of respondents relating to any matters contained in this order; and
2. Upon five days' notice to respondents and without restraint or interference from it, to interview officers, directors, or employees of respondents, who may have counsel present, regarding such matters.

**XIII.**

**IT IS FURTHER ORDERED THAT** this order shall terminate ten (10) years from the date this order becomes final.

Signed this \_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

**TIME WARNER INC., A CORPORATION**

By: \_\_\_\_\_

Gerald M. Levin

\_\_\_\_\_  
Counsel for Time Warner Inc.

**TURNER BROADCASTING SYSTEM, INC., A CORPORATION**

By: \_\_\_\_\_

General Counsel

\_\_\_\_\_  
Counsel for Turner Broadcasting System, Inc.

**TELE-COMMUNICATIONS, INC., A CORPORATION**

By: \_\_\_\_\_

John C. Malone

\_\_\_\_\_  
Counsel for Tele-Communications, Inc.

**LIBERTY MEDIA CORPORATION, A CORPORATION**

By: \_\_\_\_\_

Vice President

\_\_\_\_\_

**FEDERAL TRADE COMMISSION**

By:

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James A. Fishkin  
Thomas N. Dahdouh  
Attorneys  
Bureau of Competition

Approved:

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Robert W. Doyle, Jr.  
Deputy Assistant Director  
Bureau of Competition

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Willard K. Tom  
Assistant Director  
Bureau of Competition

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George S. Cary  
Senior Deputy Director  
Bureau of Competition

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William J. Baer  
Director  
Bureau of Competition

Appendix I

**UNITED STATES OF AMERICA  
BEFORE FEDERAL TRADE COMMISSION**

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)  
)  
In the Matter of )  
)  
**TIME WARNER INC.,** )  
a corporation; )  
)  
**TURNER BROADCASTING** )  
**SYSTEM, INC.,** )  
a corporation; )  
)  
**TELE-COMMUNICATIONS, INC.,** )  
a corporation; and )  
)  
**LIBERTY MEDIA CORPORATION,** )  
a corporation. )  
)  
)  

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File No. 961-0004

**INTERIM AGREEMENT**

This *Interim Agreement* is by and between Time Warner Inc. ("Time Warner"), a corporation organized, existing, and doing business under and by virtue of the law of the State of Delaware, with its office and principal place of business at New York, New York; Turner Broadcasting System, Inc. ("Turner"), a corporation organized, existing, and doing business under and by virtue of the law of the State of Georgia with its office and principal place of business at Atlanta, Georgia; Tele-Communications, Inc. ("TCI"), a corporation organized, existing, and doing business under and by virtue of the law of the State of Delaware, with its office and principal place of business located at Englewood, Colorado; Liberty Media Corp. ("LMC"), a corporation organized, existing and doing business under and by virtue of the law of the State of Delaware, with its office and principal place of business located at Englewood, Colorado; and the Federal Trade Commission ("Commission"), an independent agency of the United States Government, established under the Federal Trade Commission Act of 1914, 15

U.S.C. § 41 *et seq.*

**WHEREAS**



\_\_\_\_\_

\_\_\_\_\_  
Stephen Calkins  
General Counsel

**FOR TIME WARNER INC., A CORPORATION**

By: \_\_\_\_\_  
Gerald A. Levin

\_\_\_\_\_

Counsel for Time Warner Inc.

**FOR TURNER BROADCASTING SYSTEM, INC., A CORPORATION**

By: \_\_\_\_\_  
General Counsel

\_\_\_\_\_

Counsel for Turner Broadcasting System, Inc.

**FOR TELE-COMMUNICATIONS, INC., A CORPORATION**

By: \_\_\_\_\_  
John C. Malone

\_\_\_\_\_

Counsel for Tele-Communications, Inc.



**FOR LIBERTY MEDIA CORPORATION, A CORPORATION**

By: \_\_\_\_\_

Vice President

\_\_\_\_\_

Counsel for Liberty Media Corporation

[Appendix II attached to paper copies but not available in electronic format]

**UNITED STATES OF AMERICA  
BEFORE FEDERAL TRADE COMMISSION**

	)	
In the Matter of	)	
	)	
<b>TIME WARNER INC.,</b>	)	
a corporation;	)	
	)	
<b>TURNER BROADCASTING</b>	)	
<b>SYSTEM, INC.,</b>	)	Docket No.
a corporation;	)	
	)	
<b>TELE-COMMUNICATIONS, INC.,</b>	)	
a corporation; and	)	
	)	
<b>LIBERTY MEDIA CORPORATION,</b>	)	
a corporation.	)	

**COMPLAINT**

b. "Fully Diluted Equity of Time Warner" means all Time Warner common stock actually issued and outstanding plus the aggregate number of shares of Time Warner common stock that would be issued and outstanding assuming the exercise of all outstanding options, warrants and rights (excluding shares that would be issued in the event a poison pill is triggered) and the conversion of all outstanding securities that are convertible into Time Warner common stock.

c. "Multichannel Video Programming Distributor" or "MVPD" means a person providing multiple channels of video programming to subscribers in the United States for which a fee is charged, by any of various methods including, but not limited to, cable, satellite master antenna television, multichannel multipoint distribution, direct-to-home satellite (C-band, Ku-band, direct broadcast satellite), ultra high-frequency microwave systems (sometimes called LMDS), open video systems, or the facilities of common carrier telephone companies or their affiliates, as well as buying groups or purchasing agents of all such persons.

d. "Turner Cable Television Programming Service" means each Cable Television Programming Service, whether or not satellite-delivered, that is currently owned, controlled by, or affiliated with Turner.

## II. Respondent Time Warner Inc.

2. Respondent Time Warner Inc. ("Time Warner") is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its headquarters office and principal place of business located at 75 Rockefeller Plaza, New York, New York 10019. Time Warner had sales of approximately \$8 billion in 1995.

3. Respondent Time Warner is, and at all times relevant herein has been, engaged in the sale of Cable Television Programming Services to MVPDs throughout the United States. Time Warner's primary Cable Television Programming Services include Home Box Office ("HBO") and Cinemax, and their multiplexed versions. Other Cable Television Programming Services that are controlled by or affiliated with Time Warner include E! Entertainment Television, Comedy Central, and Court TV. Time Warner also owns approximately 20 percent of the outstanding stock of Turner. Time Warner is the nation's largest producer of Cable Television Programming Services sold to MVPDs, measured on the basis of subscription revenues. Time Warner's subscription revenues from the sale of Cable Television Programming Services to MVPDs in 1995 were approximately \$1.5 billion, and its total revenues from Cable Television Programming Services in 1995 were approximately \$1.6 billion.

4. Respondent Time Warner's HBO, the largest Cable Television Programming Service measured on the basis of subscription revenues, is viewed by MVPDs as a "marquee" or "crown jewel" service, *i.e.*, those services necessary to attract and retain a significant percentage of their subscribers.

5. Respondent Time Warner is, and at all times relevant herein has been, an MVPD.

Time Warner currently serves, either directly or indirectly, approximately 11.5 million households in selected areas in the United States. These 11.5 million households are approximately 17 percent of all of the households in the United States that purchase Cable Television Programming Services from MVPDs. Time Warner is the nation's second largest MVPD. Time Warner's total revenues in 1995 from serving as an MVPD were approximately \$3.25 billion.

6. Respondent Time Warner is, and at all times relevant herein has been, engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a corporation whose business is in or affecting commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

### III. Respondent Turner Broadcasting System, Inc.

7. Respondent Turner Broadcasting System, Inc. ("Turner") is a corporation existing and doing business under and by virtue of the laws of the State of Georgia with its headquarters and principal place of business located at One CNN Center, Atlanta, Georgia 30348. Turner had sales of approximately \$3.4 billion in 1995.

8. Respondent Turner is, and at all times relevant herein has been, engaged in the sale of Cable Television Programming Services to MVPDs throughout the United States. Turner's Cable Television Programming Services include Cable News Network ("CNN"), Headline News ("HLN"), Turner Network Television ("TNT"), TBS Superstation ("WTBS"), Cartoon Network, Turner Classic Movies ("TCM"), CNN International USA ("CNNI USA"), CNN Financial Network ("CNNfn"), and services emphasizing regional sports programming. Turner is one of the nation's largest producers of Cable Television Programming Services sold to MVPDs as measured by subscription revenue. Turner's subscription revenues from the sale of Cable Television Programming Services to MVPDs in 1995 were approximately \$700 million, and its total revenues from Cable Television Programming Services in 1995 were approximately \$2 billion. As a programmer that does not own its own distribution systems, Turner had no incentive to, and generally did not, charge significantly higher prices for the same Cable Television Programming Services to new MVPD entrants compared to the prices offered to established MVPDs.

9. Respondent Turner's CNN, TNT, and WTBS are viewed by MVPDs as "marquee" or "crown jewel" services, *i.e.*, those services necessary to attract and retain a significant percentage of their subscribers.

10. Respondent Turner is, and at all times relevant herein has been, engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a corporation whose business is in or affecting commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

### IV. Respondent Tele-Communications, Inc.

11. Respondent Tele-Communications, Inc. ("TCI") is a corporation existing and doing business under and by virtue of the laws of the State of Delaware, with its headquarters and principal place of business located at 5619 DTC Parkway, Englewood, Colorado 80111. TCI had sales of approximately \$6.85 billion in 1995.

12. Respondent TCI is, and at all times relevant herein has been, engaged in the sale of Cable Television Programming Services to MVPDs throughout the United States. Some of the larger Cable Television Programming Services that are controlled by or affiliated with TCI include Starz!, Encore, Discovery Channel, The Learning Channel, Court TV, E! Entertainment Television, BET, The Family Channel, Home Shopping Network, and services emphasizing regional sports programming. TCI also owns, directly or indirectly, approximately 24 percent of the outstanding stock of Turner. TCI's subscription revenues from the sale of Cable Television Programming Services controlled by TCI to MVPDs in 1995 were approximately \$300 million. TCI's total revenues, excluding home shopping retail sales, from Cable Television Programming Services that are controlled by or affiliated with TCI in 1995 were approximately \$520 million.

13. Respondent TCI is, and at all times relevant herein has been, an MVPD. TCI currently serves approximately 14 million households in selected areas in the United States. TCI also has either direct or indirect interests in cable television systems that distribute Cable Television Programming Services to an additional approximately 4 million households in the United States. These 18 million households are approximately 27 percent of all of the households in the United States that subscribe to Cable Television Programming Services from MVPDs. TCI is the nation's largest MVPD. TCI's total revenues in 1995 from serving as an MVPD were approximately \$5 billion.

14. Respondent TCI is, and at all times relevant herein has been, engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a corporation whose business is in or affecting commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

#### V. Respondent Liberty Media Corporation

15. Respondent Liberty Media Corporation ("LMC") is a corporation existing and doing business under and by virtue of the laws of the State of Delaware, with its headquarters and principal place of business located at 8101 East Prentice Avenue, Englewood, Colorado 80111. LMC is a wholly-owned subsidiary of Respondent TCI.

16. Respondent LMC is, and at all times relevant herein has been, engaged in the sale of Cable Television Programming Services to MVPDs throughout the United States.

17. Respondent LMC is, and at all times relevant herein has been, engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a corporation whose business is in or affecting commerce as "commerce" is defined in Section 4

of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

## VI. The Agreements

18. This matter comprises three related principal agreements: (a) the acquisition by Time Warner of Turner; (b) the acquisition by TCI and LMC of an interest in Time Warner; and (c) the long-term mandatory carriage agreements between TCI, Turner, and Time Warner requiring TCI to carry Turner's CNN, Headline News, TNT, and WTBS at a discounted price based on the industry average price.

### A. The Time Warner-Turner Acquisition

19. On or about September 22, 1995, Respondent Time Warner and Respondent Turner entered into an agreement for Time Warner to acquire the approximately 80 percent of the outstanding shares in Turner that it does not already own.

20. The value of the Time Warner-Turner acquisition as of the date the Time Warner-Turner agreement was entered into was approximately \$7.5 billion. As initially structured, the transaction called for each share of Turner Class A Common Stock and Turner Class B Common Stock to be converted into the right to receive .75 of a share of New Time Warner Common Stock. In addition, each share of Turner Class C Convertible Preferred Stock was to be converted into the right to receive 4.8 shares of New Time Warner Common Stock.

### B. The TCI-Time Warner Acquisition

21. Respondents TCI and LMC have, directly or indirectly, an approximately 24 percent existing interest in Respondent Turner. By trading their interest in Turner for an interest in Time Warner, TCI and LMC would have acquired approximately a 7.5 percent interest in the Fully Diluted Equity of Time Warner, or approximately 10 percent of the outstanding shares of Time Warner, valued at approximately \$2 billion as of the date the Respondents signed the proposed consent agreement.

22. Respondent TCI also would acquire a right of first refusal on the approximately 7.4 percent interest in the Fully Diluted Equity of Time Warner that R. E. Turner, III, chairman of Turner, would receive as result of trading his interest in Turner for an interest in Respondent Time Warner. Although Time Warner has a "poison pill" that would prevent TCI from acquiring more than a certain amount of stock without triggering adverse consequences,

23. On or about September 14, 1995, and September 15, 1995, in anticipation of and contingent upon the Time Warner-Turner and TCI-Time Warner acquisitions, TCI, Turner, and Time Warner entered into two long-term mandatory carriage agreements formally referred to as the Programming Services Agreements ("PSAs"). Under the terms of these PSAs, TCI would be required, on virtually all of its cable television systems, to carry CNN, Headline News, TNT, and WTBS for a 20-year period. The price to TCI would be 85 percent of the average price paid by the rest of the industry for these services.

## VII. Trade and Commerce

24. One relevant line of commerce (*i.e.*, the product market) in which to analyze the effects of the proposed transaction is the sale of Cable Television Programming Services to MVPDs.

25. Another relevant line of commerce in which to analyze the effects of the proposed transaction is the sale of Cable Television Programming Services to households.

26. Cable Television Programming Services are a relevant line of commerce because over-the-air broadcast television, video cassette rentals, and other forms of news and entertainment do not have a sufficient price-constraining effect on the sales of Cable Television Programming Services to MVPDs, or the resale of Cable Television Programming Services by MVPDs to households so as to prevent the exercise of market power.

27. The relevant section of the country (*i.e.*, the geographic market) in which to analyze the effects of the sale of Cable Television Programming Services to MVPDs is the entire United States.

28. The entire United States is the relevant section of the country in which to analyze the effects of the proposed transactions in the sale of Cable Television Programming Services to MVPDs because most Cable Television Programming Services are distributed throughout the United States.

29. The relevant sections of the country in which to analyze the effects of the sale of Cable Television Programming Services by MVPDs to households are each of the local areas in which either Respondent Time Warner or Respondent TCI operate as MVPDs.

## VIII. Market Structure

30. The sale of Cable Television Programming Services to MVPDs in the United States is highly concentrated, whether measured by the Herfindahl-Hirschman Index (commonly referred to as "HHI") or by two-firm and four-firm concentration ratios.

31. The post-acquisition HHI for the sale of Cable Television Programming Services to



37. Respondent Time Warner faces actual and potential competition from other MVPDs and potential MVPD entrants in the sale of Cable Television Programming Services to households in each of the local areas in which it serves as an MVPD.

38. The effects of the agreements, if consummated, may be substantially to lessen competition in the relevant lines of commerce in the relevant sections of the country in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, in the following ways, among others:

- a. enabling Respondent Time Warner to increase prices on its Cable Television Programming Services sold to MVPDs, directly or indirectly (*e.g.*, by requiring the purchase of unwanted programming), through its increased negotiating leverage with MVPDs, including through conditioning purchase of one or more "marquee" or "crown jewel" channels on purchase of other channels;
- b. enabling Respondent Time Warner to increase prices on its Cable Television Programming Services sold to MVPDs by raising barriers to entry by new competitors or to repositioning by existing competitors, by preventing such rivals from achieving sufficient distribution to realize economies of scale; these effects are likely, because
  - (1) Respondent Time Warner has direct financial incentives as the post-acquisition owner of the Turner Cable Television Programming Services not to carry other Cable Television Programming Services that directly compete with the Turner Cable Television Programming Services; and
  - (2) Respondent TCI has diminished incentives and diminished ability to either carry or invest in Cable Television Programming Services that directly compete with the Turner Cable Television Programming Services because the PSA agreements require TCI to carry Turner's CNN, Headline News, TNT, and WTBS for 20 years, and because TCI, as a significant shareholder of Time Warner, will have significant financial incentives to protect all of Time Warner's Cable Television Programming Services; and
- c. denying rival MVPDs and any potential rival MVPDs of Respondent Time Warner competitive prices for Cable Television Programming Services, or charging rivals discriminatorily high prices for Cable Television Programming Services.

## XI. Violations Charged

39. The agreement entered into between Time Warner and Turner for Time Warner to acquire Turner violates Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and would, if consummated, violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45.

40. The agreement entered into between TCI, LMC, and Time Warner for TCI and LMC to acquire an equity interest in Time Warner violates Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and would, if consummated, violate Section 7

## **ANALYSIS OF PROPOSED CONSENT ORDER TO AID PUBLIC COMMENT**

### **I. Introduction**

The Federal Trade Commission has accepted for public comment from Time Warner Inc. ("Time Warner"), Turner Broadcasting System, Inc. ("Turner"), Tele-Communications, Inc. ("TCI"), and Liberty Media Corporation ("LMC") (collectively "the proposed respondents") an Agreement Containing Consent Order ("the proposed consent order"). The Commission has also entered into an Interim Agreement that requires the proposed respondents to take specific action during the public comment period.

The proposed consent order is designed to remedy likely antitrust effects arising from Time Warner's acquisition of Turner as well as related transactions, including TCI's proposed ownership interest in Time Warner and long-term cable television programming service agreements between Time Warner and TCI for post-acquisition carriage by TCI of Turner programming.

### **II. Description of the Parties, the Acquisition and Related Transactions**

Time Warner is a leading provider of cable networks and a leading distributor of cable television. Time Warner Entertainment ("TWE"), a partnership in which Time Warner holds the majority interest, owns HBO and Cinemax, two premium cable networks. Time Warner and Time Warner Cable, a subsidiary of TWE, are collectively the nation's second largest distributor of cable television and serve approximately 11.5 million cable subscribers or approximately 17 percent of U.S. cable television households.

Turner is a leading provider of cable networks. Turner owns the following “marquee” or “crown jewel” cable networks: Cable News Network ("CNN"), Turner Network Television ("TNT"), and TBS SuperStation (referred to as "WTBS"). Turner also owns Headline News (“HLN”), Cartoon Network, Turner Classic Movies, CNN International USA and CNN Financial Network.

TCI is the nation's largest operator of cable television systems, serving approximately 27 percent of all U.S. cable television households. LMC, a subsidiary of TCI, is a leading provider of cable programming. TCI also owns interests in a large number of cable networks.

In September 1995, Time Warner and Turner entered into an agreement for Time Warner to acquire the approximately 80 percent of the outstanding shares in Turner that it does not already own. TCI and LMC have an approximately 24 percent existing interest in Turner. By trading their interest in Turner for an interest in Time Warner, TCI and LMC would acquire approximately a 7.5 percent interest in the fully diluted equity of Time Warner as well as the right of first refusal on the approximately 7.4 percent interest in Time Warner that R. E. Turner, III, chairman of Turner, would receive as a result of this acquisition. Although Time Warner has a 'poison pill' that would prevent TCI from acquiring more than a certain amount of stock without triggering adverse consequences, that poison pill would still allow TCI to acquire approximately 15 percent of the Fully Diluted Equity, and if the poison pill were to be altered or waived, TCI could acquire more than 15 percent of the fully diluted equity of Time Warner. Also in September 1995, Time Warner entered into two long-term mandatory carriage agreements referred to as the Programming Service Agreements (PSAs).

Under the terms of these PSAs, TCI would be required, on virtually all of its cable television systems, to carry CNN, HLN, TNT and WTBS for a twenty-year period.

### **III. The Complaint**

The draft complaint accompanying the proposed consent order and the Interim Agreement alleges that the acquisition, along with related transactions, would allow Time Warner unilaterally to raise the prices of cable television programming and would limit the ability of cable television systems that buy such programming to take responsive action to avoid such price increases. It would do so, according to the draft complaint, both through horizontal combination in the market for cable programming (in which Time Warner, after the acquisition, would control about 40% of the market) and through higher entry barriers into that market as a result of the vertical integration (by merger and contract) between Turner's programming interests and Time Warner's and TCI's cable distribution interests. The complaint alleges that TCI and Time Warner, respectively, operate the first and second largest cable television systems in the United States, reaching nearly half of all cable households; that Time Warner would gain the power to raise prices on its own and on Turner's programming unilaterally; that TCI's ownership interest in Time Warner and concurrent long term contractual obligations to carry Turner programming would undermine TCI's incentive to sign up better or less expensive non-Time Warner programming, preventing rivals to the combined Time Warner and Turner from achieving sufficient distribution to realize economies of scale and thereby to erode Time Warner's market power; that barriers to entry into programming and into downstream retail distribution markets would be raised; and that substantial increases in wholesale programming costs for both cable systems and alternative service providers—

including direct broadcast satellite service and other forms of non-cable distribution—would lead to higher service prices and fewer entertainment and information sources for consumers.

The Commission has reason to believe that the acquisition and related transactions, if successful, may have anticompetitive effects and be in violation of Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act.

#### **IV. Terms of the Proposed Consent Order**

The proposed consent order would resolve the alleged antitrust concerns by breaking down the entry barriers that would otherwise be erected by the transaction. It would do so by: (1) requiring TCI to divest all of its ownership interests in Time Warner or, in the alternative, capping TCI's ownership of Time Warner stock and denying TCI and its controlling shareholders the right to vote any such Time Warner stock; (2) canceling the PSAs; (3) prohibiting Time Warner from bundling Time Warner's HBO with any Turner networks and prohibiting the bundling of Turner's CNN, TNT, and WTBS with any Time Warner networks; (4) prohibiting Time Warner from discriminating against rival Multichannel Video Programming Distributors ("MVPDs") in the provision of Turner programming; (5) prohibiting Time Warner from foreclosing rival programmers from access to Time Warner's distribution; and (6) requiring Time Warner to carry a 24-hour all news channel that would compete with Turner's CNN. The following sections discuss the primary provisions of the proposed consent order in more detail.

**A. TCI Will Divest Its Interest in Time Warner or Accept a Capped Nonvoting Interest**

The divestiture provision of the proposed consent order (Paragraph II) requires TCI and LMC to divest their collective ownership of approximately 7.5 percent of the fully diluted shares in Time Warner—the amount they will obtain from Time Warner in exchange for their 24 percent ownership interest in Turner—to a different company ("The Separate Company") that will be spun off by TCI and LMC. The stock of The Separate Company would be distributed to all of the shareholders of TCI's LMC subsidiary. Because that stock would be freely tradeable on an exchange, the ownership of The Separate Company would diverge over time from the ownership of the Liberty Media Tracking Stock (and would, at the outset, be different from the ownership of TCI). TCI would therefore breach its fiduciary duty to its shareholders if it forestalled programming entry that could benefit TCI as a cable system operator in order to benefit Time Warner's interests as a programmer.

following provisions that will wall off the TCI Control Shareholders from influencing the officers, directors, and employees of The Separate Company and its day-to-day operations:



- The Separate Company is prohibited from acquiring more than 14.99% of the fully diluted equity shares of Time Warner, with exceptions in the event that the TCI Control Shareholders sell their stock in The Separate Company or in TCI and LMC; and
- The Separate Company is prohibited from voting its shares (other than a *de minimis* voting share necessary for tax purposes) in Time Warner, except that such shares can become voting if The Separate Company sells them to an Independent Third Party or in the event that the TCI Control Shareholders sell their stock in The Separate Company or in TCI and LMC.

The Commission has reason to believe that the divestiture of TCI's and LMC's interest in Time Warner to The Separate Company is in the public interest. The required divestiture of the Time Warner stock by TCI and LMC and the ancillary restrictions outlined above are beneficial to consumers because (1) they would restore TCI's otherwise diminished incentives to carry cable programming that would compete with Time Warner's cable programming; and (2) they would eliminate TCI's and LMC's ability to influence the operations of Time Warner.

The proposed consent order also requires TCI and LMC to apply to the Internal Revenue Service ("IRS") for a ruling that the divestiture of TCI's and LMC's interest in Time Warner to The Separate Company would be generally tax-free. Upon receipt of the IRS Ruling, TCI and LMC has thirty days to transfer its Time Warner stock to The Separate Company. After TCI and LMC divest this interest in Time Warner to The Separate Company, TCI, LMC, Magness and Malone are prohibited from acquiring any stock in Time Warner, above a collective *de minimis* nonvoting amount, without the prior approval of the Commission.

Pending the ruling by the IRS, or in the event that the TCI and LMC are unable to obtain such an IRS ruling, (1) TCI, LMC, John C. Malone and Bob Magness, collectively and individually, are capped at level no more than the lesser of 9.2 percent of the fully diluted

equity of Time Warner or 12.4% of the actual issued and outstanding common stock of Time Warner, as determined by generally accepted accounting principles; and (2) TCI, LMC and the TCI Control Shareholders' interest in Time Warner must be nonvoting (other than a *de minimis* voting share necessary for tax purposes), unless the interest is sold to an Independent Third Party. This nonvoting cap is designed to restore TCI's otherwise diminished incentives to carry cable programming that would compete with Time Warner's cable programming as well as to prevent TCI from seeking to influence Time Warner's competitive behavior.

**B. TCI's Long-Term Carriage Agreement with Turner Is Canceled**

As part of the transaction, Time Warner and TCI entered into PSAs that required TCI to carry Turner programming for the next twenty years, at a price set at the lesser of 85% of the industry average price or the lowest price given to any distributor. According to the complaint, the PSAs would tend to prevent Time Warner's rivals from achieving sufficient distribution to threaten Time Warner's market power by locking up scarce TCI channel space for an extended period of time. By negotiating this arrangement as part of the Turner acquisition, and not at arm's length, Time Warner was able to compensate TCI for helping to achieve this result. Under the Interim Agreement, TCI and Time Warner are obligated to cancel the PSAs. Following cancellation of the PSAs, there would be a six month "cooling off" period during which Time Warner and TCI could not enter into new mandatory carriage requirements on an analog tier for Turner programming.<sup>1</sup> This cooling off period will ensure

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<sup>1</sup> Analog technology is currently used for cable programming distribution and places

that such agreements are negotiated at arm's length. Thereafter, the parties cannot enter into any agreement that would secure Time Warner guaranteed mandatory carriage rights on TCI analog channel capacity for more than five-year periods. This restriction would not prevent

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significant limitations on the addition of new channels. Digital technology, which is still in its infancy and not currently a competitive factor in video distribution, has the potential to expand capacity sixfold, thereby substantially alleviating capacity constraints on the digital tier.

**C. Time Warner is Barred From Bundling HBO with any Turner Programming and CNN, TNT and WTBS with Time Warner Programming**

Paragraph V bars Time Warner from bundling HBO with Turner channels—that is, making HBO available, or available on more favorable terms, only if the purchaser agrees to take the Turner channels. Time Warner is also barred from bundling CNN, TNT, or WTBS with Time Warner channels. This provision applies to new programming as well as existing programming. This provision is designed to address concerns that the easiest way the combined firm could exert substantially greater negotiating leverage over cable operators is by combining all or some of such “marquee” services and offering them as a package or offering them along with unwanted programming. Because the focus of the provision is on seeking to prevent the additional market power arising from this combination of programming, this provision does not prevent bundling engaged in pre-merger—that is, Turner channels with Turner channels and pre-merger Time Warner channels with Time Warner channels. Rather, it is narrowly targeted at Time Warner’s use of its newly-acquired stable of “marquee” channels to raise prices by bundling.

The Commission emphasizes that, in general, bundling often benefits customers by giving firms an incentive to increase output and serve buyers who would otherwise not obtain the product or service. The Commission, however, believes that, in the context of this transaction, the limited bar on bundling is a prudent measure that will prevent actions by Time Warner that are likely to harm competition.

**D. Time Warner is Barred from Price Discrimination Against Rival MVPDs**

Paragraph VI is designed to prevent Time Warner from using its larger stable of programming interests to disadvantage new entrants into the distribution of cable programs such as Direct Broadcast Services, wireless systems, and systems created by telephone companies. The complaint alleges that, as a programmer that does not own its own distribution, Turner pre-merger had no incentive to and did not generally charge significantly higher prices to new MVPD entrants compared to the prices offered to established MVPDs. Under the terms of Paragraph VI, the preacquisition range of pricing offered by Turner is used as a benchmark to prevent Time Warner from discriminating against the rival distributors of programming in its service areas, and Time Warner may not increase the range of pricing on Turner programming services between established MVPDs and new entrants any more than Turner had pre-merger. Because Time Warner's incentive to discriminate against MVPDs stems from an incentive to protect its own cable company from those in or entering its downstream distribution areas, this provision only covers competitors in Time Warner's distribution areas. Because the price charged by Time Warner as a programmer to Time Warner's cable systems is, to some extent, an internal transfer price, the proposed consent

ensures that Time Warner's additional market power as a result of this merger does not result in higher prices to new MVPD entrants, while it narrowly protects only those new entrants that Time Warner may have an incentive to harm.

**E. Conduct and Reporting Requirements Designed to Ensure that Time Warner Cable Does Not Discriminatorily Deny Carriage to Unaffiliated Programmers**

The order has two main provisions designed to address concerns that this combination increases Time Warner's incentives to disadvantage unaffiliated programmers in making carriage decisions for its own cable company. Paragraph VII, drawn from statutory provisions in the 1992 Cable Act, is designed to prevent Time Warner from discriminating in its carriage decisions so as to exclude or substantially impair the ability of an unaffiliated national video programmer to enter into or to compete in the video programming market. The Commission views these provisions as working in tandem with the collection and reporting requirements contained in Paragraph VIII. Under that paragraph, Time Warner is required to collect and maintain information about programming offers received and the disposition of those offers as well as information comparing Time Warner cable systems' carriage rates to carriage rates on other MVPDs for national video programming services. Such information would be reported on a quarterly basis to the management committee of TWE. TWE's management committee includes representatives of U S West since U S West is a minority partner in TWE. TWE owns or operates all of Time Warner's cable systems. Because U S West's incentives would be to maximize return to TWE's cable systems rather than to Time Warner's wholly owned programming interests, it would have strong incentives to alert the Commission to actions by Time Warner that favored Time Warner's wholly owned programming interests at the expense of Time Warner cable systems' profitability. Such information would also be available for



provision by carrying a channel not currently carried by Time Warner. This shorter period is possible in the former case because, to the extent that Time Warner is already committed to carry the channel on a portion of Time Warner's systems, less additional capacity would need to be found in order to achieve the required penetration. On the other hand, the longer period if a new news service is selected assures that an existing news service or other service need not be displaced to make room for the new service.

This provision was crafted so as to give Time Warner flexibility in choosing a new news channel, without undermining the Commission's competitive concern that the chosen service have the opportunity to become a strong competitor to CNN. To ensure that the competing news channel is competitively significant, the order obligates Time Warner to choose a news service that will have contractual commitments with unaffiliated cable operators to reach 10 million subscribers by February 1, 1997. Together with Time Warner's commitments required by the proposed order, such a service would have commitments for a total of approximately 15 million subscribers. In the alternative, Time Warner could take a service with a smaller unaffiliated subscriber base, if it places the service on more of its own systems in order to assure that the service's total subscribers would reach 15 million. In order to attract advertisers and become a competitive force, a news service must have a critical mass of subscribers. The thresholds contained in this order give Time Warner flexibility while ensuring that the service selected has enough subscribers to have a credible opportunity to become an effective competitor. The



February 1, 1997, date was selected so as to give competitive news services an opportunity to achieve the required number of subscribers.

Accordingly, this provision should not interfere with Time Warner's plans to carry programming of its choosing or unduly involve the Commission in Time Warner's choice of a new service. It is analogous to divestiture of one channel on some cable systems and is thus far less burdensome to Time Warner than the typical antitrust remedy which would require that Time Warner divest some or all of cable systems in their entirety. The Commission, however, recognizes that this provision is unusual and invites public comment on the appropriateness of such a requirement.

#### **V. Opportunity for Public Comment**

The proposed consent order has been placed on the public record for 60 days for reception of comments from interested persons. Comments received during this period will become part of the public record. After 60 days, the Commission will again review the agreement and comments received, and will decide whether it should withdraw from the agreement or make final the order contained in the agreement.

By accepting the consent order subject to final approval, the Commission anticipates that the competitive problems alleged in the complaint will be resolved. The purpose of this analysis is to invite and facilitate public comment concerning the consent order. It is not intended to constitute an official interpretation of the agreement and proposed order or in any way to modify their terms.

**Separate Statement of Chairman Pitofsky, and  
Commissioners Steiger and Varney**

**In the Matter of**

**Time Warner Inc.  
File No. 961-0004**

The proposed merger and related transactions among Time Warner, Turner, and TCI involve three of the largest firms in cable programming and delivery -- firms that are actual or potential competitors in many aspects of their businesses. The transaction would have merged the first and third largest cable programmers (Time Warner and Turner). At the same time it would have further aligned the interests of TCI and Time Warner, the two largest cable distributors. Finally, the transaction as proposed would have greatly increased the level of vertical integration in an industry in which the threat of foreclosure is both real and substantial.<sup>1</sup> While the transaction posed complicated and close questions of antitrust enforcement, the conclusion of the dissenters that there was no competitive problem at all is difficult to understand.

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<sup>1</sup> Both Congress and the regulators have identified problems with the effects of vertical foreclosure in this industry. See generally James W. Olson and Lawrence J. Spiwak, Can Short-term Limits on Strategic Vertical Restraints Improve Long-term Cable Industry Market Performance?, 13 Cardozo Arts & Entertainment Law Journal 283 (1995). Enforcement action in this case is wholly consistent with the goals of Congress in enacting the 1992 Cable Act: providing greater access to programming and promoting competition in local cable markets.

Many of the concerns raised in the dissenting Commissioners statements are carefully addressed in the analysis to aid public comment. We write to clarify our views on certain specific issues raised in the dissents.

Product market. The dissenting Commissioners suggest that the product market alleged, "the sale of Cable Television Programming Services to MVPDs (Multichannel Video Programming Distributors)," cannot be sustained. The facts suggest otherwise. Substantial evidence, confirmed in the parties' documents and testimony, as well as documents and sworn statements from third-parties, indicated the existence of an all cable television market. Indeed, there was significant evidence of competitive interaction in terms of carriage, promotions and marketing support, subscriber fees, and channel position between different segments of cable programming, including basic and premium channel

definition, which would segregate offerings into basic and premium cable programming markets.

Entry. Although we agree that entry is an important factor, we cannot concur with Commissioner Azcuenaga's overly generous view of entry conditions in this market. While new program channels have entered in the past few years, these channels have not become competitively significant. None of the channels that has entered since 1991 has acquired more than a 1% market share.

Moreover, the anticompetitive effects of this acquisition would have resulted from one firm's control of several marquee channels. In that aspect of the market, entry has proven slow and costly. The potential for new entry in basic services cannot guarantee against competitive harm. To state the matter simply, the launch of a new "Billiards Channel," "Ballet Channel," or the like will barely make a ripple on the shores of the marquee channels through which Time Warner can exercise market power.

Technology. Commissioner Azcuenaga also seems to suggest that the Commission has failed to recognize the impact of significant technological changes in the market, such as the emergence of new delivery systems such as direct broadcast satellite networks ("DBS").<sup>2</sup> We agree that these alternative technologies may someday become a significant

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<sup>2</sup> DBS providers are included as participants in the relevant product market.

competitive force in the market. Indeed, that prospect is one of the reasons the Commission has acted to prevent Time Warner from being able to disadvantage these competitors by discriminating in access to programming.

But to suggest that these technologies one day may become more widespread does not mean they currently are, or in the near future will be, important enough to defeat anticompetitive conduct. Alternative technologies such as DBS have only a small foothold in the market, perhaps a 3% share of total subscribers. Moreover, DBS is more costly and lacks the carriage of local stations. It seems rather unlikely that the emerging DBS technology is sufficient to prevent the competitive harm that would have arisen from this transaction.

Horizontal competitive effects. Although Commissioner

concern from participants in all segments of the market about the potential anticompetitive effects of this merger.

One of the most frequent concerns expressed was that the merger heightens the already formidable entry barriers into programming by further aligning the incentives of both Time Warner and TCI to deprive entrants of sufficient distribution outlets to achieve the necessary economies of scale. The proposed order addresses the impact on entry barriers as follows. First, the prohibition on bundling would deter Time Warner from using the practice to compel MVPDs to accept unwanted channels which would further limit available channel capacity to non-Time Warner programmers. Second, the conduct and reporting requirements in paragraphs VII and VIII provide a mechanism for the Commission to become aware of situations where Time Warner discriminates in handling carriage requests from programming rivals.

Third, the proposed order reduces entry barriers by eliminating the programming service agreements (PSAs), which would have required TCI to carry certain Turner networks until 2015, at a price set at the lower of 85% of the industry average price or the lowest price given to any other MVPD. The PSAs would have reduced the ability and incentives of TCI to handle programming from Time Warner's rivals. Channel space on cable systems is scarce. If the PSAs effectively locked up significant channel space on TCI, the ability of rival programmers to enter would have been

harmed. This effect would have been exacerbated by the unusually long duration of the agreement and the fact that TCI would have received a 15% discount over the most favorable price given to any other MVPD. Eliminating the twenty-year PSAs and restricting the duration of future contracts between TCI and Time Warner would restore TCI's opportunities and incentives to evaluate and carry non-Time Warner programming.

We believe that this remedy carefully restricts potential anticompetitive practices, arising from this acquisition, that would have heightened entry barriers.

Vertical foreclosure. The complaint alleges that post-acquisition Time Warner and TCI would have the power to: (1) foreclose unaffiliated programming from their cable systems to protect their programming assets; and (2) disadvantage competing MVPDs, by engaging in price discrimination. Commissioner Azcuenaga contends that Time Warner and TCI lack the incentives and the ability to engage in either type of foreclosure. We disagree.

First, it is important to recognize the degree of vertical integration involved. Post-merger Time Warner alone would control more than 40% of the programming assets (as measured by subscriber revenue obtained by MVPDs). Time Warner and TCI, the nation's two largest MVPDs, control access to about 44% of all cable subscribers. The case law

have found that these levels of concentration can be problematic.<sup>3</sup>

Second, the Commission received evidence that these foreclosure threats were real and substantial. There was clearly reason to believe that this acquisition would increase the incentives to engage in this foreclosure without remedial action. For example, the launch of a new channel that could achieve marquee status would be almost impossible without distribution on either the Time Warner or TCI cable systems. Because of the economies of scale involved, the successful launch of any significant new channel usually requires distribution on MVPDs that cover 40-60% of subscribers.

Commissioner Starek suggests that we need not worry about foreclosure because there are sufficient number of unaffiliated programmers and MVPDs so that each can survive by entering into contracts. With all due respect, this view ignores the competitive realities of the marketplace. TCI and Time Warner are the two largest MVPDs in the U.S. with market shares of 27% and 17% respectively.<sup>4</sup> Carriage on one or both systems is critical for new programming to achieve

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<sup>3</sup> See Ash Grove Cement Co. v. FTC, 577 F.2d 1368 (9th Cir. 1978); Mississippi River Corp. v. FTC, 454 F.2d 1083 (8th Cir. 1972); United States Steel Corp. v. FTC, 426 F.2d 592 (6th Cir. 1970); see generally Herbert Hovenkamp, Federal Antitrust Policy § 9.4 (1994).

<sup>4</sup> They are substantially larger than the next largest MVPD, Continental, which has an approximately 6% market share.



competitive viability. Attempting to replicate the coverage of these systems by lacing together agreements with the large number of much smaller MVPDs is costly and time consuming.<sup>5</sup> The Commission was presented with evidence that denial of coverage on the Time Warner and TCI systems could further delay entry of potential marquee channels for several years.

TCI ownership of Time Warner. Commissioner Azcuenaga suggests that TCI's potential acquisition of a 15% interest in Time Warner, with the prospect of acquiring up to 25% without further antitrust review, does not pose any competitive problem. We disagree. Such a substantial ownership interest, especially in a highly concentrated market with substantial vertically interdependent relationships and high entry barriers, poses significant competitive concerns.<sup>6</sup> In particular, the interest would give TCI greater incentives to disadvantage programmer competitors of Time Warner; similarly it would increase Time Warner's incentives to disadvantage MVPDs that compete with TCI. The Commission's remedy would eliminate these

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<sup>5</sup> See U.S. Department of Justice Horizontal Merger Guidelines, ¶13,103 Trade Cas. (CCH) at 20,565-66, §§ 4.2, 4.21 (June 14, 1984), incorporated in U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, ¶13,104 Trade Cas. (CCH) (April 7, 1992).

<sup>6</sup> See United States v. dupont de Nemours & Co., 353 U.S. 586 (1957); F & M Schaefer Corp. v. C. Schmidt & Sons, Inc., 597 F.2d 814, 818-19 (2d Cir. 1979); Gulf & Western Indus. v. Great Atlantic & Pacific Tea Co., 476 F.2d 687 (2d Cir. 1973).

incentives to act anticompetitively by making TCI's interest truly passive.

Efficiencies. Finally, Commissioner Azcuenaga seems to suggest that the acquisition may result in certain efficiencies in terms of "more and better programming options" and "reduced transactions costs." There was little or no evidence presented to the Commission to suggest that these efficiencies were likely to occur.

**DISSENTING STATEMENT OF COMMISSIONER MARY L. AZCUENAGA**

in Time Warner Inc., File No. 961-0004

The Commission today accepts for public comment a proposed consent agreement to settle allegations that the proposed acquisition by Time Warner Inc. (Time Warner) of Turner Broadcasting System, Inc. (Turner), and related agreements with Tele-Communications, Inc. (TCI),<sup>1</sup> would be unlawful. Alleging that this transaction violates the law is possible only by abandoning the rigor of the Commission's usual analysis under Section 7 of the Clayton Act. To reach this result, the majority adopts a highly questionable market definition, ignores any consideration of efficiencies and blindly assumes difficulty of entry in the antitrust sense in the face of overwhelming evidence to the contrary. The decision of the majority also departs from more general principles of antitrust law by favoring competitors over competition and contrived theory over facts.

The usual analysis of competitive effects under the law, unlike the apparent analysis of the majority, would take full account of the swirling forces of innovation and technological advances in this dynamic industry. Unfortunately, the complaint

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<sup>1</sup> Liberty Media Corporation, a wholly-owned subsidiary of TCI, also is named in the complaint and order. For simplicity, references in this statement to TCI include Liberty.

and the underlying theories on which the proposed order is based do not begin to satisfy the rigorous standard for merger analysis that this agency has applied for years. Instead, the majority employs a looser standard for liability and a regulatory order that threatens the likely efficiencies from the transaction. Having found no reason to relax our standards of analysis for this case, I cannot agree that the order is warranted.

### **Product Market**

We focus in merger analysis on the likelihood that the transaction will create or enhance the ability to exercise market power, i.e., raise prices. The first step usually is to examine whether the merging firms sell products that are substitutes for one another to see if there is a horizontal competitive overlap. This is important in a case based on a theory of unilateral anticompetitive effects, as this one is, because according to the merger guidelines, the theory depends on the factual assumption that the products of the merging firms are the first and second choices for consumers.<sup>2</sup>

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<sup>2</sup> 1992 Horizontal Merger Guidelines ¶ 2.2. The theory is that when the post-merger firm raises the price on product A or on products A and B, sales lost due to the price increase on the first-choice product (A) will be diverted to the second-choice product (B). The price increase is unlikely to be profitable unless a significant share of consumers regard the products of the merged firm as their first and second choices.

In this case, it could be argued that from the perspective of cable system operators and other multichannel video program

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<sup>3</sup> Complaint ¶ 24.

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<sup>4</sup> Complaint ¶¶ II.4 & III.9. To the extent that each network (CNN and HBO) is viewed as "necessary" to attract subscribers, as alleged in the complaint, each would appear to have market power quite independent of the proposed transaction and of each other.

<sup>5</sup> If the market includes premium cable channels, it probably ought also to include video cassette rentals, which

horizontal overlaps warranting enforcement action in any other cable programming market.<sup>6</sup> Under these circumstances, it would seem appropriate to withdraw the proposed complaint.

### **Entry**

The proposed complaint alleges that entry is difficult and unlikely.<sup>7</sup> This is an astonishing allegation, given the amount of entry in the cable programming market. The number of cable programming services increased from 106 to 129 in 1995, according to the FCC.<sup>8</sup> One source reported thirty national 24-hour channels expected to launch this year,<sup>9</sup> and another recently identified seventy-three networks "on the launch pad" for 1996.<sup>10</sup> That adds up to between fifty-three and ninety-six new and announced networks in two years. Another source listed 141 national 24-hour cable networks launched or announced between

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<sup>6</sup> In the two product markets most likely to be sustained under the law, basic cable services and premium cable services, the transaction falls within safe harbors described in the 1992 Merger Guidelines.

<sup>7</sup> Complaint ¶¶ 33-35.

<sup>8</sup> FCC Report ¶ 10.

<sup>9</sup> National Cable Television Association, Cable Television Developments 103-17 (Fall 1995).

<sup>10</sup> "On the Launch Pad," Cable World, April 29, 1996, at 143; see also Cablevision, Jan. 22, 1996, at 54 (98 announced services with expected launches in 1996).

January 1993 and March 1996.<sup>11</sup>

This does not mean that entry is easy or inexpensive. Not all the channels that have announced will launch a service, and not all those that launch will succeed.<sup>12</sup> But some of them will. Some recent entrants include CNNfn (December 1995), Nick at Nite (April 1996), MS/NBC (July 1996) and the History Channel (January 1995).<sup>13</sup> The Fox network plans to launch a third 24-hour news channel, and Westinghouse and CBS Entertainment recently announced that they will launch a new entertainment and information cable channel, Eye on People, in March 1997.<sup>14</sup> The fact of so much ongoing entry indicates that entry should be regarded as virtually immediate.

New networks need not be successful or even launched before they can exert significant competitive pressure. Announced launches can affect pricing immediately. The launch of MS/NBC

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<sup>11</sup> "A Who's Who of New Nets," Cablevision, April 15, 1996 (Special Supp.) at 27A-44A (as of March 28, 1996, 163 new networks when regional, pay-per-view and interactive services are included).

<sup>12</sup> "The stamina and pocket-depth of backers of new players [networks] still remain key factors for survival. However, distribution is still the name of the game." Cablevision, April 15, 1996 (Special Supp.), at 3A.

<sup>13</sup> Carter, "For History on Cable, the Time Has Arrived," N.Y. Times, May 20, 1996, at D1. The article reported that the History Channel began in January 1995 with one million subscribers, reached 8 million subscribers by the end of the year and by May 1996 was seen in 18 million homes.

<sup>14</sup> Carmody, "The TV Channel," The Washington Post, Aug. 21, 1996, at D12.



and the announcement of Fox's cable news channel already may have affected the incumbent all-news channel, CNN, because cable system operators can credibly threaten to switch to one of the new news networks in negotiations to renew CNN.<sup>15</sup>

Any constraint on cable channel capacity does not appear to be deterring entry of new networks. Indeed, the amount of entry that is occurring apparently reflects confidence that channel capacity will expand, for example, by digital technology. In addition, alternative MVPDs, such as Direct Broadcast Satellite (DBS), may provide a launching pad for new networks.<sup>16</sup> For example, CNNfn was launched in 1995 with 4 to 5 million households, divided between DBS and cable.

Nor should we ignore significant technological changes in video distribution that are affecting cable programming. One such change is the development and commercialization of new distribution methods that can provide alternatives for both cable programmers and subscribers. DBS is one example. With digital capability, DBS can provide hundreds of channels to subscribers. By September 1995, DBS was available in all forty-eight

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<sup>15</sup> This is the kind of competition we would expect to see between cable networks that are substitutes for one another and the kind of competition that is non-existent between CNN and HBO.

<sup>16</sup> The entry of alternative MVPD technologies may put competitive pressure on cable system operators to expand capacity more quickly. See "The Birth of Networks," Cablevision (Special Supp. April 15, 1996), at 8A (cable system operators "don't want DBS and the telcos to pick up the services of tomorrow while they are being overly arrogant about their capacity").

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<sup>17</sup> FCC Report ¶ 49.

<sup>18</sup> DBS Digest, Aug. 22, 1996 (<http://www.dbsdish.com/dbsdata.html> (Sept. 5, 1996)).

<sup>19</sup> See Breznick, "Crowded Skies," Cable World (April 29, 1996) (<http://www.mediacentral.com/magazines/CableWorld/News96/>

Communications (The Discovery Channel) has announced that it will launch four new programming services designed for digital boxes in time for TCI's "digital box rollout" this fall.<sup>22</sup> (Even without digital service, cable systems have continued to upgrade their capacity; in 1994, about 64% of cable systems offered thirty to fifty-three channels, and more than 14% offered fifty-four or more channels.<sup>23</sup>) Local telephone companies have entered as distributors via video dialtone, MMDS<sup>24</sup> and cable systems, and the telcos are exploring additional ways to enter video distribution markets. Digital compression and advanced television technologies could make it possible for multiple programs to be broadcast over a single over-the-air broadcast channel.<sup>25</sup> When these developments will be fully realized is open to debate, but it is clear that they are on the way and

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<sup>22</sup> Katz, "Discovery Goes Digital," Multichannel News Digest, Sept. 3, 1996 ("The new networks . . . will launch Oct. 22 in order to be included in Tele-Communications Inc.'s digital box rollout in Hartford, Conn.") (<http://www.multichannel.com/digest.htm> (Sept. 5, 1996)).

<sup>23</sup> FCC Report at B-2 (Table 3).

<sup>24</sup> MMDS stands for multichannel multipoint distribution service, a type of wireless cable. See FCC Report at ¶¶ 68-85. Industry observers project that MMDS will serve more than 2 million subscribers in 1997 and grow more than 280% between 1995 and 1998. FCC Report ¶ 71.

<sup>25</sup> FCC Report ¶ 116.

affecting competition. According to one trade association official, cable operators are responding to competition by "upgrading their infrastructures with fiber optics and digital compression technologies to boost channel capacity . . . .

What's more, cable operators are busily trying to polish their images with a public that has long registered gripes over pricing, customer service and programming choice."<sup>26</sup>

Ongoing entry in programming suggests that no program seller could maintain an anticompetitive price increase and, therefore, there is no basis for liability under Section 7 of the Clayton Act. Changes in the video distribution market will put additional pressure on both cable systems and programming providers to be competitive by providing quality programming at reasonable prices. The quality and quantity of entry in the industry warrants dismissal of the complaint.

#### **Horizontal Theory of Liability**

The proposed complaint alleges that Time Warner will be able to exploit its ownership of HBO and the Turner basic channels by "bundling" Turner networks with HBO, that is, by selling them as a package.<sup>27</sup> As a basis for liability in a merger case, this

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<sup>26</sup> Pendleton, "Keeping Up With Cable Competition," Cable World, April 29, 1996, at 158.

<sup>27</sup> Complaint ¶ 38a.

appears to be without precedent.<sup>28</sup> Bundling is not always anticompetitive, and one problem with the theory is that we cannot predict when it will be anticompetitive.<sup>29</sup> Bundling can be used to transfer market power from the "tying" product to the "tied" product, but it also is used in many industries as a means of discounting. Popular cable networks, for example, have been sold in a package at a discount from the single product price. This can be a way for a programmer to encourage cable system

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<sup>28</sup> Cf. Heublein, Inc., 96 F.T.C. 385, 596-99 (1980) (rejecting a claim of violation based on leveraging).

<sup>29</sup> See Whinston, "Tying, Foreclosure, and Exclusion," 80 Am. Econ. Rev. 837, 855-56 (1990) (tying can be exclusionary, but "even in the simple models considered [in the article], which ignore a number of other possible motivations for the practice, the impact of this exclusion on welfare is uncertain. This fact, combined with the difficulty of sorting out the leverage-based instances of tying from other cases, makes the specification of a practical legal standard extremely difficult.").

such conduct appears to fall short of the "reasonable probability" standard under Section 7 of the Clayton Act. We do not seek to enjoin mergers on the mere possibility that firms in the industry may later choose to engage in unlawful conduct. It is difficult to imagine a merger that could not be enjoined if "mere possibility" of unlawful conduct were the standard. Here, the likelihood of anticompetitive effects is even more removed, because tying, the conduct that might possibly occur, in turn might or might not prove to be unlawful. Second, anticompetitive tying is unlawful, and Time Warner would face private law suits and agency enforcement action for such conduct.

The proposed remedy for the alleged bundling is to prohibit it,<sup>30</sup> with no attempt to distinguish efficient bundling from anticompetitive bundling.<sup>31</sup> Assuming liability on the basis of an anticompetitive horizontal overlap, the obvious remedy would be to enjoin the transaction or require the divestiture of HBO. Divestiture is a simple, easily reviewable and complete remedy for an anticompetitive horizontal overlap. The weakness of the Commission's case seems to be the only impediment to imposing that remedy here.

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<sup>30</sup> Order ¶ V.

<sup>31</sup> Although the proposed order would permit any bundling that Time Warner or Turner could have implemented independently before the merger, the reason for this distinction appears unrelated to distinguishing between pro- and anti-competitive bundling.

### Vertical Theories

The complaint also alleges two vertical theories of competitive harm. The first is foreclosure of unaffiliated

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<sup>32</sup> Complaint ¶ 38b.

<sup>33</sup> Complaint ¶ 38c.

this transaction improbable.

The foreclosure theory also is inconsistent with the incentives of the market. Cable system operators want more and better programming, to woo and win subscribers. To support their cable systems, Time Warner and TCI must satisfy their subscribers by providing programming that subscribers want at reasonable prices. Given competing distributors and expanding channel capacity, neither of them likely would find it profitable to attempt to exclude new programming.

TCI as a shareholder of Time Warner, as the transaction has been proposed to us (with a minority share of less than 10%), would have no greater incentive than it had as a 23% shareholder of Turner to protect Turner programming from competitive entry. Indeed, TCI's incentive to protect Turner programming would appear to be diminished.<sup>34</sup> If TCI's interest in Time Warner increased, it stands to reason that TCI's interest in the well-being of the Turner networks also would increase. But it is important to remember that TCI's principal source of income is its cable operations, and its share of Time Warner profits from Turner programming would be insufficient incentive for TCI to jeopardize its cable business.<sup>35</sup> It may be that TCI could

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<sup>34</sup> Turner programming would account for only part of TCI's interest in Time Warner.

<sup>35</sup> Even if its share of Time Warner were increased to 18%, TCI's interest in the combined Time Warner/Turner cash flow would be only slightly greater than TCI's pre-transaction interest in



acquire an interest in Time Warner that could have anticompetitive consequences, but the Commission should analyze that transaction when and if TCI increases its holdings. The divestiture requirement imposed by the order<sup>36</sup> is not warranted at this time.

Another aspect of the foreclosure theory alleged in the complaint is a carriage agreement (programming service agreement or PSA) between TCI and Turner. Under the PSA, TCI would carry certain Turner networks for twenty years, at a discount from the average price at which Time Warner sells the Turner networks to other cable operators. The complaint alleges that TCI's obligations under the PSA would diminish its incentives and ability to carry programming that competes with Turner programming,<sup>37</sup> which in turn would raise barriers to entry for unaffiliated programming. The increased difficulty of entry, so the theory goes, would in turn enable Time Warner to raise the price of Turner programming sold to cable operators and other MVPDs. It is hard to see that the PSA would have anticompetitive effects. TCI already has contracts with Turner that provide for mandatory carriage of CNN and TNT, and TCI is likely to continue

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Turner cash flow, and it would still amount to only an insignificant fraction of the cash flow generated by TCI's cable operations.

<sup>36</sup> Order ¶¶ II & III.

<sup>37</sup> Complaint ¶ 38b(2).

to carry these programming networks for the foreseeable future.<sup>38</sup> The current agreements do not raise antitrust issues, and the PSA raises no new ones. Any theoretical bottleneck on existing systems would be even further removed by the time the carriage requirements under the PSA would have become effective (when existing carriage commitments expire), because technological changes will have expanded cable channel capacity and alternative MVPDs will have expanded their subscribership. The PSA could even give TCI incentives to encourage the entry of new programming to compete with Time Warner's programming and keep TCI's costs down.<sup>39</sup> The PSA would have afforded Time Warner long term carriage for the Turner networks, given TCI long term programming commitments with some price protection, and eliminated the costs of renegotiating a number of existing Turner/TCI carriage agreements as they expire. These are efficiencies. No compelling reason has been advanced for requiring that the carriage agreement be cancelled.<sup>40</sup>

In addition to divestiture by TCI of its Time Warner shares

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<sup>38</sup> Cable system operators like to keep their subscribers happy, and subscribers do not like to have popular programming cancelled.

<sup>39</sup> Under the "industry average price" provision of the PSA, Time Warner could raise price to TCI by increasing the price it charges other MVPDs. TCI could encourage entry to defeat any attempt by Time Warner to increase price.

<sup>40</sup> See Order ¶ IV. There would appear to be even less justification for cancelling the PSA after TCI has been required either to divest or to cap its shareholdings in Time Warner.

and cancellation of the TCI/Turner carriage agreement, the proposed remedies for the alleged foreclosure include:

(1) antidiscrimination provisions by which Time Warner must abide in dealing with program providers;<sup>41</sup> (2) recordkeeping requirements to police compliance with the antidiscrimination provision;<sup>42</sup> and (3) a requirement that Time Warner carry "at least one Independent Advertising-Supported News and Information National Video Programming Service."<sup>43</sup> These remedial provisions are unnecessary, and they may be harmful.

Paragraph VII of the proposed order, the antidiscrimination provision, seeks to protect unaffiliated programming vendors from exploitation and discrimination by Time Warner. The order provision is taken almost verbatim from a regulation of the Federal Communications Commission.<sup>44</sup> It is highly unusual, to say the least, for an order of the FTC to require compliance with a law enforced by another federal agency, and it is unclear what expertise we might bring to the process of assuring such compliance. Although a requirement to obey existing law and FCC regulations may not appear to burden Time Warner unduly, the additional burden of complying with the FTC order may be costly

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<sup>41</sup> Order ¶ VII.

<sup>42</sup> Order ¶ VIII.

<sup>43</sup> Order ¶ IX.

<sup>44</sup> See 47 C.F.R. § 76.1301(a)-(c).

for both Time Warner and the FTC. In addition to imposing extensive recordkeeping requirements,<sup>45</sup> the order apparently would create another forum for unhappy programmers, who could seek to instigate an FTC investigation of Time Warner's compliance with the order, instead of or in addition to citing the same conduct in a complaint filed with and adjudicated by the FCC.<sup>46</sup> The burden of attempting to enforce compliance with FCC regulations is one that this agency need not and should not assume.

Paragraph IX of the proposed order requires Time Warner to carry an independent all-news channel (presumably MS/NBC or the anticipated Fox all-news channel). This requirement is entirely

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<sup>45</sup> The recordkeeping requirement may simply replicate an FCC requirement and perhaps impose no additional costs on Time Warner.

<sup>46</sup> See 47 C.F.R. § 76.1302. The FCC may mandate carriage and impose prices, terms and other conditions of carriage.

<sup>47</sup> Even in New York City, undoubtedly an important media market, available data indicate that Time Warner apparently serves only about one-quarter of cable households. See Cablevision, May 13, 1996, at 57; April 29, 1996, at 131 (Time Warner has about 1.1 million subscribers in New York, which has about 4.5 million cable households). We do not have data about alternative MVPD subscribers in the New York area.

a monopolist but is one of many cable programming services in the all-programming market alleged in the complaint. Clearly, CNN also is one of many sources of news and information readily available to the public, although this is not a market alleged in the complaint. Antitrust law, properly applied, provides no justification whatsoever for the government to help establish a competitor for CNN. Nor is there any apparent reason, other than the circular reason that it would be helpful to them, why Microsoft, NBC, or Rupert Murdoch's Fox needs a helping hand from the FTC in their new programming endeavors. CNN and other program networks did not obtain carriage mandated by the FTC when they launched; why should the Commission now tilt the playing field in favor of other entrants?

### **Price Discrimination**

The complaint alleges that Time Warner could discriminatorily raise the prices of programming services to its MVPD rivals,<sup>48</sup> presumably to protect its cable operations from competition. This theory assumes that Time Warner has market power in the all-cable programming market. As discussed above, however, there are reasons to think that the alleged all-cable programming market would not be sustained, and entry into cable programming is widespread and, because of the volume of entry,

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<sup>48</sup> Complaint ¶ 38c.

immediate. Under those circumstances, it appears not only not likely but virtually inconceivable that Time Warner could sustain any attempt to exercise market power in the all-cable programming market.

Whatever the merits of the theory in this case, however, discrimination against competing MVPDs in price or other terms of sale of programming is prohibited by federal statute<sup>49</sup> and by FCC regulations,<sup>50</sup> and the FCC provides a forum to adjudicate complaints of this nature. Unfortunately, the majority is not content to leave policing of telecommunications to the FCC.

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<sup>49</sup> 47 U.S.C.A. § 548.

<sup>50</sup> 47 C.F.R. §§ 76.1000 - 76.1002.

Paragraph VI of the proposed order addresses the alleged violation in the following way: (1) it requires Time Warner to provide Turner programming to competing MVPDs on request; and (2) it establishes a formula for determining the prices that Time Warner can charge MVPDs for Turner programming in areas in which Time Warner cable systems and the MVPDs compete. The provision is inconsistent with two antitrust principles: Antitrust traditionally does not impose a duty to deal absent monopoly, which does not exist here, and antitrust traditionally has not viewed price regulation as an appropriate remedy for market power. Indeed, price regulation usually is seen as antithetical to antitrust.

Although Paragraph VI ostensibly has the same nondiscrimination goal as federal telecommunications law and FCC regulations, the bright line standard in the proposed order for determining a nondiscriminatory price fails to take account of the circumstances Congress has identified in which price differences could be justified, such as, for example, cost differences, economies of scale or "other direct and legitimate economic benefits reasonably attributable to the number of subscribers serviced by the distributor."<sup>51</sup> These are significant omissions, particularly for an agency that has taken pride in its mission to prevent unfair methods of competition.

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<sup>51</sup> 47 U.S.C.A. § 548(c)(2)(B)(i)-(iii).

There is no apparent reason or authority for creating this exception to a congressional mandate. To the extent that the proposed order creates a regulatory scheme different from that afforded by the FCC, disgruntled MVPDs may find it to their advantage to seek sanctions against Time Warner at the FTC.<sup>52</sup> This is likely to be costly for the FTC and for Time Warner, and the differential scheme of regulation also could impose other, unforeseen costs on the industry.

### **Efficiencies**

As far as I can tell, the proposed consent order entirely ignores the likely efficiencies of the proposed transaction. The potential vertical efficiencies include more and better programming options for consumers and reduced transaction costs for the merging firms. The potential horizontal efficiencies include savings from the integration of overlapping operations and of film and animation libraries. For many years, the Commission has devoted considerable time and effort to identifying and evaluating efficiencies that may result from proposed mergers and acquisitions. Although cognizable efficiencies occur less frequently than one might expect, the Commission has not stinted in its efforts to give every possible

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<sup>52</sup> Most people outside the FTC and the FCC already confuse the two agencies. Surely we do not want to contribute to this confusion.



consideration to efficiencies. That makes the apparent disinterest in the potential efficiencies of this transaction decidedly odd.

### **Industry Complaints**

We have heard many expressions of concern about the proposed transaction. Cable system operators and alternative MVPDs have been concerned about the price and availability of programming from Time Warner after the acquisition. Program providers have been concerned about access to Time Warner's cable system. These are understandable concerns, and I am sympathetic to them. To the extent that these industry members want assured supply or access and protected prices, however, this is the wrong agency to help them. Because Time Warner cannot foreclose either level of service and is neither a monopolist nor an "essential facility" in the programming market or in cable services, there would appear to be no basis in antitrust for the access requirements imposed in the order.

The Federal Communications Commission is the agency charged by Congress with regulating the telecommunications industry, and the FCC already has rules in place prohibiting discriminatory prices and practices. While there may be little harm in requiring Time Warner to comply with communications law, there also is little justification for this agency to undertake the task. To the extent that the proposed consent order offers a

standard different from that promulgated by Congress and the FCC, it arguably is inconsistent with the will of Congress. To the extent that the proposed consent order would offer a more attractive remedy for complaints from disfavored competitors and customers of Time Warner, they are more likely to turn to us than to the FCC. There is much to be said for having the FTC confine itself to FTC matters, leaving FCC matters to the FCC.

The proposed order should be rejected.

**DISSENTING STATEMENT OF COMMISSIONER ROSCOE B. STAREK, III**

**In the Matter of**

***Time Warner Inc., et al.***

**File No. 961 0004**

I respectfully dissent from the Commission's decision to accept a consent agreement with Time Warner Inc. ("TW"), Turner Broadcasting System, Inc. ("TBS"), Tele-Communications, Inc. ("TCI"), and Liberty Media Corporation. The proposed complaint against these producers and distributors of cable television programming alleges anticompetitive effects arising from (1) the horizontal integration of the programming interests of TW and TBS and (2) the vertical integration of the TBS's programming interests with TW's and TCI's distribution interests. I am not persuaded that either the horizontal or the vertical aspects of this transaction are likely "substantially to lessen competition" in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, or otherwise to constitute "unfair methods of competition" in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Moreover, even if one were to assume the validity of one or more theories of violation underlying this action, the proposed order does not appear to prevent the alleged effects and may instead create inefficiency.

## *Horizontal Theories of Competitive Harm*

This transaction involves, *inter alia*, the combination of TW and TBS, two major suppliers of programming to multichannel video program distributors ("MVPDs"). Accordingly, there is a straightforward theory of competitive harm that merits serious consideration by the Commission. In its most general terms, the theory is that cable operators regard TW programs as close substitutes for TBS programs. Therefore, the theory says, TW and TBS act as premerger constraints on each other's ability to raise program prices. Under this hypothesis, the merger eliminates this constraint, allowing TW -- either unilaterally or in coordination with other program vendors -- to raise prices on some or all of its programs.

Of course, this story is essentially an illustration of the standard theory of competitive harm set forth in Section 2 of the 1992 *Horizontal Merger Guidelines*.<sup>1</sup> Were an investigation pursuant to this theory to yield convincing evidence that it applies to the current transaction, under most circumstances the Commission would seek injunctive relief to prevent the consolidation of the assets in question. The Commission has eschewed that course of action, however, choosing instead a very different sort of "remedy" that allows the parties to proceed with the

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<sup>1</sup> U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, § 2 (1992), 4 Trade Reg. Rep. (CCH) ¶ 13,104 at 20,573-6 *et seq.*

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<sup>2</sup> In the *Analysis of Proposed Consent Order to Aid Public Comment* (§ IV.C), the Commission asserts that "the easiest way the combined firm could exert

determine which producers they regard as their closest competitors. This assessment also depends frequently on internal documents supplied by customers that show them playing off one supplier against another -- via credible threats of supplier termination -- in an effort to obtain lower prices.

In this matter, however, documents of this sort are conspicuous by their absence. Notwithstanding a voluminous submission of materials from the respondents and third parties (and the considerable incentives of the latter --

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branded carbonated soft drinks" ("CSDs"), while respondent argued for a much broader market. In determining that all branded CSDs constituted the relevant market, the Commission placed great weight on internal documents from local bottlers of branded CSDs showing that those bottlers "[took] into account only the prices of other branded CSD products [and not the prices of private label or warehouse-delivered soft drinks] in deciding on pricing for their own branded CSD products." 5 Trade Reg. Rep. (CCH) ¶ 23,681 at 23,413 (Aug. 31, 1994), *vacated and remanded on other grounds, Coca-Cola Bottling Co. of the Southwest v. FTC*, No. 94-41224 (5th Cir., June 10, 1996). (The Commission dismissed its complaint on September 6, 1996.)

following the acquisition. Although customers' opinions on the potential effects of a transaction often are important, they seldom are dispositive. Typically the Commission requires substantial corroboration of these opinions from independent information sources.<sup>4</sup>

Independent validation of the anticompetitive hypothesis becomes particularly important when key elements of the story lack credibility. For a standard horizontal theory of harm to apply here, one key element is that, prior to the acquisition, a MVPD could credibly threaten to drop a marquee network (e.g., CNN), provided it had access to another programmer's marquee network (e.g., HBO) that it could offer to potential subscribers. This threat would place the MVPD in a position to negotiate a better price for the marquee networks than if

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<sup>4</sup> For example, in *R.R. Donnelley Sons & Co., et al.*, Docket No. 9243, the Administrative Law Judge's decision favoring complaint counsel rested in part on his finding that "[a]s soon as the Meredith/Burda acquisition was announced, customers expressed concern to the FTC and the parties about the decrease in competition that might result." (Initial Decision Finding 404.) In overturning the ALJ's decision, the Commission cautioned: "There is some danger in relying on these customer complaints to draw any general conclusions about the likely effects of the acquisition or about the analytical premises for those conclusions. The complaints are consistent with a variety of effects, and many -- including those the ALJ relied upon -- directly contradict [c]omplaint [c]ounsel's prediction of unilateral price elevation." 5 Trade Reg. Rep. (CCH) ¶ 23,876 at 23,660 n.189 (July 21, 1995).

Also, in several instances involving hospital mergers in concentrated markets, legions of third parties came forth to attest to the transaction's efficiency. The Commission has discounted this testimony, however, when these third parties could not articulate or document the source of the claimed efficiency, or when the testimony lacked corroboration from independent information sources. I believe that the Commission should apply the same evidentiary standards to the third-party testimony in the current matter.

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<sup>5</sup> In virtually any case involving less pressure to come up with something to show for the agency's strenuous investigative efforts, the absence of such evidence would lead the Commission to reject a hypothesized product market that



in what appears to be a very different theory of postmerger competitive behavior. This theory posits an increased likelihood of program "bundling" as a consequence of the transaction.<sup>6</sup> But there are two major problems with this theory as a basis

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<sup>6</sup> As I noted earlier, a remedy that does nothing more than prevent "bundling" of different programs would fail completely to prevent the manifestations of market power -- such as across-the-board price increases -- most consistent with conventional horizontal theories of competitive harm.

<sup>7</sup> As I have noted, *supra* n.2, the *Analysis* also claims that TW could obtain "substantially greater negotiating leverage over cable operators . . . by combining all or some of [the merged firm's] 'marquee' services and offering them as a package . . ." If the *Analysis* uses the term "negotiating leverage" to mean "market power" as the latter is conventionally defined, then it confronts three

however, is any sensible explanation of *why* TW should wish to pursue this strategy, because the incentives to do so are not obvious.<sup>8</sup>

A possible anticompetitive rationale for "bundling" might run as follows: by requiring cable operators to purchase a bundle of TW and TBS programs that contains substantial amounts of "unwanted" programming, TW can tie up scarce channel capacity and make entry by new programmers more difficult. But even if

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difficulties: (1) the record fails to support the proposition that the TW and TBS "marquee" channels are close substitutes for each other; (2) even assuming that those channels are close substitutes, there are more straightforward ways for TW to exercise postmerger market power; and (3) the remedy does nothing to prevent these more straightforward exercises of market power. See discussion *supra*.

<sup>8</sup> In "A Note on Block Booking" in THE ORGANIZATION OF INDUSTRY (1968), George Stigler analyzed the practice of "block booking" -- or, in current parlance, "bundling" -- "marquee" motion pictures with considerably less popular films. Some years earlier, the United States Supreme Court had struck this practice down as an anticompetitive "leveraging" of market power from desirable to undesirable films. *United States v. Loew's Inc.*, 371 U.S. 38 (1962). As Stigler explained (at 165), it is not obvious why distributors should wish to force exhibitors to take the inferior film:

Consider the following simple example. One film, Justice Goldberg cited *Gone with the Wind*, is worth \$10,000 to the buyer, while a second film, the Justice cited *Getting Gertie's Garter*, is worthless to him. The seller could sell the one for \$10,000, and throw away the second, for no matter what its cost, by-gones are forever by-gones. Instead the seller compels the buyer to take both. But surely he can obtain no more than \$10,000, since by hypothesis this is the value of both films to the buyer. Why not, in short, use his monopoly power directly on the desirable film? It seems no more sensible, on this logic, to block book the two films than it would be to compel the exhibitor to buy *Gone with the Wind* and seven Ouija boards, again for \$10,000.

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<sup>9</sup> The argument here basically is a variant of the argument often used to condemn exclusive dealing as a tool for monopolizing a market. Under this argument, an upstream monopolist uses its market power to obtain exclusive distribution rights from its distributors, thereby foreclosing potential manufacturing entrants and obtaining additional market power. But there is problem with this argument, as Bork explains in *THE ANTITRUST PARADOX* (1978):

[The monopolist] can extract in the prices it charges retailers all that the uniqueness of its line is worth. It cannot charge the retailer that full worth in money and then charge it again in exclusivity the retailer does not wish to grant. To suppose that it can is to commit the error of double counting. If [the firm] must forgo the higher prices it could have demanded in order to get exclusivity, then exclusivity is not an imposition, it is a purchase.

*Id.* at 306; see also *id.* at 140-43.

Although modern economic theory has established the theoretical possibility

can tie up a cable channel and thereby displace a potential entrant's programming, the order hardly would constrain TW's opportunities to carry out this "foreclosure"

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<sup>11</sup> Perhaps this reflects the fact that the economics literature does not provide clear guidance on this issue. See, e.g., Adams and Yellen, "Commodity Bundling and the Burden of Monopoly," 90 *Q.J. Econ.* 475 (1976). Adams and Yellen explain how a monopolist might use bundling as a method of price discrimination. (This also was Stigler's explanation, *supra* n.8.) As Adams and Yellen note, "public policy must take account of the fact that prohibition of commodity bundling without more may increase the burden of monopoly . . . [M]onopoly itself must be eliminated to achieve high levels of social welfare." 90 *Q.J. Econ.* at 498. Adams and Yellen's conclusion is apposite here: if the combination of TW and TBS creates (or enhances) market power, then the solution is to enjoin the transaction rather than to proscribe certain types of bundling, since the latter "remedy" may actually make things worse. And if the acquisition does not create or enhance market power, the basis for the bundling proscription is even harder to discern.

consequence of this transaction, I would find the proposed remedy inadequate.

### *Vertical Theories of Competitive Harm*

The proposed consent order also contains a number of provisions designed to alleviate competitive harm purportedly arising from the increased degree of vertical integration between program suppliers and program distributors brought about by this transaction.<sup>12</sup> I have previously expressed my skepticism about enforcement actions predicated on theories of harm from vertical relationships.<sup>13</sup> The current complaint and proposed order only serve to reinforce my doubts about such enforcement actions and about remedies ostensibly designed to address the alleged competitive harms.

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<sup>12</sup> Among other things, the order (1) constrains the ability of TW and TCI to enter into long-term carriage agreements (¶ IV); (2) compels TW to sell Turner programming to downstream MVPD entrants at regulated prices (¶ VI); (3) prohibits TW from unreasonably discriminating against non-TW programmers seeking carriage on TW cable systems (¶ VII(C)); and (4) compels TW to carry a second 24-hour news service (*i.e.*, in addition to CNN) (¶ IX).

<sup>13</sup> Dissenting Statement of Commissioner Roscoe B. Starek, III, in *Waterous Company, Inc./Hale Products, Inc.*, File No. 901 0061, 5 Trade Reg. Rep. (CCH) ¶ 24,076 at 23,888-90; Dissenting Statement of Commissioner Roscoe B. Starek, III, in *Silicon Graphics, Inc. (Alias Research, Inc., and Wavefront Technologies, Inc.)*, Docket No. C-3626 (Nov. 14, 1995), 61 Fed. Reg. 16797 (Apr. 17, 1996); Remarks of Commissioner Roscoe B. Starek, III, "Reinventing Antitrust Enforcement? Antitrust at the FTC in 1995 and Beyond," remarks before a conference on "A New Age of Antitrust Enforcement: Antitrust in 1995" (Marina Del Rey, California, Feb. 24, 1995) [available on the Commission's World Wide Web site at <http://www.ftc.gov>].

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<sup>14</sup> I say "inexplicably" not because I necessarily believed this horizontal combination should have been enjoined, but because the horizontal aspect of the transaction would have exacerbated the upstream market power that would have had to exist for the vertical theories to have had any possible relevance.

supracompetitive prices for) TW and TBS programming -- thus lessening their ability to effectively compete against TW's cable operations. The complaint further charges that the exclusion of nonintegrated program vendors from TW's and TCI's

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<sup>15</sup> Moreover, as was also true in *SGI*, the proposed complaint in the present case characterizes premerger entry conditions in a way that appears to rule out significant anticompetitive foreclosure of nonintegrated upstream producers as a consequence of the transaction. Paragraphs 33, 34, and 36 of the complaint allege in essence that there are few producers of "marquee" programming before the merger (other than TW and TBS), in large part because entry into "marquee" programming is so very difficult (stemming from, *e.g.*, the substantial irreversible investments that are required). If that is true -- *i.e.*, if the posited programming

In response to this criticism, one might argue -- and the complaint alleges<sup>16</sup> -- that pervasive scale economies in programming, combined with a failure to obtain carriage on the TW and TCI systems, would doom potential programming entrants (and "foreclosed" incumbent programmers) because, without TW and/or TCI carriage, they would be deprived of the scale economies essential to their survival. In other words, the argument goes, the competitive responses of "foreclosed" programmers and "foreclosed" distributors identified in the preceding paragraph never will materialize. There are, however, substantial conceptual and empirical problems with this argument, and its implications for competition policy have not been fully explored.

First, if one believes that programming is characterized by such substantial scale economies that the loss of one large customer results in the affected programmer's severely diminished competitive effectiveness (in the limit, that programmer's exit), then this essentially is an argument that the number of program producers that can survive in equilibrium (or, perhaps more accurately, the number of program producers in a particular program "niche") will be small -- with perhaps only one survivor. Under the theory of the current case, this will result in

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market already was effectively foreclosed before the merger -- then, as in *SGI*, TW's acquisition of TBS could not cause substantial postmerger foreclosure of competitively significant alternatives to TW/TBS programming.

<sup>16</sup> See Paragraph 38.b of the proposed complaint.



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the dropped program would suffer substantially from lost scale economies, severely diminishing its competitive effectiveness, which in turn would confer market power on the vertically integrated entrant in its program sales to other MVPDs. Were the Commission to apply its current theory of competitive harm consistently, it evidently would have to find this *de novo* entry into programming by this large MVPD competitively objectionable.

I suspect, of course, that virtually no one would be comfortable challenging such integration, since there is a general predisposition to regard expansions of capacity as procompetitive.<sup>18</sup> Consequently, one might attempt to reconcile the differential treatment of the two forms of vertical integration by somehow distinguishing them from each other.<sup>19</sup> But in truth, the situations actually merit

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<sup>18</sup> This would appear true especially when, as posited here, there is substantial premerger market power upstream because, under such circumstances, vertical integration is a means by which a downstream firm can obtain lower input prices. As noted earlier (*supra* n.17 and accompanying text), this integration can be procompetitive whether it occurs via merger or internal expansion.

<sup>19</sup> One might attempt to differentiate my hypothetical from a situation involving an MVPD's acquisition of a program supplier by arguing that the former would yield two suppliers of the relevant type of programming, but the latter only one. But this conclusion would be incorrect. If we assume that the number of suppliers that can survive in equilibrium is determined by the magnitude of scale economies relative to the size of the market, and that the pre-entry market structure represented an equilibrium, then the existence of two program suppliers will be only a transitory phenomenon, and the market will revert to the equilibrium structure dictated by these technological considerations -- that is, one supplier. Upstream integration by the MVPD merely replaces one program monopolist with another; but as noted above, under these circumstances vertical integration can yield substantial efficiencies.

similar treatment -- albeit not the treatment prescribed by the proposed order. In neither case should an enforcement action be brought, because any welfare loss flowing from either scenario derives from the structure of the upstream market, which in turn is determined primarily by the size of the market and by technology, not by the degree of vertical integration between different stages of production.

Third, it is far from clear that TCI's incentives to preclude entry into programming are the same as TW's.<sup>20</sup> As an MVPD, TCI is harmed by the creation of entry barriers to new programming. Even if TW supplies it with TW programming at a competitive price, TCI is still harmed if program variety or innovation is diminished. On the other hand, as a part owner of TW, TCI benefits if TW's programming earns supracompetitive returns on sales to other MVPDs. TCI's *net* incentive to sponsor new programming depends on which factor dominates -- its interest in program quality and innovation, or its interest in supracompetitive returns on TW programming. All of the analyses of which I am aware concerning this tradeoff show that TCI's ownership interest in TW would have to increase substantially -- far beyond what the current transaction contemplates, or what would be possible without a significant modification of

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<sup>20</sup> Even TW has mixed incentives to preclude programming entry. As a programmer allegedly in possession of market power, TW would wish to deter programming entry to protect this market power. But as a MVPD, TW -- like any other MVPD -- benefits from the creation of valuable new programming services that it can sell to its subscribers. On net, however, it appears true that TW's incentives balance in favor of wishing to prevent entry.

TW's internal governance structure<sup>21</sup> -- for TCI to have an incentive to deter entry by independent programmers. TCI's incentive to encourage programming entry is intensified, moreover, by the fact that it has undertaken an ambitious expansion program to digitize its system and increase capacity to 200 channels. Because this appears to be a costly process, and because not all cable customers can be expected to purchase digital service, the cost per buyer -- and thus the price -- of digital services will be fairly high. How can TCI expect to induce subscribers to buy this expensive service if, through programming foreclosure, it has restricted the quantity and quality of programming that would be available on this service tier?<sup>22</sup>

The foregoing illustrates why foreclosure theories fell into intellectual

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<sup>21</sup> TW has a "poison pill" provision that would make it costly for TCI to increase its ownership of TW above 18 percent.

<sup>22</sup> Note too that there is an inverse relationship between TCI's *ability* to prevent programming entry and its *incentives* to do so. Much of the analysis in this case has emphasized that TCI's size (27 percent of cable households) gives it considerable ability to determine which programs succeed and which fail, and the logic of the proposed complaint is that TCI will exercise this ability so as to protect TW's market power in program sales to non-TW/non-TCI MVPDs. But although increases in TCI's size may increase its ability to preclude entry into programming, at the same time such increases reduce TCI's *incentives* to do so. The reasoning is simple: as the size of the non-TW/non-TCI cable market shrinks, the supracompetitive profits obtained from sales of programming to this sector also shrink. Simultaneously, the harm from TCI (as a MVPD) from precluding the entry of new programmers increases with TCI's subscriber share. (In the limit -- *i.e.*, if TCI and TW controlled *all* cable households -- there would be no non-TW/non-TCI MVPDs, no sales of programming to such MVPDs, and thus no profits to be obtained from such sales.) Any future increases in TCI's subscriber share would, other things held constant, reduce its incentives to "foreclose" entry by independent programmers.

disrepute: because of their inability to articulate how vertical integration harms competition and not merely competitors. The majority's analysis of the Program Service Agreement ("PSA") illustrates this perfectly. The PSA must be condemned, we are told, because a TCI channel slot occupied by a TW program is a channel slot that cannot be occupied by a rival programmer. As Bork noted, this is a tautology, not a theory of competitive harm.<sup>23</sup> It *is* a theory of harm to competitors -- competitors that cannot offer TCI inducements (such as low prices) sufficient to cause TCI to patronize them rather than TW.

All of the majority's vertical theories in this case ultimately can be shown to be theories of harm to competitors, not to competition. Thus, I have not been persuaded that the vertical aspects of this transaction are likely to diminish competition substantially. Even were I to conclude otherwise, however, I could not support the extraordinarily regulatory remedy contained in the proposed order, two of whose provisions merit special attention: (1) the requirement that TW sell programming to MVPDs seeking to compete with TW cable systems at a price determined by a formula contained in the order; and (2) the requirement that TW carry at least one "Independent Advertising-Supported News and Information National Video Programming Service."

Under Paragraph VI of the proposed order, TW must sell Turner programming

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<sup>23</sup> Bork, *THE ANTITRUST PARADOX*, *supra* n.9, at 304.

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<sup>24</sup> See, e.g., *RxCare of Tennessee, Inc., et al.*, Docket No. C-3664, 5 Trade Reg. Rep. (CCH) ¶ 23,957 (June 10, 1996);

Most objectionable is Paragraph IX of the order, the "must carry" provision that compels TW to carry an additional 24-hour news service. I am baffled how the Commission has divined that consumers would prefer that a channel of supposedly scarce cable capacity be used for a second news service, instead of for something else. More generally, although remedies in horizontal merger cases sometimes involve the creation of a new competitor to replace the competition eliminated by the transaction, no competitor has been lost in the present case. Indeed, there is substantial entry *already occurring* in this segment of the programming market, notwithstanding the severe "difficulty" of entering the markets alleged in the complaint.<sup>27</sup> Obviously, the incentives to buy programming from an independent vendor are diminished (all else held constant) when a distributor integrates vertically into programming. This is true whether the integration is procompetitive or anticompetitive on net, and whether the integration occurs via merger or via *de novo* entry.<sup>28</sup> I could no more support a must-carry provision for TW as a result of its acquisition of CNN than I could endorse a similar

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direct and legitimate economic benefits reasonably attributable to the number of subscribers served by the distributor." 47 U.S.C. § 548(c)(2)(B)(iii); 47 C.F.R. § 76.1002(b)(3).

<sup>27</sup> The Microsoft/NBC joint venture, MSNBC, already is in service; the Fox entry apparently will also be operational shortly.

<sup>28</sup> The premise inherent in this provision of the order is that TW can "foreclose" independent programming entry independently (*i.e.*, without the cooperation of TCI, whose incentives to sponsor independent programming are ostensibly preserved by the stock ownership cap contained in Paragraphs II and III of the order). Given that TW has only 17 percent of total cable subscribership, I find this proposition fanciful.

requirement to remedy the "anticompetitive consequences" of *de novo* integration by TW into the news business.